CORPORATE INSOLVENCY LAW REFORM

An Autopsy on the Past and an Anatomy of the Future

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INTRODUCTION - WILL AUSTRALIA LOSE THE PR WOOD CUP?

Australia may claim to be pre-eminent amongst all other nations as a protector of the rights of creditors, especially secured creditors. At least, that seems to be the correct view based upon the judgment of one of our special guests from overseas at this year's Conference, Philip Wood. In 1992 Philip volunteered his awards of excellence in that field (see *'Banks and Remedies'* edited Cranston LLP 1992 Chapter 1 *Remedies and Risk: International Comparisons*). In doing so, he ranked, albeit in his words 'somewhat impressionistically', some 20 or so nations according to whether they were 'pro-creditor' or 'pro-debtor'. He judged Australia and Canada jointly as 'number 1 ... extreme pro-creditor'. That judgment was based on, amongst other things, an evaluation of the respective insolvency laws of the competing nations: '... according to whether their corporate insolvency laws are pro-debtor or pro-creditor'.

Since the inaugural award of the PR Wood Cup, Canada fell from grace when, toward the end of 1992, it committed (in the minds of some) an indecency by introducing a new corporate reorganisation regime into its insolvency law and combined that with some associated legislative restrictions on the enforcement of a floating charge. That confluence has undoubtedly wrested Canada from its joint holding of the trophy.

So Australia has since stood alone. But will it be for long? For Australia, too, has committed itself to an Act known as the *Corporate Law Reform Act* 1992 which, by 1 July 1993, will marry into the burgeoning and bulky *Corporations Law*. Indeed, probably at the very time Philip Wood was adjudicating on the contenders for the awards, work had commenced on that Australian legislation which was to contain substantial and sweeping changes to Australian corporate insolvency law. Philip, of course, had to judge things as they then stood and, whether he knew of the intentions of Australia in the following season or not, the verdict was inescapable at the time.

The Australian legislation is already on the statute books. It is to be complemented, supported and completed by rules, regulations and forms. In a strictly mechanical sense it will not 'commence' until 25 June 1993.

Philip Wood applied what he described as a series of 'litmus' tests to determine his academy of awards. They are, with respect, very suitable to make judgment of 'user friendly' creditor laws or otherwise. It is convenient to repeat them here and, with one or two additions of my own (which are very much subsidiary to the tests devised by Philip and included only to suit my purposes for this paper), to apply them in a self examination or post mortem on the old; in describing the anatomy of the new; and, using that examination and description, to determine whether the result will topple Australia from the crown and, if so, how great the fall may be.

THE CREDITOR FRIENDLY TESTS

1. The availability of the universal floating charge.

2. The availability of a non-possessory chattel mortgage and security over receivables. Allied to this is the upholding of finance leases, hire purchase, retention of title and the like without re-characterisation as mortgages.

3. Insolvency set off (enabling the reciprocal unsecured creditor to be paid ahead of other unsecured creditors).

4. Protections to good faith creditors in relation to the recapture of preferences and the like and the length of the suspect period.

5. Directors personal liability on insolvency.

6. Rescission of land and equipment leases, licences and executory contracts.

To which I would only add the following:

7. The extent to which property, commercial and taxation statute or general law might restrict creditor remedies or impact on returns to creditors.

8. The general impact of insolvency regimes concerning, in particular, restrictions on enforcement of creditor/security remedies and whether they support the commercial practices of creditors.

9. Avoiding transactions (other than preferences involving an 'arm's length' creditor) effected by a company which subsequently becomes subject to a formal insolvency regime.

LAYING OUT THE BODY

Before undertaking that examination it is appropriate that the body should be laid out and some history and antecedents of the examinee first recorded. For an insolvency law cannot be examined in a vacuum. In the same way that a forensic pathologist must be aware of and take into consideration the general surrounding circumstances of the subject, in the context of what we are about the examination requires account to be taken of the general body of commercial and other law (of which an insolvency law is a part) and, of course, commercial practices. That commercial law indubitably includes an insolvency law cannot be doubted, if one is wise enough to ask, in relation to any commercial transaction, the question: 'what if?'. That examination, by reference to the above tests, would, in relation to Australia, presently show these features:

1. The floating charge has been long recognised and available in Australia. However non-registration is fatal in the event of an insolvency. Registration is also a vital factor in priority issues. Further, a floating charge taken to secure past indebtedness will be invalid if the company is wound up within the 'suspect' period of six months.

2. There are a number of non-possessory chattel mortgages or securities over receivables which are required to be registered under Australian law (so that the above comments regarding registration and priority apply), although finance leases, hire purchase and retention of title are available without re-characterisation as mortgages and, therefore, do not require registration.

3. Insolvency set-off is available to creditors under the existing corporate insolvency regimes of official management, schemes of arrangement and winding up (liquidation).

4. Generally stated, transactions involving a debtor company and a creditor who has acted without knowledge or reason to suspect that the debtor company is insolvent (which presently constitutes 'good faith') will be protected. The length of the suspect period is six months. A notable exception to this 'good faith' relief is that a floating charge, taken within the suspect period, in respect of which no 'new' money has been provided, will be avoided no matter that the creditor acted in 'good faith'.

5. Australia has had, in one form or another, laws for several decades that might be loosely described as 'insolvent trading' and which, on occasions, flutter and even sometimes actually lift the veil of incorporation.

6. There is little or no statutory nor general law restriction on the rescission of land and equipment leases, licences and executory contracts in Australia. The right of rescission turns on the contract.

7. Some property law and some credit law statutes of Australia restrain the exercise of creditor remedies. Generally stated, these require statutory forms of notice to be served before, for example, a power of sale in respect of land may be exercised or repossession of property under a credit purchase agreement may be made. Another statute, the *Income Tax Assessment Act*, accords a significant priority to the revenue for certain tax claims. This impacts on both secured and unsecured creditors in an insolvency.

8. Corporate insolvency regimes restrict the remedies of unsecured creditors but (except as noted in 1 and 2 above) have no impact on the exercise of secured creditor remedies nor on the remedies available to 'quasi secureds' (landlords, lessors of equipment, retention of title owners and the like). In other respects existing Australian corporate insolvency regimes do not take specific account of commercial practices of creditors (for example, the recognition of subordination arrangements).

9. Avoidance of antecedent transactions is provided for in Australian insolvency statutes which can help to swell returns to creditors. More scope for success, however, appears to have come from reliance on the general law and general principles of causation and damage rather than from reliance on avoiding powers in statutes.

Now, when the scalpel is used to dissect the body of insolvency law, what is discovered?

SOME REMINDERS OF THE PAST

In 1975 I had the occasion to present a paper titled 'Companies in Trouble - The Choices'. In that paper I went to some length examining an aberration for which Australian Commonwealth and State Parliaments were responsible in 1961.

Up to that time it was a fairly time honoured tradition that in most cases Australia would follow large slabs of English legislation in commercial and corporate areas. Despite the apparent ease by which that somewhat lazy approach could be perfected, there was the occasional problem. But did it really matter that many decades ago a *Bills of Sale Act* enacted by one of our state parliaments ended with the flourishing pronouncement that 'this Act shall not apply to Scotland'!

That type of colonial impertinence aside, the practice of following English legislation generally worked well. What was it then that possessed our legislators to become deviants in 1961? In that year we copied into our statute books a law from, of all places, South Africa. It was a law relating to 'judicial management', a form of insolvency regime that had been developed in South Africa for insolvent companies. We termed it 'official management'.

In endeavouring to discover the reason why we did this, it is probably fair to assume that it was motivated by an endeavour to take a more constructive approach to insolvent companies. An attitude of that kind in 1961 was 'advanced radical'. All that we then had in the box of insolvency tricks was winding up and schemes of arrangement.

Unfortunately, what can only now be most kindly described as an 'experiment' or 'adventure' was undertaken. What a pity it all was. It did not appear to have been the product of considered views. It simply did not work from the very beginning. In its original form it was so advanced and radical that it permitted anyone, even a director of the insolvent company, to be the 'official manager' (a concept somewhat in advance in time of the later (1978) American concept of the 'debtor in possession'). That produced inevitable abuses which was not surprising. The 'model' from South Africa had, by 1961, come under attack in that country because of its prevalent use as a form of clandestine liquidation procedure. It was similarly used in this country.

Another difficulty which emerged was that an official management might only be effected in respect of a company if the creditors came to a collective opinion of their number that the company would pay its debts in **full** within a prescribed period of time. Unfortunately it was the fact that the creditors were invited to and more often than not did so opine in a vacuum. This was repeatedly used as an excuse to shift blame for the ensuing debacle upon the creditors.

The conclusion to my paper in 1975 was: '... the official management provisions of the *Companies Act* need a complete overhaul or removal from the statute'.

Our 'experiment' in official management provides a good example of what not to do when endeavouring to provide for a more constructive and positive approach to corporate insolvency in our law. Perhaps, however, more importantly and positively, we have had the opportunity to learn and benefit from that 'trial and error'. [To link it to the present, the official management provisions of Australian company legislation will be buried forever by 1 July 1993.]

Around that same time, however, there was a distinct loyalty to and admiration for the scheme of arrangement (or compromise) provisions of our legislation. Although not often used, that at least provided a vehicle that seemed to have sufficient safeguards to enable a restructuring to be attempted in respect of an insolvent or near insolvent company with few of the dangers associated with the official management regime. However, as the years rolled on, even it suffered from some abuse. That led to a considerable body of case law and secondary legislation to ensure that abuses were few and far between. But that increased the cost and meant considerable delay. As a result, the cost and time burden of exercises in schemes of arrangement became and remain too great except, perhaps, for 'big' and relatively 'wealthy' insolvent companies.

The other 'method' of dealing with an insolvent company, the winding up provisions, while absolutely necessary, seemed to simply reflect an unhappy philosophy that had existed for a long time in Australia in relation to care and control of the environment - 'if it moves, shoot it; if it is standing still, cut it down'.

Broadly stated, that analysis of the position of corporate insolvency law in Australia ultimately led to the search for a new and better approach. Without repeating the history of it all, a new approach was found and will soon come to Australia in the form of the new voluntary administration procedure.

OTHER AREAS OF THE BODY

There are many deficiencies in other areas of corporate insolvency law. These may be best, although no way sufficiently, described in summary as follows:

- **Invalidity of Floating Charges taken within the Suspect Period**

  This provision is narrow in the extreme and does not take account of contemporary commercial practices (for example, securing obligations other than advances of money).

- **Non-Possessory 'Securities'**

  The generally unregulated scope for the use of retention of title devices causes conflict between creditors; creates an uncertain market place for lending; and causes problems in enforcement of security rights.

- **Insolvency Set-Off**

  Although generally satisfactory, the 'translation' of statutory insolvency set off from the bankruptcy (individual insolvency) statute to corporate insolvency is, at times, problematical.

- **Recapture of Preferences**

  'Good faith' creditors are put to proof of repetitive and redundant grounds of defence and, moreover, are subject to some curious interpretations of the law in consequence (the 'ordinary course of business' test is a prime example).

- **Directors Personal Liability**

  Assuming that the invasion of the corporate veil is a desirable policy, the present law which gives an individual creditor the right of individual action against directors of an insolvent company in some circumstances is contrary to the proper jurisprudential base for the policy - namely, the damage resulting from a breach of duty by directors to consider the interests of the company as a whole (including the creditors viewed as a 'commune').

- **Rescission of Leases, Executory Contracts**

  A strange and unsupportable divergence between bankruptcy and corporate insolvency law means that a right of rescission might be prevented in a case of bankruptcy but not in a case of corporate insolvency.

- **Impact of Property/Commercial Statute and General Law**

  The *Income Tax Assessment Act* impacts sometimes mightily upon creditors in a case of corporate insolvency. Unremitted tax deductions from employee wages rank for priority ahead of all unsecured creditors and, on most occasions, ahead of floating chargeholders. It is an unfair impost on creditors and contributes, in many cases, to companies continuing to trade when insolvent.

- **Impact of Insolvency Regimes**

  There is a total absence of any regime that might support a proper intent to rescue or salvage a company or, even, the business of a company. Further, within the existing regimes there are many absences that might support a 'pro-creditor' approach to insolvency.

- **Avoiding Transactions**

  These are seriously out of date; they use antiquated concepts, and they fail to provide for (and, hence, address) contemporary practices and devices that, unless curbed, could result in considerable damage to the general body of creditors. Importantly, also, the lazy legislative approach that requires the avoiding provisions of the *Bankruptcy Act* to be imported into cases of corporate insolvency results in considerable difficulty.

That, then, summarises the main features of the autopsy report. What is the anatomy of the new body?

THE ANATOMY OF THE NEW

THE NEW ADMINISTRATION REGIME

This is the major part of the anatomy. Although schemes of arrangement and winding up will remain, there will be a significant focus on administration as a means of taking a more positive and constructive approach to a company in financial difficulty. However, it is probably this reform rather than anything else that might topple Australia from a predominantly 'creditor friendly' country to one destined to join other countries as being a 'middle of the road' contender for several seasons to come, perhaps for ever. This is because of the restrictions that are placed upon the exercise of rights of creditors during the moratorium or stay period as provided for in the legislation.

In that respect it has been compared with the administration order regime of England and, due primarily to the colourful pens of some Australian commercial journalists, with Chapter 11 of the United States *Bankruptcy Code*. Although it is tiresome to have to continually repeat it, the suggestion that the new Australian regime is 'closely modelled' on or portrays a 'mini' Chapter 11, is really not fair comment. The fact is that the Australian regime has been modelled very closely in many of its aspects upon a procedure that has been available under the Australian *Bankruptcy Act* for individual debtors since 1968 - the Part X voluntary administration regime that can lead to a deed of assignment, a deed of arrangement or a compromise between an individual debtor and the creditors without the unnecessary involvement of a court and without a formal bankruptcy. [In case that statement should be doubted some extracts from an exploratory document - the Issues Paper on insolvency reform in Australia published by the Australian Law Reform Commission in December 1985 in which mention was made of that proposed 'model' - are annexed as **Appendix 'A'** to this paper.]

In contrast to both England and the United States, the Australian regime has deliberately avoided the involvement of the courts, other than to give a court a generally 'supervisory' role during the process on the application of an interested person. This should take some of the intensity and cost that is a feature of overseas regimes out of the very crucial 'initiation' stage of the procedure. The procedure is simply initiated by the directors resolving to appoint and appointing an administrator to the company. As the procedure progresses through the consequent 'moratorium' to the 'deed of company arrangement' or 'winding up' stages, the general body of creditors (including secured creditors) are very much involved. A description of the new regime is **Appendix 'B'** to this paper.

But, we must now come to that which some have seen as the most vital or critical issue in the whole procedure - the stay or moratorium on creditor remedies.

RESTRAINTS ON CREDITORS REMEDIES

It is the fact that the Australian voluntary administration regime will put some significant restraints on the exercise of secured creditors' rights or remedies. A detailed statement of the effect is **Appendix 'C'** to this paper. Some examples should suffice to paint the picture here. The main effect will be to stay the exercise of rights against a company and property owned, possessed, used or occupied by it. The stay will operate for a period of up to 35 days or such longer period as a court may order or as the creditors may extend it (but not beyond a further 60 days). The stay will affect all unsecured creditors, secured creditors (with some exceptions) and persons who have an interest, whether as owner or lessor in property in the possession, use or occupancy of the company. This latter category includes lessors of real or personal property and persons who claim title to property in the possession of the company through 'reservation of title' devices.

FLOATING CHARGE SANCTUM

The 'floating charge' is given some sanctity from the stay. The holder of a charge over the whole or substantially the whole of the property of a company is afforded a choice in the face of either an actual or possible voluntary administration. This 'fully secured creditor' will be entitled to either accept and be

bound by the stay or 'stand out' of the administration and the stay by exercising normal powers of enforcement that are available to such a creditor. That enforcement right must however be exercised before or within a period of 14 days of notification of the commencement of the administration. A further choice accorded to the fully secured creditor is that such a creditor may invoke the voluntary administration regime as an alternative to enforcement by the more traditional methods.

EFFECT ON LESS THAN 'FULLY SECURED' CREDITORS

A creditor holding a specific security over a mortgage, for example, land will be subject to the stay except if the stay is lifted by order of a court or with the agreement of the administrator. If, however, that secured creditor has commenced to enforce the security such that a sale is set to occur, the legislation anticipates possible deliberate delay tactics by the directors by permitting the sale to proceed notwithstanding the initiation of voluntary administration.

PERSONS HAVING NON-POSSESSORY AND THE LIKE 'SECURITIES'

All will be affected by the voluntary administration regime. They will all be 'stayed' unless, through an application to the court or with the consent of the administrator, the stay is lifted. Thus, while there is no suggestion of non-recognition of this type of 'security', there are limitations placed in the way of the exercise of rights. As examples:

- a lessor of property may not repossess the property;
- a supplier of goods who claims an effective (retention of) title to the goods may not repossess the goods.

Not all of these 'creditors' will simply suffer under the regime. Some benefits will accrue to some of them. For example, a lessor of property will be entitled to rent or other forms of payment for the continued use or occupation of the property during the administration regime. They will not lose the right to the property involved in the 'security' but will not be able to prevent an administrator exercising dominion over that property and, where it is possible, causing that property to be sold and the proceeds applied according to the respective rights of the creditor and the company.

MORE TO COME

In connection with 'quasi securities' it is probably worth observing that Australia is likely in the coming 12 to 18 months to adopt and implement a reform proposal to create a 'personal property securities' regime similar to that operating under the US *Commercial Code*, in certain areas of Canada and as proposed in New Zealand. This will mean that 'securities' such as finance leases, retention of title contract dealings and so forth will require registration for their recognition in the event of insolvency and for priority recognition.

OTHER ANATOMICAL PARTS

ENFORCEMENT OF SECURITIES

Outside of the administration regime there are new provisions affecting receivers and other persons, including the mortgagee itself, in the enforcement of a security involving property of a company, including a floating charge. Generally stated, a receiver, agent for the mortgagee and the mortgagee will now be largely governed by the same legislative regime. They will all be categorised as a 'controller'. Importantly, such a 'controller':

- will be liable for rent or other payments payable by a company in respect of property leased, hired or occupied by the company under a pre-existing agreement if, during or as a result of the enforcement, the company continues to possess, use or occupy property of another person;

- will have a duty to take reasonable care when exercising a power of sale to sell any property which is subject to the security for the best price reasonably obtainable having regard to the circumstances existing when the property is sold.

The court may, in certain circumstances, enquire into the conduct of and remove a 'controller' (the day has probably come when an unnecessarily prolonged receivership will not be tolerated). It should also be observed that, in certain circumstances and subject to some proper protection, a court may authorise the sale by a 'controller' of property secured by a charge having priority to the security under which the controller has been appointed or is enforcing.

SET OFF IN CORPORATE INSOLVENCY

Set off in corporate insolvency will be alive and well. The legislation does nothing to interfere with accepted, traditional notions of statutory insolvency set off (confirming that 'cherry picking' is not tolerated). There is a new and separate provision relating to set off in corporate insolvency (in the past and at present it has been 'borrowed' from the bankruptcy legislation and fitted to corporate winding up). Set off will not be available to a creditor who seeks to apply the receipt of a 'credit' or benefit received or taken at a time when the creditor knew that the company was insolvent.

AVOIDANCE OF FLOATING CHARGES CREATED WITHIN THE SUSPECT PERIOD

Some amendments have been made to the existing statutory provision which avoids floating charges created by a company within six months of the commencement of a winding up in insolvency unless the charge secures a contemporaneous or subsequent advance of money to the company. The provision will now not avoid a charge given to secure a guarantee nor a charge given to secure the price of a contemporaneous or subsequent supply of goods and/or services. Furthermore, where the charge is to secure an advance of money, the advance need not be made direct to the company but can be made as directed by the company.

On the 'debit' side are amendments to the same provision which will restrict creditors from being able to 'fudge' the securing of 'old' against the advance of 'new' money; a provision which will prevail against 'quick' enforcement of a suspect charge before a winding up actually commences; and a provision which will review a charge given in favour of a 'related entity' more sternly.

PREFERENCES

A new provision overcomes the difficulties that were associated with the old. Relevantly the broad policy of the old has been maintained (so that the Australian philosophy which avoids any necessity to show an 'intention' to prefer remains, in contrast to the English policy).

Importantly there is:

- a specific provision to protect creditors from claw back in respect of 'running accounts';

- a 'good faith' defence available to creditors that avoids some of the eccentricities of the old; and

- a suspect period of six months, except in relation to related entity creditors where the suspect period is extended to four years.

AVOIDANCE OF ANTECEDENT TRANSACTIONS

A wider net has been cast to uncover and avoid transactions affecting or involving a company which is subsequently wound up in insolvency. In broad terms there is a new provision that may be used to avoid what are described as 'uncommercial transactions'. This could affect creditors who extract securities, guarantees and the like, especially where group company guarantees might be involved. The test of an 'uncommercial transaction' might generally be likened to the 'corporate benefit' test. There are protective

provisions that will assist a 'good faith creditor'. On a more positive side, there has been quite deliberate aim taken at transactions involving related persons (which normally do not involve third party arm's length creditors).

BLOCKS ON RESCISSION

One provision which has been deleted from the new law (but remains under consideration by the government) relates to a prohibition on contractual provisions which provide for termination/rescission of an executory agreement for sale or lease of property to a company if the company becomes insolvent or becomes subject to a formal insolvency regime.

Such a provision should have been aimed only at particular executory contracts, such as building contracts, contracts for the purchase of land and so forth, with the aim of endeavouring to preserve the benefit of such contracts for a company under administration. There was, however, justifiable concern that the provision as drafted might be interpreted as applicable to financial market instruments or treasury risk management contracts which involve sales of property (for example, repurchase agreements or, even, foreign exchange contracts). Amendments to the proposed provision which would exclude those types of contracts were mooted but it all became too hard in a short time and, so, the provision was deleted. The subject is likely, however, to be further addressed.

DIRECTOR LIABILITY

These provisions have been totally restructured. There is now a more forceful, powerful and pragmatic approach to the issue of director liability. This is the 'stick' with which to propel the directors to the 'carrot' (seeking voluntary administration of a company before insolvent trading begins). If the stick does not work there are more potential benefits for creditors (treating them as a commune) than were present before.

One particular area that is important for its pragmatic approach is the presumption of insolvency that will obtain in respect of an insolvent company if that company has failed to keep and maintain proper books of account. If that omission or failure is established at some point in time, then a presumption arises that from that time onwards the company was insolvent. It will make the task of the liquidator somewhat easier. It may result in companies keeping proper books and records such that the state of the company's financial affairs can be more easily ascertained. Recovery will be a 'communal' affair, with the liquidator of the company able to seek to recover a quantum of damage from the directors for the loss suffered by the company as a result of insolvent trading.

SUBORDINATION

Some doubt exists whether and, if so, to what extent, a subordination agreement may be recognised by, for example, the liquidator of a company being wound up in insolvency. This is because recognition and enforcement of a subordination arrangement in a case of bankruptcy or winding up would offend a basic and cardinal rule of insolvency, namely the *pari passu* rule which requires that all ordinary unsecured debts are to rank equally and be paid accordingly.

A new provision provides that in a case of corporate insolvency nothing renders a debt subordination by a creditor of a company unlawful or unenforceable except so far as the subordination would disadvantage any creditor of the company who was not a party to or otherwise concerned in the debt subordination.

ABOLITION OF A CROWN PRIORITY

Although reference to this is not made in the *Corporate Law Reform Act*, a further and much overdue improvement to the position of creditors (both secured and unsecured) in a corporate insolvency will occur on or about 1 July 1993. The Federal Government is to enact legislation amending the *Income Tax*

Assessment Act to abrogate the entitlement of the Commissioner of Taxation to priority for unpaid group tax (employee's) deductions where the employer company became insolvent.

The detail of the legislation is not yet available. One outstanding issue is whether it will apply in a case of enforcement of a floating charge by a secured creditor. But, whatever, it will result in a significant improvement for creditors. It will mean that a claim for such tax will rank with all other unsecured creditors. No longer will the assets be first deployed to meet such unpaid taxes and no longer will artificial and quite transparent devices be employed in an endeavour to defeat the fiscal authorities. Another benefit will emerge. A company that does not remit tax deductions made from employee wages is clearly struggling and probably insolvent. It is often the first sign. Yet little is done by the revenue authorities. The tax debt can build up. It is a 'hidden' liability, often of a considerable amount. Once the priority is abolished the revenue is likely to place employers on watch and, if the pattern of remittances suddenly changes, take action. In short, fewer companies will be able to avoid being exposed at an earlier stage. That completes the anatomy of the new.

TRANS TASMAN ISSUES

New Zealand was given something of a hiding in the running of the PR Wood Cup. The principal reason that caused New Zealand to limp home a distant second last (followed only by France) was no doubt due to the reign of potential terror unleashed under the statutory manager insolvency regime in New Zealand. That is not surprising when it is considered that the relevant consequence of the appointment of a statutory manager to a company is to suspend all claims and the exercise of enforcement of all rights against the company. In particular, that:

- if a receiver has been appointed, the appointment is suspended;
- no person may foreclose, enter into possession, sell or appoint a receiver of property of the company; nor exercise any power or right under a mortgage, charge debenture or other security over the property of the company;
- no person may claim or recover any property in the possession of the company; and
- a right of set off against the company may not be exercised.

There is no parallel for it in Australia (nor, indeed, in any other country - except, maybe Ireland) and, one may confidently state, there is not likely to be.

It is not for this paper to state what or what not New Zealand should do about its insolvency law. We do know that, in keeping with the general exercise of 'harmonisation' of law between the two countries, both governments from time to time pay some lip service to that ideal. Insolvency law harmonisation does seem to have some priority. In June 1990 a joint statement made on behalf of the two governments said this about insolvency law:

> *'..., Australian officials regard harmonisation as a priority in Australia's insolvency law reform exercise and have agreed to maintain a high level of consultation with New Zealand officials in developing the relevant legislation.'*

The New Zealand Law Reform Commission has no doubt that:

> *'(i)n the case of company insolvency, the benefits of harmonisation are more evident'.*

If Australia and New Zealand are able to develop compatible insolvency laws, the ideal of reciprocity and recognition could be easily reached. And if that were to occur we, in the antipodes, would become pre-eminent in cross border recognition of insolvencies. This area is in a shambles in the rest of the world. Two examples illustrate that point:

- Canada and the United States, each the largest trading partner of the other and bound to one another in a far reaching free trade agreement, could not bring themselves to sign a 1979 United States-Canada Bankruptcy Treaty;

- The EEC despite being able to agree on many common uniform laws relating to trade, transport, tax, customs and the like, cannot conclude a Community Convention on Bankruptcy.

There is, thus, much to be said in favour of harmonisation of insolvency law between the two countries.

However, if the Australian adventure in the administration regime is not followed in some way in New Zealand and if New Zealand clings to its statutory manager regime, there are severe difficulties in the way.

SUMMARY

It is for others to judge, but my conclusions based on the application of the creditor friendly tests to the 'new wave' insolvency laws of Australia are these:

1. **Availability of the Floating Charge**

   With the amendments to the invalidity during suspect period provision, the 'availability' of the floating charge seems healthier.

2. **Availability of Non-Possessory 'Securities'**

   No real change; slight cloud (viewed from some perspectives) on horizon with possible adoption of personal property securities regime next season.

3. **Protection to Good Faith Creditors in Relation to Preferences**

   No change and may be even a plus as regards potential recovery from 'insider' creditors.

4. **Directors Personal Liability**

   Subject to one's view of whether a device to lift the corporate veil is a good thing and 'pro creditor', there is an improvement since the collective interests of ordinary unsecured creditors is advanced and the more distinct threat of personal liability may encourage directors to seek voluntary administration at an early stage.

5. **Rescission of Leases/Executory Contracts**

   No change, but near miss and changes may yet occur.

6. **Property/Commercial/Taxation Law Interference**

   Significant improvement with the abolition of revenue priority.

7. **Impact on Insolvency Regimes**

   A considerable effect on secured and other creditors. A plus for subordination arrangements.

8. **Avoiding Transactions**

   Some considerable gains for the general body of creditors.

APPENDIX 'A'

GENERAL INSOLVENCY INQUIRY

Extracts from The Law Reform Commission Issues Paper No 6, January 1985

4. COMPANY INSOLVENCY PROCEEDINGS

If the procedures available for the insolvent individual appear meagre, so also must those for the insolvent company.

There are two courses open to an insolvent company which seeks to avoid winding up. One is official management, the other is a scheme of arrangement.

Official Management

The aim of this procedure is, at present, difficult to describe or define. It was first introduced in 1961. The aim was to provide an insolvent company the time and opportunity to meet its debts in full — and so avoid being wound up. It was a voluntary procedure in which the company sought the co-operation of creditors to trade out of financial difficulties. Thus it was primarily directed at companies whose business warranted continued trading. The operation of the procedure was initially premised on the probability that the company would meet its debts in full within a certain period of time. But recent amendments have changed that. The only criterion at present is that the company is insolvent. As a result it appears almost aimless in its intent or purpose. Presumably it rests on the assumption that it would be of more benefit to creditors than a winding up. Yet there are severe shackles upon it. The official manager has quite narrow powers. And there is a duty on the official manager to propel the company toward winding up if and as soon as he forms the opinion that the continuation of the official management will not enable payment of the debts of the company in full. Because of the requirement that a company must be insolvent before it is eligible to promote an official management it is doubtful whether this form of administration could possibly suit any insolvent company.

Most commentators agree that it has had a disappointing record. Scarcely used, when it has been implemented it has rarely succeeded. Often its implementation has led to a worsened financial position for all concerned.

So should the concept of official management be retained? Alternatively, can it be given a more useful and positive role?

Schemes of Arrangement

For the insolvent (or near insolvent) company the 'arrangements and reconstruction' provisions of the companies legislation does offer some medium of negotiation with creditors. The ultimate aim is to effect a compromise of the claims of creditors. It may take almost any form.

However, like official management, it is not greatly used.

A proposed scheme is caught up in a long and involved procedure. That involves the corporate affairs commissions, a court and meetings of creditors and members. The criticisms of this procedure are:

- Normally a quite lengthy period of time elapses between the initiation of the scheme and its formal effect. There are no bars on the rights of creditors nor any formal independent control of the affairs and property of the company during that period of time.

- Compared with compositions and arrangements that an individual might effect with creditors, the procedure is formal, complicated and expensive. For example, it invariably involves a court

having to peruse and sanction the proposal. It is not necessary to procure the sanction of a court when an individual insolvent seeks to arrange or compromise matters with creditors.

While substantial safeguards might sometimes be necessary in the case of a complicated scheme involving a large company, the law is in an unsatisfactory state if those formalities and complexities have to be also thrust upon a small company where the proposals are relatively straightforward.

These questions, therefore, arise:

- Should the arrangements and reconstruction provisions of the companies legislation be retained in the case of insolvent companies?
- Should those provisions be modified? If so, in what way?

Receivers and Managers

Some reference must be made in the context of insolvent company procedures to that of appointing a 'receiver and manager'. It is not a proper 'insolvency' procedure because it is not representative of all the creditors. However, often a company in financial distress actively invites and encourages the appointment of a receiver by a secured creditor entitled to do so. Alternatively the secured creditor will impose a receiver upon a company. More often than not these companies are insolvent. The task of the receiver is sometimes one of salvage of a wreck. In such a case he performs the functions of a liquidator but without the duties of that office. As a result many such companies suffer the process of a 'winding up' without any formal sanction and with very limited involvement on the part of the creditors. They seem to be prejudiced. A receiver, for example, cannot recover preferences as might a liquidator.

Should the law make greater provision for more extensive involvement and control by unsecured creditors when a receiver has been appointed? Should a receiver have more extensive duties and powers?

Winding Up

An insolvent company may be wound up by one of two methods. The members can resolve to wind it up. In that case the winding up takes the form of a *creditors voluntary winding up*. Or a company may be *compulsorily wound up* by a court at the suit of a variety of persons, including the company itself or a creditor.

The procedure necessary to effect a *voluntary winding up* has been criticised. For one thing, it is slow. Another is that the company is left for a considerable time without independent control and floundering in financial distress. How can these faults be best remedied?

One possibility is to have the company brought under the immediate control of an insolvency administrator by the directors or creditors pending a determination as to what is to become of it. That proposal is discussed further in the context of a new procedure later in this part.

Proceedings for the *compulsory winding up* of an insolvent company are part of the general winding up provisions of the companies legislation. It is, of course, no part of this Commission's inquiry to concern itself with the winding up of companies that are solvent.

The main areas where the law and practice relating to the compulsory winding up of insolvent companies are criticised are these:

- **The Notice of Demand.** Practically all petitions for the winding up of an allegedly insolvent company rely upon the failure to comply with a notice of demand. Unlike the bankruptcy notice procedure in bankruptcy, a notice of demand does not need to be supported or preceded by a

judgment; it is not required to be issued by a court official; and strict proof of the service of such a notice of demand is generally not required in company winding up proceedings. Because of that comparatively relaxed procedure it is no doubt the case that notices of demand are open to abuse. Some so-called 'creditors' seek to use the winding up procedures as an attempt to enforce payment of a disputed debt. Exposure to those proceedings could damage a solvent company. It also sometimes results in the Supreme Courts of the States having to adjudicate upon claims that would otherwise be in the jurisdiction of inferior courts.

So the notice of demand procedure is open to the reverse criticism made of bankruptcy notice procedure. Is there a need for an alliance and compromise between the two? That would necessitate greater controls upon notices of demand. But, what should the nature of those controls be? Should, for example, a creditor be required to state on oath that the 'debt', the subject of the notice of demand, is due and owing and that the creditor has no knowledge that the debt is in dispute? Or should the more formal requirements which pertain to a bankruptcy notice apply to a notice of demand?

- **Advertising a Petition.** Under the rules pertaining to the winding up of companies, a petition must be advertised in both the government gazette and in a newspaper. No advertisement is required to be made in a case of a bankruptcy petition. Advertisements of the type required in company windings up are expensive.

  Does advertisement nowadays serve any real purpose? Should the requirement to advertise be retained?

- **Procedure Generally.** Much the same criticism as is made of bankruptcy petition proceedings can be made of the compulsory company winding up procedures. As well there is a considerable element of time between the initiation of compulsory winding up proceedings and their resolution. That can result in considerable damage to the company and the creditors. The assets and business of the company can become paralysed. Directors may become perplexed. The procedure for the appointment of a provisional liquidator is expensive and complicated.

  So what is needed to modernise and simplify the procedures?

A New Procedure

From that general survey of the existing options available to an insolvent company and its creditors these observations may be made:

- It is possibly the case that many companies in the past have been deterred from seeking to deal with their affairs under these available mechanisms because of cost, lack of initial protection, complexity of procedure and the length of time that they take.

- The record of rescue in regard to companies is poor. And some would suggest that the salvage record is not much better. Very few insolvent companies initiate other than winding up procedures. Creditors who are forced to take proceedings against a company have no option than to look to winding up. Perhaps there should be greater encouragement for the rehabilitation, whether in part or in whole, of financially troubled companies.

- The present mechanisms are rigid. They are exclusive to one another. If a company seeks to implement a scheme of arrangement and does not succeed it cannot within the context of that procedure turn to official management or winding up as alternatives. And the same is true of official management. Any voluntary remedial action should provide for clear alternatives available to creditors so that the total range of alternatives may be contemplated at the one sitting.

Therefore, aside of considering particular reforms to existing procedures, a possible answer to many of the difficulties and restrictions apparent from those observations on official management, schemes of arrangement, winding up and receivers might be the introduction of a new procedure. The most apparent model for any new procedure is that based upon voluntary arrangements for individuals under Part X of the *Bankruptcy Act*.

The best features of Part X might be encompassed in a new set of provisions directed at companies. Those provisions could, in turn, incorporate the best of the scheme of arrangement and official management provisions so as to produce a range of alternatives (including voluntary winding up) to a financially distressed company and its creditors. It might also be extended so as to be imposed upon or, at least, available to a company facing compulsory winding up.

Should there be provision for a procedure similar to Part X in the case of companies? If so, what should be the essential features of such a procedure?

8. CREDITORS

Is our insolvency law sufficiently directed toward the common benefit of all creditors? There seem to be instances where the interests of the general body of creditors are unnecessarily affected by the indulgence of the law toward certain classes of creditors or other persons whose interests may have some significant effect upon the insolvency. In addition there are issues which concern the involvement of creditors in the administration of an insolvency and the role of creditors in voluntary arrangements.

Priority Creditors

As a matter of legislative policy the claims of some creditors are given a right of prior payment. These are the 'priority claims'. An example is the claim of an employee for unpaid wages or leave entitlement.

The claims of some others are deferred from payment to the general body of creditors. These are the 'deferred claims'. Claims by spouses fall into that category.

There are also instances of priority in another sense. For example, a distinction is drawn, in the case of joint or partnership debtors, between joint creditors and separate creditors. They have, except in some instances, priority to the joint estate and separate estate respectively.

Should the application of some of these priorities be reviewed? For example:

- Should claims for unpaid wages and leave entitlement made by employee/directors of insolvent companies in the winding up of those companies be entitled to the priority presently afforded to employees of insolvent persons?

- The distinction between joint and separate creditors and joint and separate property is sometimes arbitrary. It can create quite horrific administrative problems. Should the distinction be continued?

Revenue Claims

Apart from the policy expressed in the insolvency laws that give rise to these priorities, there are other laws which intrude upon the general policy of equal distribution. Of particular importance are the provisions of some revenue laws. The *Income Tax Assessment Act* is conspicuous. Some would say that it is notorious. It creates a priority all of its own in favour of the revenue for unpaid group tax and, more lately, prescribed work payments tax. The *Bankruptcy Act* is made subject to those provisions. They override state companies legislation. The effect is to disturb significantly the policy of priorities as set out in bankruptcy and company legislation.

They can operate, for example, to deny an employee unpaid wages. And they can have the effect of absorbing all of the property of the insolvent leaving all other creditors with nothing to be had and, therefore, no interest in the insolvency whatsoever.

There has been much criticism and debate over this issue. It runs against the policy of equal sharing. It is destined to be, yet again, a major consideration in our insolvency laws.

There are also other provisions of Commonwealth revenue laws which may operate so as to defeat the claims of creditors generally. An instance is found in section 218 *Income Tax Assessment Act*. The *Sales Tax Assessment Act* has a similar provision. By employing those provisions it may be possible for the Commissioner of Taxation to obtain a statutory charge or right of acquisition over certain assets of a debtor taxpayer, thus effectively removing the property from the reach of a trustee or liquidator in a subsequent insolvency of the debtor.

The Commission seeks submissions on these aspects of revenue priorities. Should they be abolished or modified?

Creditors or other Persons Having Secured or Other Rights Over Property

Secured creditors, landlords and lessors of property are not greatly affected by the insolvency of the debtor. Secured creditors have security to look to. There is nothing in our insolvency legislation to impede the secured creditor from exercising full rights in respect of that security. Note in particular the position of a creditor who has a charge over the assets of a company (a subject more specifically dealt with in Part 10 of this paper). Likewise a landlord, provided he does not rely solely upon the fact of the insolvency of the tenant, may determine a tenancy if there has been a breach of the terms and conditions of the lease or tenancy by the insolvent. The same is true of a lessor of chattels.

An insolvency administrator, presented for the first time with the financial mess of a failing business, may find that decisions whether or not to continue carrying on the business of the insolvent are out of his control. The quite lawful actions of a secured creditor, landlord or lessor against the property over which they have control may leave the administrator with nothing with which to continue the business.

Sometimes this might act to the considerable prejudice and detriment of the insolvent and unsecured creditors. It might be that, given some time, the business of the insolvent might have been restored or possibly disposed of as a going concern with little or no prejudice to secured creditors or property owners. But with the premises or equipment upon which the business has depended for operating purposes gone, or effectively denied to the administrator, there is little to salvage.

The insolvency law of America is inclined to the view that all creditors (including secured) and those having property interests affecting the insolvent, should be bound to the insolvency process thus enabling the total financial and property affairs of the insolvent to be administered without fragmentation.

Should the law provide for a stay upon the exercise of the rights of secured creditors and others provided no substantial prejudice to them is shown?

'Reservation of Title' Creditors

Some concern has been expressed about the growing use of 'reservation of title' clauses in contracts for the supply of goods. Particularly when the 'purchaser' of those goods becomes insolvent.

By this means a supplier of materials seeks, as part of the terms of the contract for the supply of the materials, to preserve title until payment in full. If the purchaser becomes insolvent without having paid, the supplier maintains that ownership of the materials remain with the supplier. In some instances the claim is made against goods manufactured out of the materials supplied. An ambitious supplier might even maintain a claim for the price paid or payable for the manufactured goods.

The law relating to the creation and registration of securities is outside the direct terms of this reference. Nonetheless the Commission invites submission on the extent of use of such 'title' clauses and whether the impact, for insolvency purposes, requires statutory intervention.

Administrators and Creditors

Creditors rely upon administrators for the proper conduct of the insolvent administration. Meetings are the formal source of relationships between administrators and creditors. Meetings are expensive. Not simply due to their direct cost.

There is an indirect cost to the creditors or their representatives in attending meetings. These proposals are put forward for consideration:

- might creditors be equally well informed at less expense if administrators were required to publish written reports on a regular basis?
- alternatively, should there be a greater involvement of committees of creditors who can act on behalf of all their number? If so, how might committees of creditors be more encouraged and become more responsive in insolvency administration?

Meetings of Creditors and Voluntary Arrangements

Possibly the most vital element in voluntary arrangements is the role of the creditors. It is ultimately their decision. Perhaps the position might be improved. These aspects need consideration:

- Stalemates at meetings can occur under systems that require a 50% majority in number coupled with a 3/4 majority in monetary value of those voting on a proposal. One large creditor (in monetary value) may effectively block the will of the majority in number; and some small in value creditors can prevent a majority in number being obtained. Possible remedies are:
  - do away with monetary values for the purpose of voting and reduce the resolving requirement to a simple majority resolution of number;
  - reduce percentage of monetary values required to a lesser percentage;
  - provide for appeals by creditors (and, even, the debtor) when the will of a majority in number is defeated or blocked by majority in value.
- Creditors need information, else they can hardly be expected to make an informed, intelligent decision on the affairs of the debtor. Often meetings are held with creditors knowing very little of the debtor. Adjournments become necessary. This adds to the cost and prolongs the exercise. That should be avoided. These are possible solutions:
  - Extend the time for holding the vital first meeting.
  - Require more information to be made available to creditors. An improved and more informative statement of affairs would assist. So too might a written report of the trustee which summarises the debtor's position, the causes of the insolvency, the antecedent transactions and conduct of the debtor, the proposals; and a recommendation by the trustee as to which course creditors should take.
- Voting on a proposal may be denied to a person whose 'debt' is unascertained or contingent. Yet that same person would be eligible to prove that liability in a subsequent administration. For that purpose the debt would have to be estimated or otherwise fixed. Is it appropriate that these persons should be excluded from voting power at an initial meeting when the fate of the insolvent is to be determined?

APPENDIX 'B'

THE NEW VOLUNTARY ADMINISTRATION REGIME

- **Access**

Any company that is insolvent or likely to become insolvent will have access to the procedure.

- **Purpose**

The object is to maximise the chance of saving the company or its business or to provide a better return to creditors than if the company was immediately wound up.

- **Initiation**

The procedure is initiated by a simple written appointment of an administrator. There is no requirement for any application to or 'filing' with a court. An appointment may be made by the directors of a company; the liquidator/provisional liquidator of a company; or by a secured creditor whose security extends to the whole or substantially the whole of the property of a company ('a fully secured creditor'). Notice of the appointment must be given to the regulatory authority (the Australian Securities Commission); to a fully secured creditor; and, generally, by advertisement.

The procedure will most often be utilised by the directors of a company. In such a case the appointment of the administrator is made pursuant to a resolution of the directors of the company under its common seal.

A fully secured creditor may appoint an administrator (as an alternative to enforcing the security by, for example, appointing a receiver), if the security is enforceable.

- **Effect of appointment of administrator**

The main effect is to stay the exercise of rights against the company and property owned, possessed, used or occupied by it. The stay will thus affect all unsecured creditors, secured creditors (with some exceptions) and persons who have an interest, whether as owner or lessor in property in the possession, use or occupancy of the company. This latter category includes lessors of real or personal property occupied or used by the company and persons who claim title to property in the possession of the company through 'reservation of title' devices.

A fully secured creditor can continue to enforce a security if the enforcement commenced before the appointment of the administrator or if it is commenced during a 14 day period, commencing from notice of the appointment of the administrator to the secured creditor. (It should be observed, however, that such enforcement does not paralyse the administration.) A security over perishable property may be enforced. Other secured creditors may only enforce their security if the enforcement process had commenced before the appointment of the administrator but this is subject to a power of the court to order, on the application of the administrator, a restraint on the continued enforcement of the security. Also, in some circumstances a person holding a fixed or specific security over, for example, land, who has progressed the enforcement of the security to the point of exercising a power of sale of that property, may complete that process.

- **Commencement and termination of the stay provisions**

The stay commences upon the appointment of the administrator. It will continue for a period anticipated, in many cases, to be not longer than 35 days, but which may be extended by order of the court in a complex or large administration.

- **Role of administrator**

The administrator has control of the company, to act as its agent and to exercise all the powers of its officers. The administrator is required to convene a first meeting of creditors within five days of appointment, to enable the possible appointment of a committee of creditors or of another person to be the administrator.

The administrator is to investigate the affairs of the company and form an opinion whether one of three options (a deed of company arrangement, a termination of the administration or a winding up of the company) is in the best interests of the creditors. If a deed of company arrangement is proposed the details of the plan of that arrangement must be notified to the creditors.

- **Role of creditors**

A main meeting of creditors must be convened within 35 days of the appointment of the administrator (the time for convening the meeting may be extended by the court). Creditors are required to resolve for one of the three options. A simple majority in number (and value, if required) will be required for an effective resolution. They may adjourn their meeting for a period of up to 60 days to further consider matters (in which event the period of administration and the stay is extended accordingly).

- **A deed of company arrangement**

The plan of a proposed arrangement between a company and its creditors may be tailored to suit the circumstances. The legislation places little restriction on the form that such an arrangement may take. It may involve a continued trade on of the business of the company, a sale of part of the assets, a rescheduling of debts, a composition of debts, a swap of debt for equity, a continued moratorium on creditor's rights and so forth. However, the arrangement must ultimately provide for or deal with the debts and liabilities of the company, by providing for their satisfaction in part or in full.

To avoid unnecessary complexity, a schedule to the legislation will identify a number of basic provisions for a deed of company arrangement, which, unless expressly excluded from the deed, will be deemed to be incorporated into the deed. This will substantially lessen the extent of documentary material that is normally required in many jurisdictions to properly notify and inform creditors of the type of arrangement that is proposed.

If the creditors resolve to agree to a deed of company arrangement the resultant deed will bind all creditors specified in the deed; secured creditors who have executed the deed; owners/lessors of property possessed, used or occupied by the company who have executed the deed; the administrator of the deed; the company; and the officers of the company. A person bound by the deed cannot take or continue with proceedings against the company or its property or enforce rights against that property.

The administrator of the deed may apply to the court for an order restraining a secured creditor or owner/lessor of property who declines to become a party to the deed from enforcing rights against any relevant property. The administrator must, however, satisfy the court that the interests of the secured creditor or property owner will be sufficiently protected under the arrangement.

- **Winding up of the company**

If the creditors do not consider that the company's affairs may be suitably dealt with under a deed of company arrangement, they may resolve for the company to be wound up and, in that event, there is an automatic transmission of the company from administration to the regime of a winding up in insolvency.

- **Flexibility under a deed of company arrangement**

  There are a number of provisions that enable flexibility in the formulation of an arrangement and to the form that a deed of company arrangement may ultimately take. First, the plan proposed by the administrator may be varied at the meeting of creditors. Secondly, after a deed becomes effective, the creditors may by resolution vary it. Thirdly, the court may vary the terms of a deed. All of this eliminates the necessity, if circumstances have altered or require it, to terminate a deed of company arrangement and also the cost and delay of recommencing the administration process. If the creditors resolve for a deed of company arrangement to terminate and to wind up the company, there is an automatic transmission of the company into a winding up in insolvency.

  These provisions enable the affairs of the company to be dealt with as a cohesive whole, with consequent savings of both cost and time.

- **Personal liability of administrator**

  During the initial administration period, the administrator is personally liable for debts incurred for the supply of goods or services, for the hire or leasing of property and, also, for rent, leasing or hiring charges arising from the continued occupation or use by the company during the administration period of property of another person. These provisions are designed to encourage suppliers of goods and services to continue to deal with the company while its affairs are being reviewed and, also, to repose a proper responsibility in the administrator. The administrator is entitled to be indemnified for any such personal liability out of the assets of the company (including assets of the company which are the subject of the 'floating' component of a charge).

- **Supervision by the court**

  The voluntary administration process avoids the need for application to and constant supervision by the court. However, the court has a general jurisdiction to give directions and make relevant orders, but only on the application of the administrator or other persons who might be affected by various aspects of the administration procedure.

APPENDIX 'C'

STAY PROVISIONS

EFFECT OF VOLUNTARY ADMINISTRATION ON SECURED CREDITORS

A secured creditor may not enforce[1] its charge during the moratorium period except:

- with the administrator's written consent; s440B(a);
- with the court's leave; s440B(b);
- where the creditor holds a charge or charges; s441A(2), over the whole or substantially the whole of the company's property and either has already commenced or during the decision period; s441A, commences to enforce the charge in relation to all of the charged property; s441B;
- where enforcement proceedings were commenced prior to the beginning of the moratorium period; s441C;

- if the charged property is perishable; s441A(3) and (4).

That general restraint in relation to secured creditors does not apply in relation to the service of any notice under the security documentation which may be served notwithstanding that restraint; s441E. Whilst no mention is made in s441E to the service of a notice which may be required by a statute to be given to a mortgagor, the general restraint applies to enforcement action whereas those notices, typically, are a pre-requisite to enforcing a security.

In the case of a charge or charges over the whole or substantially the whole of the company's property, it may be enforced during the moratorium period by any of the chargee; s441A(3) and (4),[2] a receiver appointed by the chargee under a power contained in an instrument relating to the charge; s441A(3) and (4),[3] a receiver appointed by a court on the application of the chargee for the purpose of enforcing the charge; s441A(3) and (4),[4] or a person who is appointed (whether as agent for the chargee or the company) to take possession or assume control of the company's property; s441A(2)(b),[5] provided that where there are two or more charges, the same person is the chargee in respect of all of them; s441A(1)(b), s441A(2)(d). The mode of enforcement of the charge or charges need not be the same in respect of all of the charged property, rather it or they merely require to be enforced in respect of all the charged property; s441A(3)(b), s441A(4)(b) . Moreover, the mode of enforcement is not immutable even after the expiry of the decision period; s441A(3). So, for example, a chargee who has appointed a receiver may terminate that appointment and appoint a person as its agent to take possession of the charged property even though the decision period has elapsed. The chargee, receiver or other person when enforcing the charge or charges is not required to obtain the administrator's prior written consent either to the exercise of any power or function; s441A(4), or to the sale of or any other transaction affecting any of the company's property and the administrator's powers are subordinated to the powers of the chargee, receiver or other person in that circumstance; s442B.

Where, prior to the commencement of the moratorium period, a charge, irrespective of whether it extends to the whole or substantially the whole of the company's property, is being enforced by the chargee, a receiver or other person having:

- taken possession of the company's property;
- entered an agreement to sell the company's property;
- arranged for the company's property to be sold by public auction;
- publicly invited tenders for the purchase of the company's property;
- exercised any other power in relation to that property for the purpose of enforcing the charge; s441B(1),

the general limitation on the rights of a chargee to enforce its security does not apply and the chargee, receiver or other person may exercise any power or function without the prior written consent of the administrator; s441B(2). Moreover, the prior written consent of the administrator (who may only exercise his or her powers subject to the powers of that chargee, receiver or other person; s442B) is not required in relation to a transaction that affects that property where that transaction is entered into either by the chargee in the exercise of its powers as such or in the performance or exercise of a function or power of the receiver or other person which is undertaken for the purpose of enforcing the charge; s441B(3).

If a chargee holds security over perishable property, that security, to the extent to which it attaches to that property, may be enforced at any time during the moratorium period notwithstanding that the charge also extends to other property of the company; s441C(1), s441C(2). None of the chargee, a receiver or other person who is enforcing that charge (whose respective powers are superior to those of the administrator; s442D) require the administrator's prior written consent either to the exercise of a power or function; s441C(2), or to undertake a transaction which affects that property; s441C(3).

In the circumstance that a chargee, receiver or other person may enforce and is enforcing a charge on the property of a company during the moratorium period, the court, on the application of the administrator, may order that chargee, receiver or other person, other than a chargee, receiver or other person who is enforcing a charge on the whole or substantially the whole of the company's property; s441D(1), not to perform specified functions or exercise specified powers except as permitted by the order; s441D(2). That order only has effect during the moratorium period; s441D(4), and may only be made if the court is satisfied that the interests of the chargee are adequately protected; s441D(3).

Where the administrator of a company assumes control or takes possession of any of its property which is subject to a charge[6] he or she may not dispose of that property; s442C(1), otherwise than:

- in the ordinary course of the company's business; s442C(2)(a);
- with the written consent of the chargee; s442C(2)(b);
- with the leave of the court; s442C(2)(c),although the leave of the court may not be given unless the court is satisfied that arrangements have been made to adequately protect the interests of the chargee; s442C(3).

If the charge is in the nature of a floating charge, subject to those limitations and the superior powers of the chargee, receiver or other person who is entitled to and who is enforcing the charge, the administrator may deal with the company's property which is subject to that charge as though it continued to be a floating charge; s442B(2). Additionally, in the case of the company's assets which are subject to a floating charge, the administrator's right of indemnity out of those assets will enjoy priority to the claims of the chargee unless the chargee has:

- appointed a receiver under the terms of the charge;
- obtained an order appointing a receiver to enforce the charge;
- entered into possession or assume control of the company's property for the purpose of enforcing the charge; or
- appointed a person (whether as agent of the chargee or of the company) to take possession of the company's property

  (a) prior to the commencement of the administration, in which event the administrator, if the receiver or person is still in office or the chargee is still in possession or control of the company's property, will not have priority except to the extent that the chargee agrees; s443E(2); or

  (b) after the commencement of the administration,[7] where the administrator only enjoys priority for those debts incurred or remuneration accruing prior to the administrator being given written notice either of the appointment or of the chargee having taken possession of the company's property; s443E(3).

The lien which the administrator has over the company's property is only effective against a secured creditor to the extent that the administrator's claim against the company enjoys priority to the claim of that secured creditor; s443F(2).

EFFECT OF VOLUNTARY ADMINISTRATION ON OWNERS AND LESSORS OF PROPERTY

The owner or lessor of property which is used or occupied by or in the possession of the company cannot take possession or otherwise seek to recover that property during the moratorium period except:

- with the administrator's written consent; s440C(a);

- with the leave of the court; s440C(b);
- where, prior to the beginning of the moratorium period, a receiver or other person took possession of the property or exercised any other power in relation to it for the purpose of enforcing the right of the owner or lessor to take possession of it; s441F; or
- where the property is perishable; s441G.

As with secured creditors, that general restraint does not operate to preclude the service of any notice required to be served under any agreement between the company and the owner or lessor of that property; s441J.

In the case of both perishable property and property which is the subject of repossession action prior to the commencement of the moratorium period, the administrator's prior written consent is not required either to the exercise of a power or function in relation to the property; s441F(2), s441G(1), or to any transaction affecting it; s441F(3), s441G(2). Moreover, the administrator's powers and functions in relation to that property are subordinate to those of the receiver or other person who has taken possession or assumed control of it; s442D(3). However, the court, on the application of the administrator, may order any person who has taken possession of that property not to exercise specified functions or powers in relation to it except as permitted by the order; s441H(2). Such an order may only be made if the court is satisfied that adequate arrangements have been made to protect the owner or lessor; s441H(3), and the order only has effect during the moratorium period; s441H(4).

EFFECT OF DEED OF COMPANY ARRANGEMENT ON CREDITORS

Creditors of the company are bound by a deed of company arrangement; s444D(1), in the event and to the extent that their claims arose prior to the time specified for that purpose in the deed; s444D(1), s444A(4)(i). Until the deed terminates, they may not make or prosecute an application for the winding up of the company; s444E(2), nor may they take any action against the company or its property[8] including any enforcement process against that property; s444E(3)(b), otherwise than with the court's leave and on such conditions as it may impose; s444E(3).[9]

The claims of creditors against the company are only released in the event and to the extent to which the deed specifically provides and the creditor is bound by its terms; s444A(4)(d), s444H.

Notwithstanding the general limitation upon creditors exercising rights against the company, a secured creditor's rights as such are only affected by a deed if it so provides and if that creditor voted in favour of the resolution in consequence of which the company executed the deed; s444D(2). That is also the case for the owners or lessors of property which is in the company's possession and the exercise of their rights in relation to that property; s444D(3).

However, the court, on the application of the deed's administrator; s444F(7)(b), may restrain a secured creditor from realising its security or otherwise dealing with it except as the court might permit; s444F(2) and subject to such conditions as the court imposes; s444F(6). The power to restrain a secured creditor from exercising its rights does not extend to a chargee who has security in respect of the whole or substantially the whole of the company's property and who commenced the enforcement of that security in respect of all of the charged property prior to the commencement of the administration or during the decision period; s444F(2), s441A(3). Further, the court may only restrain those secured creditors who are amenable to its orders if it is satisfied that should the creditor enforce its security there would be a material adverse effect on the purposes of the deed; s444F(3)(a), and that the interests of the secured creditor will be adequately protected; s444F(3)(b).

The owner or lessor of property which is in the company's possession may also be restrained by the court, on the application of the deed's administrator; s444F(7)(b), from taking possession of or otherwise recovering that property; s444F(4). For the court to make such an order it must be satisfied of the same

matters as regulate the exercise of its power to restrain a chargee from exercising its security rights; s444F(4).

FOOTNOTES

1. 'Enforce', in relation to a charge on property of a company under administration, includes:

   (a) appoint a receiver of property of the company under a power contained in an instrument relating to the charge; or

   (b) obtain an order for the appointment of a receiver of such property for the purpose of enforcing the charge; or

   (c) enter into possession, or assume control, of such property for that purpose; or

   (d) appoint a person so to enter into possession or assume control (whether as agent for the chargee or for the company); or

   (e) exercise, as chargee or as a receiver or person so appointed, a right, power or remedy existing because of the charge, whether arising under an instrument relating to the charge, under a written or unwritten law, or otherwise; s9.

2. Section 9, definition of 'enforce', paragraph (a).

3. Section 9, definition of 'enforce', paragraph (b).

4. Section 9, definition of 'enforce', paragraph (d).

5. This would not preclude a chargee who held security over part of the company's property from both taking an assignment from another chargee who held security over the balance of the company's property and, if that assignment were perfected prior to the expiry of the decision period, the first chargee from enforcing those charges.

6. As noted, the powers of the administrator in this regard are subject to the powers of a chargee, receiver or other person who is entitled to and who is enforcing that charge.

7. The chargee may take possession or assume control of the company's property or a receiver or other person may be appointed after the commencement of the administration:

   (a) if the chargee holds a charge or charges (including the floating charge) over the whole or substantially the whole of the company's property and begins to enforce its security over all that property during the decision period; s 441A; or

   (b) to the extent to which the relevant property the subject of the floating charge is perishable; s 441C.

8. 'Property' in relation to the company, includes property used or occupied by, or in the possession of, the company; s 444E(4).

9. As the deed may stipulate a moratorium period, presumably the court would grant leave to a creditor to exercise its rights once that period had expired should that occur before the termination of the deed.