RECENT DEVELOPMENTS — VOLUNTARY ADMINISTRATIONS

Creative Solutions for Corporations in Crisis

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INTRODUCTION

For many years insolvency practitioners have been faced with the dilemma of what to do with a company which has run into financial difficulties but which could be potentially saved. The practitioner in such circumstances was faced with recommending either liquidation of the company, appointment of a receiver, a scheme of arrangement or official management program. Each of these alternatives, whilst having advantages in particular circumstances, did not provide a positive cost efficient mechanism which could be used to plan the long term survival of the company.

The Harmer Committee was appointed to address this issue. It recommended the introduction of a new voluntary procedure for insolvent companies which integrated the procedures for the voluntary winding up of a company and for a scheme of arrangement. The new Part 5.3.A implements this recommendation by the establishment of a new scheme for the voluntary administration of insolvent companies.

WHAT IS A VOLUNTARY ADMINISTRATION

A voluntary administration is a statutory procedure whereby a company can seek protection from its creditors whilst a plan for the future of the company is developed which the creditors have the power to accept or reject.

WHO CAN INITIATE APPOINTMENT?

- Director/s
- Liquidator or provisional liquidator
- Secured lender

KEY FEATURES OF A VOLUNTARY ADMINISTRATION

- Secured creditors over all/substantially all of the assets can make or break a voluntary administration.
- Appointment is swift, uncomplicated and relatively inexpensive.
- Flexibility - creditors decide the company's future at key stages.
- Operates an automatic stay of proceedings against the company by unsecured creditors and owners of property which the company is using (including landlords).
- Provides a springboard from which other insolvency administrations can be launched.

BENEFITS TO CREDITORS

Benefits of a voluntary administration derive from the nature of the procedure and early recognition of financial problems.

Seen in the greater potential for:

- Restructure and trade-out of problems **or**
- Potentially greater returns.

PRACTICAL ISSUES

Owners/lessors

Section 440C

Owners or lessors of property in the possession of the company cannot recover their property except with the written consent of the administrator or leave of the court.

Two general exceptions:

- (Section 441F). Where the owner or lessor enforce their rights to recover the property prior to the beginning of the administration.
- (Section 441G). Where the property owned or leased is perishable property.

(Note: Section 441H limits these exceptions where the property is adequately protected.)

Other contracts

There is nothing to prevent a party cancelling a contract with the company upon the administrator's appointment, subject, however, to the terms of their contractual arrangement.

Practically: The administrator will contact customers who have contracts with the company and will negotiate with them to prevent their cancellation. These negotiations may be critical to the future of the company and the administrator's plan for survival. Alternatively, if a supplier has tendered for supply and has priced its goods too aggressively, it may consider cancelling the contract and re-working it with the administrator to improve its position.

Returns to creditors

Due to the relative infancy of this form of insolvency administration, returns are difficult to gauge. The AFR have recently released statistics showing that the average return to unsecured creditors have tripled, increasing from 6.8 cents to 19.8 cents in the dollar. Returns are also received by creditors much faster than in other forms of insolvency administration.

Trading with an administrator

Know who you are dealing with

VA - Section 443A - an administrator will use the expression "Administrator Appointed": the voluntary administrator is personally liable for debts incurred in the course of the administration.

DOCA - After execution of DOCA, the administrator will use "Subject to Deed of Company Arrangement" and is not personally liable for debts incurred.

Directors' personal liability

Directors may place companies into voluntary administration on a more regular basis due to:

(i) Directors' personal liability under the *Corporations Law* being now easier to prove.

(ii) ATO - penalty notices making directors personally liable

- If Group Tax/PPS/Withholding Tax is late, then under section 222AOE the ATO can issue a penalty notice. Director's must (within 14 days):
  - enter arrangement
  - pay
  - enter liquidation
  - appoint voluntary administrator.
- As at 30/6/93, there were 20,000 businesses in arrears.

VOLUNTARY ADMINISTRATIONS IN PRACTICE

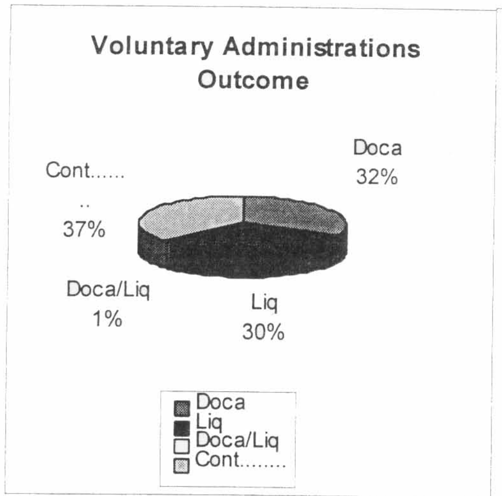
Uses to date

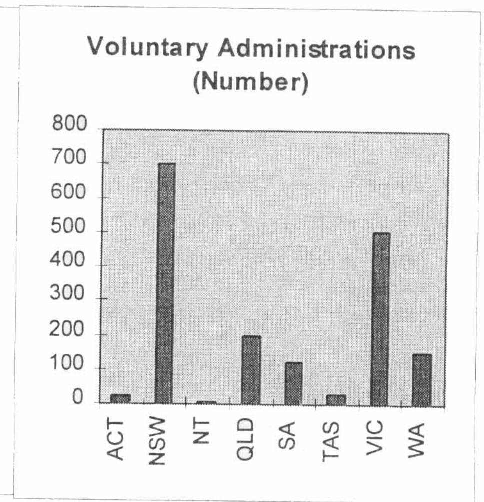
The spirit of section 435A of the *Corporations Law* has led to voluntary administration developing to allow companies which identified financial crisis early to approach their creditors with a workout proposal. If accepted, the company would hopefully survive. The result - less damage to the economy, and society, through corporate failure.

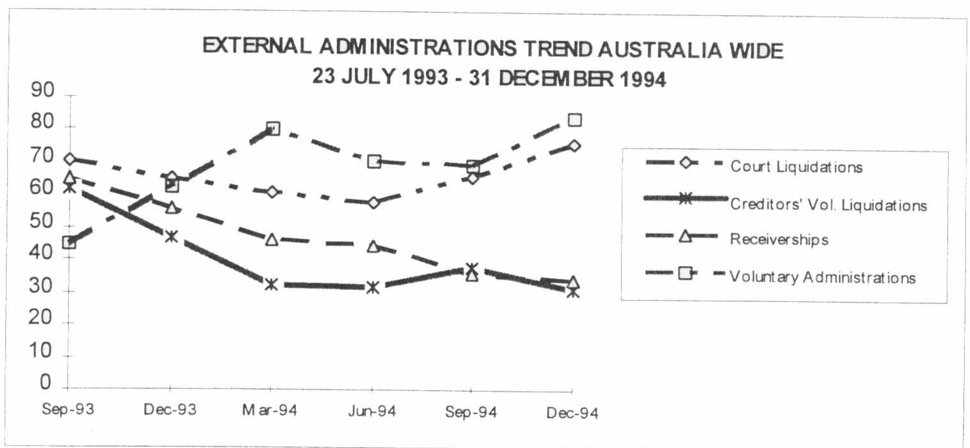
From 1 July 1993 to 31 December 1994 the new law has seen directors place over 1,100 companies into voluntary administration. This method of administration has now seemed to have effectively replaced schemes of arrangement, official management and, to a significant extent, court liquidations, all viewed by the business community as cumbersome and costly.

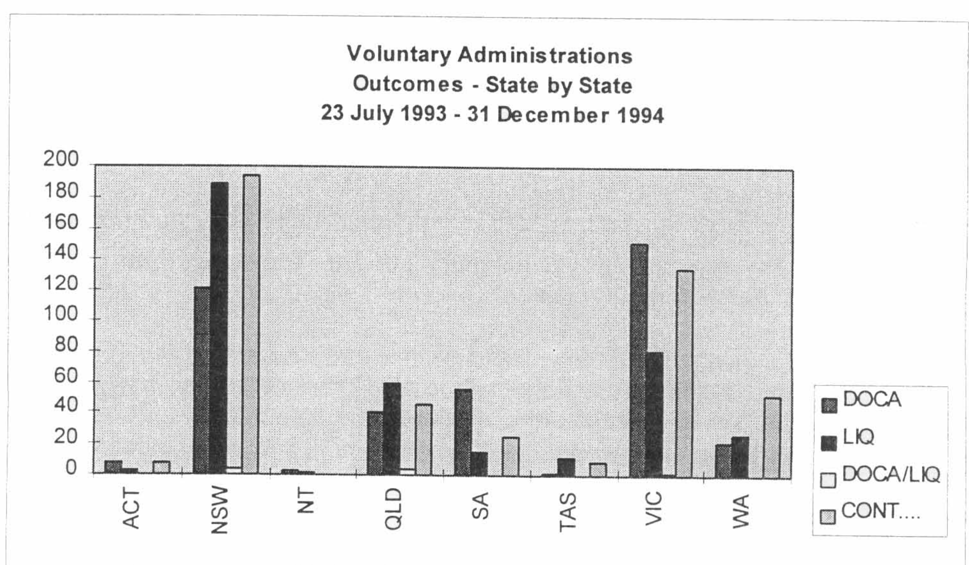
Arthur Andersen monitor all voluntary administration appointments focusing on industry type, capitalisation, impact on creditors, the attitude of banks and, most importantly, the outcome for the company involved.

A diagrammatic summary of some of the findings is presented below.









THE BRASHS GROUP OF COMPANIES

The Brash Group Administration was the first, and the remains the only voluntary administration to date, of a public company. David Beatty and Michael Humphris of Arthur Andersen were appointed to the publicly listed Brash Holdings Ltd and its various subsidiaries as voluntary administrators on 2 May 1994. This was viewed by the media, practitioners and financial markets as the first significant litmus test for the new regime.

The paper, prepared by Mr Leon Zwier of Arnold Bloch Leibler, contains a very detailed and comprehensive summary of both the legal and commercial aspects involved in the Brashs Administration, and should be read on conjunction with this case study. This overview of the administration concentrates on the transactions involving the banking syndicate to Brashs and the arrangements reached with the administrators following extensive meetings and consultation.

Background

The Brashs Group was established in Melbourne in 1862 by Mr Marcus Brash who began selling quality pianos and reed organs. After four generations, members of Brashs family continued to participate in the Brashs Group, and the trademark has become strongly enfranchised in the public perception.

Brashs Group is one of Australia's specialist retailers enjoying a market share of between 20% and 30% of product markets including video and audio systems, whitegoods, musical instruments and recorded music.

At the date of the administrators' appointment, the company employed approximately 3,000 staff trading from 170 stores Australia wide. These stores were all subject to leases, which in itself created a unique problem for the conduct of the administration. Given that the enfranchised goodwill of the business was in large part vested within the distribution network, it was imperative that those sites which were economically viable, or were capable of returning a positive contribution if onerous leases could be renegotiated, be preserved. Mr Zwier's paper addresses the legal aspects associated with the restructure of these leases.

Financial position

At the date or our appointment, the Group was incurring trading losses in the order of $4m per month. From a balance sheet perspective the company was clearly insolvent and, obviously, these losses could not continue to be sustained. The financial position, from the administrators' perspective, is summarised as follows:

	$M Book Value	Est Realisable Value
Assets		
Cash	1.3	0.2
Inventories	65.3	27.2
Debtors	13.7	9.1
Fixed Assets & Other	63.8	12.0
Total Assets	144.1	48.5
Less Priorities		
Employee Entitlements		(11.2)
Provision for Trading Losses		(18.0)
Administration/Legal Costs		(4.0)
Available Assets		15.3

Review of the financial position discloses the relatively marginal coverage available to the administrators to maintain trading operations. The most substantive asset classification in the balance sheet, inventory, was subject to extensive retention of title claims. It was estimated that retention of title creditors may have been owed $20m for stock on hand on appointment. This would result in stock of $45.3m remaining to be realised under a liquidation.

A number of suppliers undertook to supply the administrators with sale or return terms on a liquidation scenario. This would improve the realisable value of stock. However, as this sale or return right does not cover all suppliers and as it is not unusual for stock to realise as low as 25% of cost in a liquidation, it was arbitrarily estimated that a 60.0% return on non-retention of title stock would be a probable outcome.

Position of secured creditors

The Brashs Group was subject to registered mortgage debenture charges held by a banking syndicate. However, the security was created at a date where the transaction may have been voidable against a liquidator if each company within the Brashs Group had been placed into liquidation at the conclusion of the administration.

The banking syndicate had originally provided a facility to Brashs on an unsecured basis for some years, but in the period immediately prior to the administration had sought to protect their collective exposure. At the date of our appointment, the syndicate had a gross facility exposure of $58m.

Examination of the position in relation to the banking syndicate and the Brashs Group disclosed the following:

(i) the security was granted by the Brashs Group in favour of the banking syndicate on 7 February 1994;

(ii) there was a repayment by the Brashs Group of $4.0m to the banking syndicate on 6 April 1994; and

(iii) there was a purported set-off by the banking syndicate of $20m on or about the date of the commencement of the administration, resulting in a net exposure of $38m.

In summary, the resolution of many of the issues raised in relation to the above transactions would turn on the solvency of the Brashs Group and, in the case of the set off, on the banking syndicate's knowledge of the solvency of the Brashs Group.

Legal advice was commissioned, which indicated that given the significant questions of fact which could only be determined upon a detailed examination of all the facts and circumstances, a formal examination of all relevant persons would be required. Due to the limited time available, a definitive opinion with respect to the security, potential preference and set-off could, therefore, not be formed.

The dilemma in this scenario then becomes quite clear. Whilst the administrators in this case may well have had a sound argument that the companies were insolvent at the time the charges were created (which was vigorously contested by the banking syndicate), the magnitude of the syndicate's voting rights over any deed of company arrangement proposal meant that it was essential to reach a compromise.

To this end, the banking syndicate was represented on the Committee of Inspection and was kept fully briefed on the progress and conduct of the administration. All options were carefully and jointly explored by the syndicate's representatives and this office, and with that came a recognition on the part of the syndicate that the value of the security was significantly undermined by the extent of the retention of title claims. It was clearly in the interests of all parties that a commercial compromise be reached.

The outcome

The key ingredient to the successful resolution to the Brashs administration would be the ability to carefully balance the competing interests of the various stakeholders, including:

- Employees
- Unsecured creditors
- Retention of title creditors
- Lessors
- Banking syndicate
- ASC/ASX
- Customers

In constructing a formula to determine an appropriate compromise outcome, various scenarios were analysed using a detailed modeling application. The principal consideration was to ensure that each stakeholder, under the proposed deed of company arrangement, received a return that was fair and equitable in the context of the financial circumstances of the Group and the strength of their respective legal entitlements. At the same time, it was necessary to also ensure that groups of stakeholders did not become alienated from each other through perceived inequalities in prospective returns. Communication, therefore, became paramount in safeguarding the commercial settlement process. The grading of retention of title claims through independent mediation is an illustration of importance of being fair and independent.

The compromise equation eventually settled upon under the deed of company arrangement provides for the following returns:

		c/$
Banking Syndicate		61
Retention of Title	A Class	75
	B Class	56
	C Class	43
Unsecured (Consolidated)		38
Continuing Lessors		100
Employees		100
Lay By, Gift Vouchers		100

Although working to an extremely tight time frame, the Brashs administration resulted in a recapitalisation of the group and was hailed as a vindication for the VA process as:

- the core business was preserved;
- the vast majority of employees' positions were maintained; and
- creditors are likely to receive a significantly better return than under other alternative scenarios.

SANDS & McDOUGALL PRINTING PTY LTD

The benefits flowing from the voluntary administration regime, given the right context, are manifested in corporate reconstructions of entities with many different profiles. In particular, the outcome of the Sands & McDougall Printing Pty Ltd ("the company") administration, detailed below, is instructive in demonstrating the potential of Part 5.3A of the *Corporations Law* to "add value" to smaller entities, not just to larger scale public companies experiencing financial distress. The flexibility of the regime is also highlighted in the scope to deal with embedded operational and cultural problems that would otherwise have resulted in a liquidation scenario, with no prospect of a return to unsecured creditors.

Background

Sands & McDougall is one of the oldest Australian owned print houses in Australia, having started its operation in 1853 in Collins Street, Melbourne. The company printed and established the first Directory of Landlords for Melbourne and surrounding areas in 1857. The company has established an enviable reputation, having printed the racebook for the first Melbourne Cup. At the date of the appointment of the administrators to the company on 10 November 1994, it employed approximately 70 personnel.

Industry profile

Sands & McDougall provides specialised printing services for many of Australia's larger commercial and public organisations, including printing account books for major financial institutions and health funds, as well as printing tram, train and security tickets for the Public Transport Corporation of Victoria and New South Wales. Furthermore, the company prints race books for all the major Victorian race clubs, books, magazines and diaries, etc for Universities and TAFE Colleges.

The printing industry, which may be described as a secondary process industry, is currently subject to a number of strong dynamics:

- Polarization: Those participants with critical mass are expanding through acquisitive growth, whilst many smaller players are being squeezed out of existence. For smaller scale participants to survive, they need to establish a competitive advantages in niche markets. Historically the company has achieved this through establishing a strong franchise in specialist market segments.

- Mature Market: With rapid advances in communications technology, the printing industry may be characterised as a mature market. With little prospect of organic growth, industry participants are faced with an exit or prosper challenge.

- Strong Competitive Pressures: As one would expect, given the foregoing factors, in combination with the economic recession "we had to have", there have been severe pressures on prices and margins.

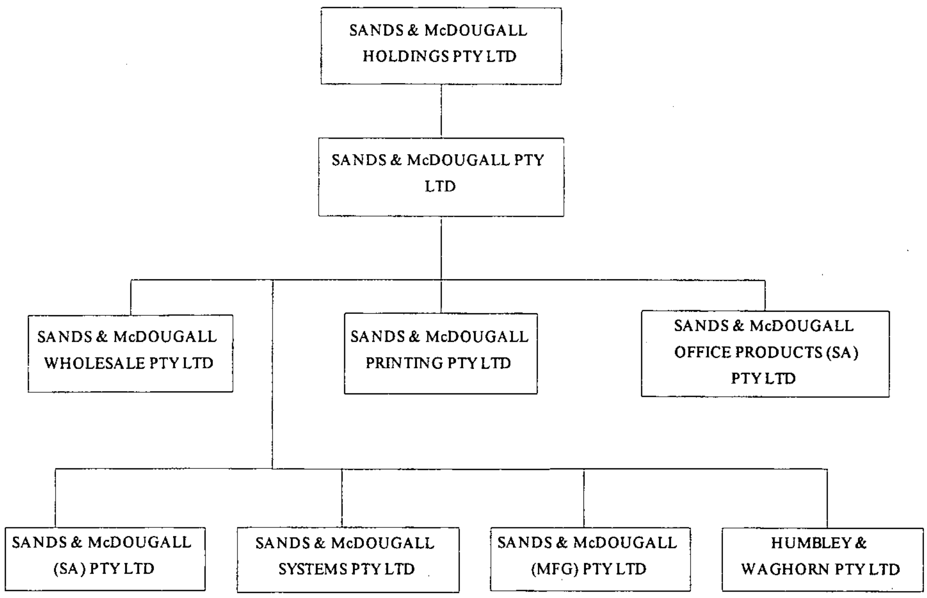
- Capital Expenditure Requirements: Significant economies of scale are available to industry participants with access to state of the art plant, which involves heavy financial investment.

- A robust balance sheet is therefore a prerequisite to a viable outlook. The company did not have the benefit of this foundation.

Group structure

The company is one of a group of entities owned by Sands & McDougall Pty Ltd (collectively the "Sands & McDougall Group").

Below is a summary of the Group structure:



Sands & McDougall Wholesale Pty Ltd (In Liquidation) ("Wholesale"), another entity owned by Sands & McDougall Pty Ltd, was wound up on 12 September 1994. Wholesale had been involved in stationery products distribution and had been incurring considerable financial losses for some time. Westpac Banking Corporation ("Westpac") had advanced loans and provided financial facilities to certain other companies in the Group of approximately $1.15m, with the majority of advances in favour of Wholesale. These loans and advances were in turn guaranteed by the company and were the subject of a debenture charge over the company. The balance of other entities in the group were essentially dormant.

Causal factors resulting in financial crisis

The factors both contributing to and precipitating the financial crisis were many and included the following:

- Group Financial Difficulties: The financial difficulties experienced by Wholesale contributed, inter alia, to the financial crisis confronting the company. Westpac had "green" charges over Wholesale and was likely to receive a return of between $350,000 and $650,000 from the Wholesale administration. Accordingly, Westpac sought to rely on its collateral security, and, prior to our appointment, served formal demands on the company to meet its guarantee obligations.

- Anachronistic Industrial Relations Regime: The company was a "blue collar" shop and had a history of industrial relations turmoil. As a consequence of a lack of management direction, work practices were deficient at best and productivity had suffered accordingly. Relations between management and staff were strained, and the general workplace climate was adversarial. In addition, the majority of employees had been with the company for the whole of their working lives and little had been invested in training and "upskilling" programs.

- Employee Factions: Productivity was further hampered by factions within the workforce, characterised by a lack of co-operation between departments and demarcation disputes.

- Workflow Planning Deficiencies: As is common with many distressed companies, there was a paucity of operational and financial controls in place. In this instance the company had a first generation Gaant Board system in use for monitoring the printing function but no interrelated planning tool to cover the estimating, finishing and binding functions. This resulted in daily bottlenecks and quality control problems.

- Declining Revenues: The company had a long history of profitability, notwithstanding the operational difficulties referred to above. This was largely attributable to the unchallenged market dominance the company enjoyed in the niche segments it serviced. However, as discussed above under the Industry Profile caption, the industry was subject to new dynamic pressures, which were manifested in early 1993 when revenues began to decline. In the period from January 1993 to November 1994 revenues contracted by 30% from $10m pa to $7m pa. During this period, management failed to address this decline by reducing the high fixed cost structure of the company, with the result that financial haemorrhaging occurred on a significant scale. At the time of our appointment, the company was incurring losses in the order of $15,000 per week.

- Capacity Under-utilisation: The ineffective work practices referred to above had seen an extensive record of plant capacity mismanagement. In particular, the company had ignored the economies of scale available through long production runs, and, in consequence, incurred the financial costs associated with frequent plant downtime whilst short production runs were set.

- Erosion of Client Base: The combination of financial instability and concerns over quality control and delivery schedules led to the risk of further erosion in the client base, which was composed predominantly of "blue chip" clients.

The central tenet in connection with the factors listed above is that the seeds of crisis had been progressively sewn over many years, notwithstanding that the company had been generating healthy net profits during the corresponding period.

Financial position

At the date of our appointment, the financial position of the company appeared salvageable upon first inspection. A summary of the balance sheet according to the books of the company as at the date of our appointment is set out below:

Assets	***$000s***
Receivables	677
Plant, Equipment, Fixtures & Fittings	1464
Inventory	449
Future Income Tax Benefit	316
Other	242
Total Assets	3148
Liabilities	
Employee Entitlements	598
Unsecured Creditors	1384
Total Liabilities	1982
Net Equity Per Books	1166

Whilst the net equity disclosed in the records of the company was in excess of $1m, the effective position was a significant deficiency of assets to liabilities by virtue of off balance sheet liabilities and crystallised contingent claims.

The effective position may be restated as follows:

		$000s
Net Equity Per Books		1166
Less		
Employee Severance Liability	-Award	(450)
	-	(800)
Non-Award		
Westpac Guarantee Claim (secured)		(1150)
Effective Net Asset Deficiency		1234

On our preliminary analysis, it was immediately apparent in a liquidation scenario, there would be no prospect of return to unsecured claimants, and, in fact, that there would be insufficient funds to satisfy priority creditors. This was in part due to the magnitude of above-award entitlements, which would become due and payable pursuant to contractual agreements in the event that all employees were retrenched.

The appointment scenario was further complicated by the collateral security held by Westpac, who determined to appoint a receiver to the fixed portion of their debenture charge on the same day administrators were appointed to the company. This decision was taken to avoid the imposition of employee liabilities, which would result in a nil recovery to Westpac from the administration of the company. Even allowing for the split appointment mechanism, Westpac faced the prospect of a significant shortfall against the group facility. The base case scenario return to Westpac was estimated as follows:

	$000s
Aggregate Facility Exposure	1150
less Estimated Recoveries	
Wholesale	(350)
Printing	(300)
Shortfall to Westpac	500

Having carefully analysed the interests of the various stakeholders and the financial affairs of the company, we took the view that a limited window of opportunity existed within which we could choose to trade the business on with a view to restructuring its affairs. There were obvious risks associated with this course of action in that the only tangible assets which we would have recourse to satisfy our trading obligations would be the recoverable balance of debtors (estimated at $0.5m), as the values attributable to work-in-progress and finished goods would be negligible, unless the business could be maintained as a going concern.

We, therefore, embarked upon a calculated strategy to restructure the company's balance sheet within the shortest possible time frame, whilst at the same time addressing the operational concerns that were jeopardising its future viability.

Our approach

A number of deliberate strategies were embarked upon to stabilise the company in conjunction with an extensive marketing campaign to attract potential purchasers/equity investors. These strategies, which are conventionally described as "turnaround strategies", included:

- Establishing an agreement with the secured creditor to support the company for the duration of the administration.
- Introducing a management team and establishing an appropriate organisational hierarchy.
- Undertaking a marketing assessment and effectiveness program.
- Engagement of specialist marketing consultant to supervise sales team.
- Conduct of a detailed activity based costing review of work processes, resulting in significant changes to work practices.
- Setting up consultative mechanisms designed to improve industrial relations.

In this instance, as in all appointments we accept, we sought the support of the secured creditor prior to confirming our acceptance to the directors of the company. Whilst Westpac were content to grant us a week to conduct a preliminary assessment of the company's prospects, they remained unconvinced that any scope existed to improve their return beyond that detailed in the base case scenario above. Having carefully analysed the internal and external influences on the company, we were able to subsequently persuade them to continue supporting the administration until a deed of company arrangement was struck.

The outcome

After two separate applications to the Supreme Court for extensions to the defined statutory period of time in which the second meeting of creditors must be convened, a number of multi-party contractual agreements were entered into, under the ambit of a deed of company arrangement, which provided for:

- The recapitalisation of the company entity on the transfer of control of the shares in the company to a new private investor.
- Approval of the proposed deed of company arrangement by the majority of administration creditors.
- Discharge in full by Westpac of its security (recognising that whilst questions exist as to the validity of the debenture charge, it must be dealt with in any negotiated settlement). In exchange, Westpac would be completely paid out on its aggregate exposure, including all penalty interest, accrued charges and out-of-pocket expenses associated with the partial enforcement of their debenture charge over the company.
- Complete waiver by consent of all employees of any above-award entitlements they may have had pursuant to an interim redundancy agreement, which are estimated at an additional $800,000. Certain anomalies existed in connection with the interim redundancy agreement, however, in a liquidation scenario, this would become an academic point, as there would insufficient funds to satisfy these claims.
- Resolution by the members of the company sponsored superannuation fund to repatriate part of the accrued surplus to the benefit of the company.

It is projected that unsecured creditors will receive approximately 78c/$ from this administration. This case study, therefore, is quite likely to be the strongest testimonial we have seen to date in favour of the voluntary application regime, and, in particular, the scope that exists to deliver value-added solutions if properly managed There is little doubt that without this form of appointment the company would have been liquidated, as the secured creditor was facing a significant security shortfall and was not of a mind to assume the risks inherent in operating the business as a going concern.

KZFM RADIO PTY LTD

The benefits available under the voluntary administration regime are considerably extended in circumstances where taxation and other statutory impost relief may be available if the corporate shell can be preserved. Historically such benefits were obviously unavailable where the corporate entity was liquidated.

The forms of tax benefits available, where the corporate shell can be restructured, may include:

- Stamp duty relief (potential reductions from 5.5% to 0.6%).
- Income tax relief through preservation of carry forward losses and franking credits.
- Capital gains tax relief through the preservation of realised losses and the maintenance of higher cost bases and indexation factors where the value of underlying assets may have declined in the period since acquisition.

The KZFM Radio case study provides a useful illustration of the mechanism by which tax benefits may be preserved through the application of a voluntary administration.

Overview

Arthur Andersen was appointed receiver and manager of KZFM Radio Pty Ltd ("KZFM") on 1 March 1994 by the Commonwealth Bank of Australia. The secured creditor was certain to incur a shortfall of at least $8m on their exposure to the group.

During March 1994, the receiver and manager entered into a formal contract to sell the shares in KZFM to Austereo Limited ("Austereo"), owner of FOX FM in Melbourne and other radio stations. The contract was subject to the completion of certain conditions precedent, including the satisfactory resolution of unsecured claims in order to preserve the accrued tax benefits within the corporate shell.

It was anticipated Austereo would float on the Australian Stock Exchange by June 1994. Accordingly, it was crucial to restructure and "clean up" KZFM to facilitate Austereo's acquisition of KZFM, in order to facilitate the finalisation of the sale. It soon became apparent to us in our capacities as receivers that the most effective mechanism for achieving this result would be to appoint an independent administrator to co-exist with the receiver.

The impact of the concurrent voluntary administration may be summarised as follows:

- Transpose KZFM from an insolvent to solvent company. There were approximately $300,000 in unsecured creditors as at 1 March 1994. It was proposed that a dividend of fifteen (15) cents in the dollar would be paid to unsecured creditors.
- Facilitate transfer of non-sale related assets to KZFM's parent company, The Industrial Printing and Publicity Company Limited (Receiver and Manager Appointed) ("IPP") [Arthur Andersen was the receiver and manager for IPP].
- Compromise inter-company debts ($7.6m) and unsecured creditors ($300,000).

- Preserve carry forward tax losses and franking credits (summarised below) within KZFM.

	$m
Franking Credits	1.4
Carried Forward Revenue Losses	6.4
Carried Forward Capital Losses	6.9
Total	14.7

- Deal with any potential directors' personal liability for post 30 June 1993 Group Tax outstanding.

A deed of company arrangement ("the deed") was executed for KZFM on 2 June 1994.

The effect of the deed, as stated in Schedule 8A of the *Corporations Regulations*, was:

> *"if the Administrator has paid to creditors their full entitlements under this deed, all debts or claims, present or future, actual or contingent ... each claim against the company ... is extinguished".*

The result of co-ordinating a receivership appointment with a voluntary administration appointment in this instance resulted in the ability to complete the contract for the sale of shares and, consequently, generate a return to the secured creditor which was significantly enhanced in comparison with the next best purchase offer. In turn, the purchaser of the shares was prepared to commit to the higher purchase price because of the future tax benefits available through the preservation of the corporate entity.

A note of caution in connection with tax planning issues associated with corporate reconstructions. The budget statement raises some specific issues in connection with the strategies for dealing with loss-making corporate entities, turnaround situations and the sale of businesses.

- Strategies for corporate reconstructions, particularly those that are tax driven, will need to be carefully assessed in future. Historically the beneficiary of any debt forgiveness agreement was not obliged, in most circumstances, to account for the writeback, either for capital or income tax purposes. Frequently the purchaser received the tax advantages of an entity which enhanced the sale value.

- The Commissioner has now re-evaluated this position. Debts forgiven after 9 May 1995 will reduce the debtor's future tax deductions in the following order - prior revenue losses, prior capital net losses, undeducted balances of capital expenditures and cost bases of capital assets. The rationale for this approach appears to be that where corporate entities engage in a pattern of economic activity that gives rise to deductions and, in certain cases, subsequent losses, scope exists for it to "double dip" through arrangements designed to preserve tax losses.

- These changes may also have unintended consequences on solvent corporate reconstructions were large groups are reorganised for other purposes.

- It remains unclear whether these new provisions will encompass the voluntary administration regime, insofar as this regime has been used for tax preservation purposes. It may be possible provisions will not impact voluntary administrations, although we will have to await the precise wording of the legislation.

SUMMARY : IMPLICATIONS FOR SECURED FINANCIERS

Appointments

Voluntary administrations do have the potential to add value as compared to alternative reconstruction scenarios, which is demonstrated in the case studies. The implications for secured creditors holding security over all or substantially all the property of the debtor company are summarised as:

- A proposed administrator must consult with the secured creditor prior to appointment in order to engender credibility. As a rule, unless the directors and the proposed administrator approach the secured creditor prior to appointment, the secured creditor would, in most, if not all cases, be reluctant to support the appointment.

- Where the existing security cover is inadequate, a secured creditor may elect to support the appointment, providing there is sufficient consultation between the administrator, the secured creditor and other stakeholders.

- Where the existing security cover is adequate, the decision to appoint a receiver becomes discretionary on the part of the secured creditor and will be dependent upon the circumstances involved.

- A secured creditor must take the decision to appoint a receiver within the first ten days, unless the administrator agrees to extend the statutory period. This would be unusual, however, it will once again depend upon the circumstances involved.

Considerations

The considerations influencing the strategy adopted by a secured creditor will be multi dimensional. The priority that the secured creditor attaches to these influences will vary, given the historical conduct of the account and options available under a formal administration or other workout alternatives. These specific influences will include:

- Client relationship issues will obviously influence the approach of the secured creditor, including a determination as to whether a continuing banking relationship is considered desirable in the future (separate consideration may need to be given to related parties and other family members and their relationship with the relevant financial institution).

- The impact of a receivership appointment on other stakeholders will be a fundamental consideration on the part of the secured creditor. In many cases, the ability to maintain supply lines or treat with unsecured creditors in particular may be jeopardised should a receivership appointment be preferred. One of the intrinsic features of the voluntary administration regime is that all parties who have a stake in the enterprise experiencing financial difficulties, have a greater incentive, than would otherwise be the case, to co-operate in achieving a commercial settlement where possible.

- Pursuant to section 440J of the *Corporations Law* creditors must seek leave of the court to proceed against directors if they hold personal guarantees. The courts have not indicated a bias either way in connection with whether leave should be granted. On the face of the two published decisions to date, decisions have been granted both for and against granting leave to proceed against the subject guarantors. It is important to note that some scope exists for "artificial" deeds to be contrived to prevent creditors holding guarantees proceeding against guarantors in their personal capacity. It is in these types of cases that redress should be sought through the courts.

- The impact of trading losses and appointment costs may materially influence the choice of appointment (either a receiver, or agreeing to support the nominated administrator). The *Corporations Law* imposes additional investigative and administrative obligations upon a voluntary administrator although they may not be financially significant, depending upon the number of creditors and the extent of antecedent transactions warranting investigation. The impact of trading losses incurred should, by and large, be analogous under either regime, assuming that the control exercised by the receiver/administrator is prudent. Once again, however, these issues will be situational.

- Voluntary administrations are most effective for dealing with businesses having the following risk exposures:

  - Leases — section 440C
  - Retention of title claims — section 440C
  - Vested goodwill with principals

  The aspects of lease and retention of title claims are comprehensively dealt with in the case studies covered earlier in this paper.

- The issue of vested goodwill with principals, which is commonly the case in professional services firms, for example, becomes difficult for secured creditors to deal with when seeking to enforce security. The voluntary administration regime represents a viable alternative in such scenarios whereby the principals are "buying in" to the process when they make the appointment of an administrator.

Voluntary administrations are more effective in dealing with concerns in connection with the enforceability of securities, in that they represent a useful mechanism for avoiding significant litigation costs through negotiating a satisfactory commercial settlement.

Deed of company arrangement

The formulation of a deed of company arrangement is a very fluid and flexible process. To be successful, extensive consultation must take place with all stakeholder groups or their representatives.

We have found that reconstruction/dividend schedules based upon prospective cashflow can be problematic. This is because of the tendency of directors to construct "blue sky projections" for inclusion in a proposal to retain control of the reconstructed corporate entity. As a consequence, such a deed of company arrangement is likely to be classified as high risk.

Secured creditors are not obliged to be bound by a deed of company arrangement. Pursuant to section 444D they may abstain from voting on a proposed deed of company arrangement and elect to enforce their security. As a consequence, they have the ability to exert considerable de facto leverage over the construction of any proposed deed of company arrangement.

Credit considerations

The impact of the voluntary administration regime has given rise to certain specific requirements for financial institutions in the credit policy sphere. These are:

- Legal review of standard facility documentation should be mandatory to ensure that the documentation takes account of the impact of an appointment of a voluntary administrator.

- It is considered prudent to require fixed and floating debenture charges where a financier has a facility that would warrant security cover over all/substantially all of the subject borrower's assets.

- It is recommended that financial institutions require full disclosure by debtors of retention of title exposures and off balance sheet liabilities.

- Financial institutions would be well served by requiring debtors to disclose the issue and service of section 222AOE notices on the directors of the borrowing entity.

- The Sales Tax Office has long had the capacity to issue sequestration orders to debtors of the borrowing entity to satisfy amounts in arrears, which undermines the available security cover to a financial institution holding a charge. It appears that the Sales Tax Office is becoming more active in this area in order to elevate itself to a priority position, partly in response to the capacity the voluntary administration regime gives directors in making expeditious insolvency appointments.