RECENT DEVELOPMENTS — VOLUNTARY ADMINISTRATIONS

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The voluntary administration of the Brashs Group of Companies under the provisions of Part 5.3A of the *Corporations Law* presented an important opportunity to assess the effectiveness of the procedure of voluntary administration as a creative solution for companies in financial distress as well as to have tested by the courts a number of provisions contained in that Part for the first time. Never before had the voluntary administration provisions been applied to an administration of the magnitude of the Brashs Group, and never before had an administration of that size resulted in a "trade-out".

This paper examines various provisions of Part 5.3A having regard to the Brashs experience. In particular, this paper considers the effectiveness of voluntary administration and the advantages it enjoys over other forms of insolvency management. In doing so, it considers several of the issues that arose during the course of the Brashs administration. The paper concludes that, when combined with a flexible and practical approach taken by administrators, their legal representatives and the courts, the voluntary administration provisions successfully enable companies such as the Brashs companies to continue in existence, in fulfilment of the stated objectives of Part 5.3A. There is no doubt that, but for the new voluntary administration provisions, the Brashs Group would neither have remained intact nor been recapitalised, with resultant detriment to creditors.

For the purpose of this paper, the period from the date of an administrator's appointment until the date of execution of a deed of company arrangement will be referred to as the "administration period", and the administrator will, in the capacity of administrator of the company during that period, be referred to as an "administrator". In respect of the time after the execution of the deed of company arrangement, references will be to the "deed period". The administrator will be referred to as the "deed administrator" when acting in the capacity as administrator of the deed.

BACKGROUND

The Brashs Group was established in Melbourne in 1862. By the 1990s, it had become one of Australia's largest specialist retailers in consumer electronics, recorded music and music products, enjoying a market share of between 20 and 25 per cent of its product markets. By 1994, the Brashs Group employed approximately 3,000 employees and was the lessee of approximately 170 stores throughout Australia. Shareholders in the Group exceeded 3,000 in number. Brashs had a distinctive name and logo with strong trading name identification and customer loyalty.

At the head of the Brashs corporate structure was Brash Holdings Limited ("BHL"), a listed public company admitted to the official list of the Australian Stock Exchange Limited ("ASX") in 1958.

BHL was the parent of 16 wholly-owned subsidiary companies, including Brashs Pty Ltd ("BPL"), the primary trading entity within the Brashs Group of Companies.

The pre-administration losses of the Brashs Group were substantial. From January 1993 the Group began to suffer trading losses on a monthly basis. The losses were of such magnitude in the second half of the financial year ended 31 July 1993 that the profits made in the first half of that year were almost completely eroded. From August 1993, the financial position of the Brashs Group continued to deteriorate.

APPOINTMENT OF THE ADMINISTRATORS

On 2 May 1994, Michael Humphris and David Beatty of Arthur Andersen were appointed administrators to each of the Brashs Companies[1] by the boards of directors of each of those companies pursuant to section 436A(1) of the Law. That section makes provision for the appointment of an administrator of a company by the company where, in the opinion of the majority of the directors, the company is or is likely to become insolvent.[2]

An administrator may also be appointed by a liquidator, a provisional liquidator[3] or a chargee who has become entitled to enforce a charge over the whole or substantially the whole of the company's property.[4]

Commencement of administration

The administration of the Brashs Companies commenced upon the affixing of the company seal to the resolution of the directors that the companies be placed in administration. It is noteworthy that a company's administration is regarded as having commenced at the time the common seal of the company is affixed, and not at the time at which the board of directors resolved to appoint an administrator. It is therefore advisable for a record of the precise time at which the company seal was affixed to be kept. This may become important during the course of the administration, for example, if a query arises regarding whether an agreement was reached, or act done, prior to or after the commencement of the administration.

Administration as a defence to insolvent trading

Section 436A(1) is being increasingly relied upon by directors of companies, in light of the positive duty imposed upon on them to prevent insolvent trading by their company under section 588G of the Law. The timely appointment of an administrator may, in certain circumstances, constitute a defence under section 588H in proceedings for contravention of that duty. In fact, the stringent penalties imposed on directors for breach of the duty to avoid insolvent trading are intended to encourage earlier treatment of insolvency (in particular through the use of the voluntary administration procedure) so as to promote enhanced asset values or enhanced prospects of survival of the company.

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1 The Companies within the Brashs Group of Companies that were placed under voluntary administration were Brash Holdings Ltd, Brashs Pty Ltd, Electronic Imports Pty Ltd, Hi-Fi Nominees Pty Ltd and Allans Publishing Pty Ltd.

2 In *Wagner & Anor v International* Heath *Promotions & Ors* (1994) 12 ACLC 986, the Supreme Court of New South Wales held that the appointment of the administrator to the Company in question by the board was invalid because the board did not resolve that the company was insolvent or likely to become insolvent as required by section 436A(1)(a).

3 Section 436B(1).

4 Section 436C(1).

ADVANTAGES OF VOLUNTARY ADMINISTRATION

Voluntary administration is one of several ways in which a company can deal with its insolvency or prospective insolvency. Prior to the introduction of Part 5.3A, the *Corporations Law* provided four principal means for a company to deal with its insolvency problems on a voluntary basis, namely, schemes of arrangement, official management, creditors voluntary winding up and court winding up. Like voluntary administrations, these procedures aim, in varying degrees, to facilitate debt recovery, provide an equitable distribution of the debtor's assets amongst creditors, and to permit an investigation into the conduct of the debtor which led to insolvency. However, these procedures each have shortcomings which limit their effectiveness including the cost, the absence of ordered administration between the time of calling meetings and the appointment of a liquidator, and the lack of independent information about the financial affairs and conduct of the business of the company at the meeting of creditors.[5]

In deciding to appoint administrators to the Brashs Companies rather than utilising one of the other voluntary insolvency procedures, it appears that the company had regard both to the shortfalls in the traditional insolvency procedures and to the numerous advantages of the voluntary administration procedure.

It is clear from the objectives of Part 5.3A that voluntary administration was designed to differ from the existing procedures. The stated objectives of the newly enacted Part are:

> "to provide for the business, property and affairs of an insolvent company to be administrated in a way that:
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> (a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or
>
> (b) if it is not possible for the company or its business to continue in existence - results in a better return for the company's creditors and members than would result from an immediate winding up of the company."[6]

In particular, the voluntary administration procedure aims to facilitate early diagnosis and treatment of insolvency or prospective insolvency with a minimum of delay and expense. Once triggered, the provisions normally result in any of a deed of company arrangement, an end to the administration or the winding up of the company.[7] Thus, in appropriate cases, voluntary administration facilitates the preservation of viable commercial enterprises through the entry into a deed of company arrangement, executed by both the company and the deed administrator.[8] In other cases, it provides for ease of transition into liquidation, if necessary.

There are numerous advantages to voluntary administration to which regard should be had when determining the form of insolvency management to be adopted by a company. These will be discussed in the course of this paper. In summary, they are:

- Administration is a palatable option for directors of a company with a solvency problem.

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5 The shortfalls of those insolvency procedures are discussed in more detail in the Australian Law Reform Commission, General Insolvency Inquiry (Report No 45, 1988) (Harmer Report paras 46 - 49; M Rose and L Law "Voluntary Administrations: Will they Work?" 1995 (3) *Insolvency Law Journal* 11 at p 11; and K Lightman "Voluntary Administration: The New Wave or the New Waif in Insolvency Law" 1994 (2) *Insolvency Law Journal* 59 at p 62 and p 67.

6 Section 435A.

7 Section 435C(2). See also section 435C(3) which sets out other possible ways in which an administration may end.

8 Section 444B(3), (5) and (6).

- Whilst a liquidator's function is to liquidate the company in order to realise its assets, an administrator aims to either maximise the chances of the company's business continuing, or to enhance its asset value.

- Unlike a receiver who realises the company's assets for the benefit of a secured creditor, an administrator is obliged to act in the interests of all stakeholders.

- The voluntary administration provisions confer broad powers upon the court to make orders appropriate to the administration of a particular company.

- Whilst a receiver has a duty of care to sell a company's property for market value, an administrator has no such obligation.

- On the commencement of the administration, a statutory moratorium is imposed against claims and actions by creditors during the administration period, without either the consent of the administrator or the leave of the court.

- An administrator is granted a "breathing period" of seven days from the commencement of the administration, during which he or she incurs no liability, to decide whether the company should continue to use, occupy or remain in possession of property belonging to someone else.

- Share trading is suspended during the administration period.

- Administrators are not in a position to provide warranties with respect to the company or its administration, other than in respect of the validity of their appointment and their power to sell shares.

- The administration provisions create a flexible regime for the reconstruction of a company through a deed of company arrangement which is binding on all creditors, including future and contingent creditors.

- A deed of company arrangement is binding on third parties.

- A restraint is statutorily imposed on the rights of owners, lessors and secured creditors.

- The appointment of a liquidator or receiver generally constitutes a default under agreements entered into by the company.

- Retention of title creditors are prohibited from reclaiming possession of their stock or commencing a proceeding without the administrator's consent or leave of the court.

- Unlike a receiver or liquidator, an administrator has the power to sell retention of title stock in the ordinary course of business.

- Unlike receivership and liquidation, the voluntary administration process is regarded as a positive one.

- The directors of a company under administration are statutorily required to assist the administrator with the investigation of the company and its affairs.

- The powers of officers are effectively suspended during the administration period.

- The tight time limits imposed by the legislation promote negotiations with prospective purchasers and facilitate speedy and commercial resolution of arrangements with respect to the company.

These advantages of voluntary administration are dealt with in turn below.

Palatable option for directors

The voluntary administration procedure is available to companies with a solvency problem, not just to those that are hopelessly insolvent. It is sufficient if the liquidator, provisional liquidator or directors appointing the administrator bona fide belief that the company is likely to become insolvent.[9] This provides scope for the directors to act before the financial difficulties of the company are so acute that it becomes insolvent, which is consistent with one of the underlying themes of Part 5.3A, namely, the early identification of solvency difficulties.

It is noteworthy that although a liquidator and the board of directors of a company are required by the *Corporations Law* to have regard to the solvency of the company when appointing an administrator, there is no similar obligation imposed upon a chargee. Section 436C does not require the company to be insolvent before a chargee can appoint an administrator, nor is the chargee obliged to have formed the opinion that the company is or is likely to become insolvent. This exposes the company to the risk of being placed under administration, at the behest of the chargee, when the charge becomes enforceable for any reason, even if only as a consequence of a technical default by the chargor, and irrespective of the state of the company's solvency. (Having regard to the object of Part 5.3A, the authors expect that if a chargee appointed an administrator to a company on the basis of a technical default by that company, without insolvency or expected insolvency, the court may, on the application of an interested person, intercede.)[10]

Liquidators liquidate the company

Unlike a liquidator, whose function is to realise the company's assets for distribution to the company's various creditors, an administrator's role is to administer the company in a way that maximises the chances of its business continuing or, if not possible, results in a better return for the company's creditors and members than would occur on the company's immediate winding up.[11]

Receivers realise assets for secured creditors

Unlike a receiver who is appointed by a secured creditor for the purposes of enforcing a creditor's security over the company's assets and who aims to obtain the best possible return for that creditor, an administrator is obliged to have regard to, and act in the interest of, all creditors.[12] This is facilitated by the moratorium period (discussed below) which prevents the immediate dismantling of the company's assets and a plethora of individual recovery actions, allowing the administrators some time to determine how best to use the company's assets in the interest of all stakeholders.

The administrators of the Brashs' Companies were mindful of their responsibility to all persons with an interest in the Group. The administrators were and were seen to be independent of all stakeholders. This independence enabled them to negotiate their way successfully through the mine field of commercial and legal issues. In fact, Brashs survival was due to the ability of the

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9 Sections 436A(1)(a) and 436B(1).

10 The role of the court in the administration process is discussed below.

11 Section 435A.

12 The regard of an administrator to the interests of all stakeholders is consistent with what the Harmer Report calls "orderly dealing" which the Committee regarded as the "fundamental purpose of insolvency law". Such "orderly dealing" attempts to procure the best use of assets for the collective group of stakeholders, as opposed to an individual creditor (Harmer Report para 33).

administrators to deal with the competing interests of all those with a stake in the Brashs Group, having regard to the objectives of Part 5.3A.[13]

Fundamental role of the court

The new voluntary administration provisions allow the courts to play a fundamental role in each administration. Section 447A confers broad powers upon the court to make such orders as it thinks appropriate about how Part 5.3A is to operate in relation to a particular company upon the application of any interested person, which includes, inter alia, the company, a creditor of the company and the administrator or deed administrator. The access of interested parties to the court and the broad discretion of the court engenders flexibility in the application of the administration provisions to the individual circumstances of each particular administration. It also allows the administrators to obtain court endorsement of their proposed actions, in advance.

The scope of the court's power under section 447A was illustrated in *Re Brashs Pty Ltd*[14] in which the court exercised its discretionary powers to allow a departure from what would otherwise appear to be a mandatory requirement of Part 5.3A.

In that case, the deed administrators applied to the Victorian Supreme Court seeking an order that the Brashs Companies could drop the words "subject to deed of company arrangement" from their names on all their public documents and negotiable instruments before the deed formally came to an end. (Under the deeds of company arrangement, the unsecured creditors were to be paid by instalments ending in July 1995. However, there was the possibility of further receipts from actions taken against persons allegedly in breach of their duties to the companies. Thus, notwithstanding that the unsecured creditors would have been paid all the instalments and the Deed effectively ended, the possibility of these actions meant that the Deed could have continued in operation well beyond July 1995.)

The application was of practical significance because suppliers were unaware or wary of the precise meaning and consequences of a deed of company arrangement in terms of receiving payment for supply of goods. They were therefore reluctant to offer credit terms to Brashs. There was a concern that the goodwill of the business would be eroded whilst there was a public perception that Brashs remained under deeds of company arrangement.

Although Hayne J refused to grant the application to drop the words "subject to deed of company arrangement" holding that it would be premature to make the order eight months before it would come into effect, he expressly rejected the contention of the Australian Securities Commission ("ASC") that the only kind of orders which might be made by the court under section 447A were ones which fill what would otherwise be a gap in the legislative scheme or add to the provisions of Part 5.3A.

The court held that section 447A enabled it to dispense with a mandatory requirement of the *Corporations Law*, namely section 4506. Under section 450E a company is obliged to have the phrase "subject to deed of company arrangement" after its name while a Deed is in force to ensure that those persons who deal with the company are put on notice of the consequences of the deed, and in particular, of the possibility that under Part 5.3A the Deed may be terminated, in which event a creditor who extended credit to the company after the commencement of the deed would be left to its right to prove in the winding up in which all creditors, including those previously affected by the deed, would be entitled to proof.

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13 In *Brash Holdings Ltd & Ors v Shafir* (1994) 12 ACLC 619, the court recognised the responsibility of the administrators to all stakeholders. It held that, to the extent that the Administrators' power to effect a transaction becomes an issue, those powers must be determined, inter alia, in the context of what the Administrator is trying to achieve and whether the stakeholders would be benefited.

14 (1995) 13 ACLC 110.

In reaching its decision the court had regard to *Brash Holdings Ltd v Katile Pty Ltd*[15] in which the Full Court held that section 447A is an unusual section, which evidently proceeds on the view that Part 5.3A is inadequate in the provision which it otherwise makes for the new form of administration and that it is therefore necessary to enable gaps in the Part to be filled by the exercise by the court of wide powers to make such orders as it thinks appropriate about how the Part is to operate in relation to a particular company. It seemed clear to the court in that case that section 447A(1) is intended to empower the court to make orders which alter what would otherwise be the operation of the Part in relation to a particular company.[16]

Receivers duty of care

Unlike a receiver who, as a controller of the property of a company for the purpose of enforcing a charge, is obliged under section 420A of the *Corporations Law* to sell the assets of the company for not less than market value if the assets have a market value,[17] an administrator is under no such duty. (In fact, Hayne J, during the course of one Brashs application, observed that the administration process, because of its tight time limits, is necessarily imperfect.)

Statutory moratorium

A moratorium is imposed immediately on the appointment of an administrator to protect the company against claims and actions by creditors during the administration period, without either the consent of the administrator or the leave of the court.[18] This moratorium period enables the status quo with respect to the company's affairs and property to be maintained whilst the administrator makes an assessment of the company's financial position.

In the Brashs administration, the moratorium imposed on owners, lessors and secured creditors curtailing their rights of repossession and preventing any creditor from commencing or continuing any proceedings against the Companies during the administration period, were crucial to the success of the administration. The moratorium period prevented the break-up of the business. This benefited not only the Brashs Group and the unsecured creditors, but also the secured creditors, such as chargeholders, as it prevented any retention of title supplier retaking possession of their alleged stock. The moratorium also enabled the creditors to decide upon the Group's future in an orderly and informed manner.

Administrators avoidance of liability in first seven days

An administrator is granted a "breathing period" of seven days from the commencement of the administration to decide whether the company should continue to use, occupy or remain in possession of property owned by someone else.[19]

This protection of the administrator from exposure to personal liability for a seven day period is specific to administrations. There is no like right in liquidations or receivership. It is a particularly important provision in light of the fact that unlike a receiver and manager appointed by a secured creditor who is invariably indemnified by the secured creditor for his or her liability, an administrator is obliged to act in the interest of all shareholders and will thus seldom have such indemnity. The administrator is entitled to be indemnified out of the company's assets in respect of personal

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15 (1994) 12 ACLC 472.

16 Ibid p 474.

17 Section 420A(1)(a) read with section 9.

18 Sections 440C and 440F respectively.

19 Section 444B(2).

liabilities for debts incurred by him during the administration.[20] However, although the statutory indemnity has priority over all unsecured debts of the company, it does not rank in priority to fixed charges, or in certain instances floating charges, and, in any case, is limited to the company's available assets.[21]

If the company continues to use or occupy property belonging to another party under an agreement made before the administration commenced, the administrator will be personally liable for rent or other amounts payable under that agreement after the seven days grace unless the administrator notifies that person that the company does not wish to exercise rights in relation to the property.[22] These provisions aim to encourage the administrators to take positive steps to avoid continuing liability.

By way of example, the Brashs administrators determined that the preservation of the underlying core business of Brashs necessitated closure of the non-profitable and vacant stores. BHL was the lessee of approximately 170 premises throughout Australia, of which approximately 162 stores were operating at that time and of which three premises were vacant. To avoid continuing liability under pre-existing leases, the landlords of each of the vacant stores were served with a notice pursuant to section 443B(3) within 7 days of the appointment of the administrators, informing them that BHL did not propose to exercise rights in relation to those vacant stores. The notice also stipulated that pursuant to section 443B(4), the administrators were not to be held liable for rental or other amounts payable by BHL under the leases of the vacant stores. Although the administrator is not personally liable for the rents and other amounts payable to the owner or lessor whilst such notice is in force the company itself will however remain liable.[23]

Share trading

Share trading is suspended immediately upon the appointment of an administrator to the company. Any transfer of shares in, or alteration in the status of, members of the company made during the administration is void, except with the courts approval.[24] This prohibition on share trading is another method by which the company's status quo is retained during the administration period.

Warranties

The administrator will not generally be in a position to provide warranties to the purchaser of the company or its business. The only warranties that an administrator can responsibly provide are with respect to the validity of his or her appointment, and following the Brashs administration, the power to sell the company's shares or assets.

In the Brashs administration, the prospective investor sought a warranty that the administrators were empowered to sell the shares of BHL's subsidiaries. As an administrator does not have an underlying indemnity from a banker, as a receiver would in receivership, the administrators could not responsibly provide such warranty. Furthermore, the sale of the main undertaking of Brashs

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20 Section 443D.

21 Section 443E. Rose and Law, op cit n 6 at p 19, suggest that a possible solution to the issue of the administrator's personal liability is for the administrator to obtain indemnity from his or her appointor (ie directors, liquidator or substantial chargee) during the administration period. This suggestion is premised on the argument that the appointors should be in a better position than the administrator to know about potential exposure. Conversely however, it may discourage use of Part 5.3A. See also O'Donovan, op cit n 6 at pp 94 and 95.

22 Section 443B read together with Regulation 5.3A.05 which prescribes the specific manner in which the notice must be given, being by personal delivery or pre-paid post to the lessor or owner's usual place of business or residence. Form 509B is the prescribed form for giving of notice under section 4443B(3).

23 Section 443B(4).

24 Section 437F.

would have constituted a breach of the Australian Stock Exchange Listing Rules which require ratification by the shareholders of a publicly listed company in a general meeting where there is a sale of the company's main undertaking or the disposal of certain of its assets.[25]

Accordingly, a further direction of the court was sought by the administrators under section 447A(1) to ascertain whether the broad powers of an interim administrator, or a deed administrator, to sell the property of a company would enable the administrators to make a sale of BHL's property, even where that sale may amount to the sale of the main undertaking of a publicly listed company in breach of Listing Rules. Whilst an administrator has control of the company's business, property and affairs and may perform any function that the company could in "normal" circumstances perform, including the disposition of the whole or any part of the business or property during the administration period under section 437A, the powers of a deed administrator in this regard, although contemplated by Schedule 8A of the Corporations Regulations, are less clear.

The Supreme Court of Victoria in *Brash Holdings Ltd & Ors v Shafir*[26] held that the administrators have power to dispose of all of the business and/or property of the company they are administering if that is the appropriate course to adopt. The court confirmed that the administrators, both during the administration period, and the deed period (if the deed makes provision for this) were empowered to dispose of the business and property of BHL, including the shares of the subsidiaries of BHL, without convening a general meeting of the members of the company. In reaching this decision the court had regard to the fact that the sale to the proposed investor was in the interests of all relevant parties.

Flexibility of the voluntary administration procedure

The voluntary administration provisions create a flexible regime for the reconstruction of a company which is binding on all creditors.

Section 444D(1) expressly provides that a deed of company arrangement binds all creditors of the company so far as concerns claims arising on a specified date, usually the date of the commencement of the administration. Under sections 444D(2) and 444D(3), a deed of company arrangement cannot affect a secured creditor's security or a property owner's property unless that secured creditor or property owner voted in favour of the deed or the court orders.

Although sections 444D(2) and 444D(3) purport to, and do, preserve the rights of secured creditors and property owners, section 444D(1) enables a deed of company arrangement to bind secured creditors and property owners in relation to their debts.

During the course of the Brashs administration, the court was asked to determine whether the deeds of company arrangement of the Brashs Companies could be drafted to compromise claims for ongoing rental, as the administrators realised that the preservation of the underlying core business may necessitate closure of non-performing stores. There was little point in the administrators restructuring the Brashs Companies if the landlord creditors could not be bound by the deed in relation to future claims for rent, if any, which arose after the commencement of the administration in respect of the vacation of stores by the Group in its eventual restructuring.

In *Brash Holdings Ltd v Katile Pty Ltd*,[27] the trial judge, Beech J, favoured a narrow interpretation of section 444D(1), namely that a deed of company arrangement would only operate in relation to a claim that had arisen prior to the appointment of the administrators and thus did not bind landlord

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25 Rules 3S(2)(a) and 3J(3)(b) respectively.

26 (1994) 12 ACLC 619.

27 (1994) 12 ACLC 407.

creditors in relation to any future claims they might have for rent and outgoings in the event that the administrators elected to terminate the lease of a non-performing store. This created practical difficulties for the administrators as although they had the power to terminate non-profitable stores they could not, in the absence of a scheme of arrangement or private treaty, extinguish the ongoing liability of the Brashs Group to continue to pay rent.

Given the fundamental importance of the issue to the Brashs administration, the administrators determined to appeal the court's decision. Although in the ordinary course of events an appeal could not be heard, let alone determined, within the time limits imposed by Part 5.3A, the Full Court, at the request of the administrators, convened to hear the appeal as a matter of urgency prior to the second creditors meeting. In so doing, the Full Court indicated its commitment to the facilitation of the voluntary administration process, as well as its regard to the strict timetable imposed by Part 5.3A.

The Full Court[28] overturned the decision of Beech J, and adopted a broad interpretation of section 444D(1). In the Full Court's opinion the whole purpose of 5.3A is to bind all creditors and the reference to "all creditors" in section 444D(1) should be read and used in the same sense throughout Part 5.3A, and should include all of the creditors for the time being of the company. As such, all creditors with claims against a company under voluntary administration based on circumstances before the date specified in the deed, usually the date of the administrator's appointment, will be bound by its terms, even if the claims were not due and payable at that date. Accordingly, all contingent and future creditors are bound by a deed of company arrangement. That meant, in the Brashs situation, that any claims for future rent would be subject to the terms of the deed of company arrangement.

It is submitted that the Full Court's interpretation of section 444D(1) is consistent with the purpose of a deed of company arrangement which is to resolve, once and for all, the financial position of the company on the date the administration commenced and allow a company to achieve a fresh start.

Importantly, a deed of company arrangement can only bind landlord creditors in their capacity as creditors, in relation to their debt. It does not effect their property rights, which are protected by section 44D(3). Thus, in the Brashs administration, whilst the administrators could compromise the landlords claims they could not have, although they did not wish to, gained access to or restricted the landlord's rights to their property.

Deed binding of third parties

By operation of statute, a deed of company arrangement is also binding on the company, its members and directors.[29]

Neither the legislation nor the Harmer Report sheds any further light on the width of the powers of deed administrators to bind members. The issue arose in *Brash Holdings Ltd & Ors v Shafir*[30] in which the administrators' powers to sell the Group's shares were considered. In that case, the Brashs' administrators took the view that a deed of company arrangement binds members as if by contract. The broad powers to bind members, and unfettered power of sale are consistent with the objects of Part 5.3A. Accordingly, very broad provisions seeking to fetter member's rights were included in the draft deeds of company arrangement put before the judge. (The draft deed of BHL provided, in relation to the powers of the Deed administrator, that during the deed period and for the purpose of implementing the Deed, the administrator would have the rights, powers, and

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28 *Brash Holdings Ltd v Katile Pty Ltd* (1994) 12 ACLC 472.

29 Section 444G.

30 Op cit n 28.

authorities conferred on the Company, its directors and members to the exclusion of BHL, its directors or members as well as all of the powers set out in Schedule 8A of the Corporations Regulations.)

Judgement was gained in favour of the administrators. Endorsing the broad powers outlined in the draft deed of company arrangement, the judge noted that the provisions of Part 5.3A of the Law focus extensively on the interests of creditors of the corporation in question and remarked that "nowhere in Part 5.3A is provision made for members to have a voice in the administration of the corporation. Expressed another way, members are excluded from contemplation during the process of an administration."[31]

Administrators should keep in mind that the members and directors of the company may, as interested parties, apply to have the deed set aside.[32] Thus, an administrator who acts capriciously without regard to the members or directors interest runs the risk of the deed being contested.

Restraint on owners, lessors and secured creditors

A unique feature of the new voluntary administration provisions is the statutory restraint on owners, lessors and secured creditors. Section 444F empowers the court on application by the administrator or deed administrator to make orders restricting the rights of secured creditors to deal with the property subject to the security[33] or the rights of owners or lessors to recover their property[34] where either the company has executed a deed of company arrangement or it is proposed that the company executes a deed.[35] The court cannot however make such an order in respect of a substantial chargee.

Given the serious impact on the creditor's rights if the court were to make an order, under section 444F the court may however only make the order if it satisfied that:

- if the secured creditor were to realise or otherwise deal with the security, or the owner or lessor were to take possession of or otherwise recover the property, it would have a material adverse effect on achieving the purposes of the deed; and

- having regard to the terms of the deed, the terms of the order and other relevant matters, the interest of the secured creditor, owner or lessor will be adequately protected.[36]

Accordingly, if an insolvent company or a company likely to become insolvent has a reasonable core business adversely affected by any of:

(a) uncommercial property leases;

(b) uncommercial finance leases;

(c) uncommercial license agreements; or

(d) retention of title creditors continually reclaiming stock,

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31 Op cit n 28 at p 622.

32 Section 445D.

33 Section 444F(2).

34 Section 444F(4).

35 Section 444F(1).

36 Sections 444F(3) and 444F(5).

voluntary administration enables, for the first time, an opportunity to restructure the company or its business in an orderly fashion. There are no like provisions to sections 444D(1), 444F or 444G in liquidation law or receivership law.

Default triggered by appointment of liquidator or receiver

In most cases the appointment of a liquidator or receiver immediately constitutes a default of financing arrangements, leases (property and chattel) and hire-purchase agreements without any statutory protection for the company. Whilst the appointment of an administrator may trigger a similar default, the legislation imposes several protections, such as the moratorium, for the company and its creditors.

Retention of title creditors

Retention of title creditors are prohibited by section 440C of the legislation from reclaiming possession of their stock without the administrator's consent or leave of the court. A complementary provision, section 440D, prohibits the commencement of a proceeding against a company in administration during the administration period without the administrators consent or leave of the court.

In the Brashs administration, when one supplier chose to institute proceedings in New South Wales[37] to resolve a retention of title dispute, the Supreme Court refused it leave to commence the proceedings and ordered that the supplier pay the administrators' costs. In reaching this decision Brownie J had regard to the administrators' submissions that, in general, leave should not be granted under section 440D as, where there are many creditors, allowing each to litigate against the company under administration would have depleted the company's resources and run contrary to the spirit and objects of Part 5.3A, as stated in section 435A. The court declared that it did not appear desirable for the administrators to incur substantial expenses of litigation in circumstances where the applicants would not be disadvantaged in a material way if they were to vote as unsecured creditors at the second creditors meeting, as the proposed deed allowed them to litigate if the administrators rejected their claims.[38]

In a later decision involving the same suppliers,[39] the suppliers wished to bring legal action against the administrators and Brashs to recover the price of goods sold during the administration and the return of goods not sold. The supplier sought a declaration as to whether it was necessary to obtain leave under section 444E to do so.

Hodgson J held that secured creditors, owners of property and lessors bound by a deed of company arrangement were required to obtain the leave of the court under section 444E(3) in order to bring court proceedings to enforce their rights against a company under voluntary administration where those creditors have claims arising on or before the day specified in the deed and where those claims are associated with the security or property. The owners of property in the possession of the company were persons bound by the deed under section 444D(1), even though the extent to which they were bound was qualified by section 444D(3).

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37 *J & B Records Ltd v Brashs Pty Ltd (Administrator Appointed)* (1994) 12 ACLC 534.

38 In *Foxcroft v The Ink Group Pty Ltd* (1994) 12 ACLC 1063, the court similarly refused an employee of a company under voluntary administration who alleged that his employment had been wrongfully terminated leave to commence proceedings for reinstatement or damages against the company. The court in that case noted that the provisions of Part 5.3A provided that there should be a complete freeze of proceedings against a company during the period of administration so that the administrator could have time to assess the situation and the company's creditors have an opportunity to work out their position. To allow one creditor to proceed would take the administrator's attention from his or her statutory duties and would involve costs in running the legal action. Accordingly, the court was of the view that an application under section 440D would rarely be granted.

39 *J&B Records Ltd v Brashs Pty Ltd* (1995) 13 ACLC 458.

Hodgson J considered that sections 444D, 444E and 444F were intended to set up a code relating to court proceedings in relation to claims arising before the date specified in the deed. This enables the court to control such proceedings either upon applications for leave under section 444E or for orders limiting actions by secured creditors or owners of property under section 444F. Hodgson J recognised that this approach may encourage self-help and resort to extra-curial enforcement and that a secured creditor or owner of property would only be restrained in taking such extra-curial action if their interests are adequately protected.[40]

Power to sell retention of title stock

An administrator is granted, negatively, a statutory power of sale of retention of title stock in the ordinary course of the company's business.[41] Conversely, a receiver or liquidator of a company is unable to deal with retention of title stock even in the ordinary course of business.

Voluntary administration regarded positively

Unlike in respect of the appointment of a receiver or liquidator, there is no stigma attached to, or adverse press about, a secured creditor involved in the appointment of an administrator. In fact, following the Brash's experience, the voluntary administration process is regarded as a positive one.

Assistance of directors of the company

Pursuant to section 438B, the directors of a company under administration are statutory required to assist the administrator with his or her investigation of the company and its affairs. If a director fails to assist or co-operate with the administrator, the administrator has the power to remove him or her from office. A failure by the creditor to comply in such circumstances also amounts to an offence and carries a penalty.[42]

In particular, the directors must deliver all books of the company in their possession to the administrator, inform the administrator of the whereabouts of any other company books of which they are aware, and provide a statement to the administrator with regard to the company's business, property and financial circumstances within seven days of the administration (or such longer period as the administrator permits).[43] The directors are also subject to the ongoing obligations to see the administrator when requested and provide such information about the company's business, property, affairs and financial circumstances as the administrator reasonably requires.[44] The directors cannot, without reasonable excuse, fail to comply with any of these obligations to assist the administrator.[45]

Suspension of officers powers

Although directors and other senior officers of the company are not removed from office during the administration period, their powers are effectively suspended. The officers are unable to exercise

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40 Obviously, the attitude of secured creditors towards the voluntary administration is crucial to its success. This issue will be dealt with in greater detail below.

41 Section 442C.

42 Section 1311 and Schedule 3.

43 Sections 438B(1) and (2).

44 Section 438B(3).

45 Section 438B(4).

any powers or perform any functions of an officer of the company without the administrator's written approval.[46] Any purported use of powers by a director or other senior officer while the company is under administration can render the officer liable to a penalty and to compensate the company.[47]

Time limits

The time limits imposed by Part 5.3A are tight, even for a simple administration, for good reason. In an administration the size of Brashs, they impose considerable difficulties, but more importantly, immeasurable benefits. The tight timetable facilitates speedy identification of the stakeholders in the administration, demands speedy negotiation and deal making by the administrators and limits the potential liability of the administrators under the *Corporations Law.* Importantly, the timetable promotes a commercial approach to the resolution of the company's difficulties and avoids regard being had to every legal nuance and technicality by either the administrators or the stakeholders in the company.

The *Corporations Law* does, in any event, recognise that difficulties might be encountered by the administrators during the course of the administration and that the prescribed time periods may present an obstacle to the fulfilment of the administrators' obligations to investigate the company's affairs and make recommendations creditors as well as compromising the creditors ability to be full informed. Accordingly, Part 5.3A makes provision for application to be made to court for an extension of time for convening the second creditors' meeting[48] and for an adjournment of that meeting for up to 60 days.[49]

ATTITUDE OF SECURED CREDITORS

Despite the obvious advantages of the voluntary administration procedure, there are also several deterrents to its use.

Secured creditors in particular, traditionally accustomed to being in control of the insolvency process, fear that they may be disenfranchised from their security rights. The attitude of secured creditors towards the voluntary administration is crucial to its success as the results of the administration will be largely dependant on the secured creditor's willingness to waive its right to remain outside insolvency law and to rely on private remedies. Terry Taylor of Ferrier Hodgson notes that the administration process ***is*** being given a run by secured creditors who feel vulnerable and exposed to risk under the new procedure. He suggests however that objections by secured creditors are more likely when the administrator fails to liaise with the secured creditor before, or on, his or her appointment.[50]

The insecurity on the part of a substantial chargee will often result in the chargee electing to enforce its charge either before the administration or within the 10 business day "decision period" after the administrators appointment, as it is entitled to do under the *Corporations Law.*[51] Substantial chargees are aware that if they do not enforce their charge during that period, they will be prohibited from making a claim or enforcing the charge during the moratorium period. Although there is some comfort in the fact that the administrator is prohibited from disposing of the charged

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46 Section 437C.

47 Section 437D.

48 Section 439A(6).

49 Section 439B(2).

50 Op cit n 5 at p 6.

51 Section 441A.

property or property owned by others which is used, held or occupied by the company during the administration period, the administrator may do so in the "ordinary course of business".[52] Secured creditors thus face the risk that their property, such as stock, may be sold by the administrator in a bid to continue the company's business.

Another factor in the decision of a secured creditor to enforce its rights is the fact that, despite the importance of the creditors meetings, the legislation is silent on the matter of voting rights. Although, in many cases, the interests of secured and unsecured creditors will not coincide, the legislation does not confer greater voting rights on a holder of security over the company's assets than on an unsecured creditor. Secured creditors fear that this may result in creditors determining either that a deed of company arrangement be executed against their wishes, or proposing a deed that reflects the wishes of a large number of unsecured creditors whilst restricting their rights as a secured creditor.

Since a secured creditor, owner or lessor is not bound by a deed of company arrangement unless it is expressed to be so bound, and unless it voted in favour of the resolution of creditors,[53] many secured creditors may thus conclude that their interests would be served by enforcing their rights under the security rather than by participating in the administration. If a substantial chargee does elect to enforce its charge, the administrator's functions and powers are severely reduced, being subject to those of the chargee or any receiver appointed by the chargee.[54]

As a consequence of the fact that the protections available under the voluntary administration provisions are only available to chargees over the whole or substantially the whole of the company's property, a practice has developed among lenders of taking "featherweight floaters" (charges over the whole, or substantially the whole, of a borrowers property, even if second ranking) which enables them to enforce their charge, even after the administrators appointment. This circumvents the fact that under the administration provisions any lesser security charge will restrict their enforcement choice if an administrator is appointed.

Although secured creditors will be tempted to enforce their security, they should have regard to the objectives and advantages of the voluntary administration procedure and to the possibility Part 5.3A presents for the company's business to be restored or its value maximised. Aside from the advantages addressed in this paper, there are several further reasons why a secured creditor should consider allowing an administrator to be appointed to take control of charged assets.[55] Briefly, the moratorium on creditors rights provides some protection to the secured creditor's interests, the security may be vulnerable to a challenge of its validity by any liquidator appointed to the company in the event that it is ultimately liquidated, and the secured creditor may prefer criticism from creditors to be directed at the administrator rather than itself or its receiver, particularly where the management of the business is difficult or the assets of the company are difficult to sell. In certain circumstances the amount due to the secured creditor may be too small to justify the appointment of a receiver, particularly having regard to the fact that a secured creditor does not have to pay for the administrator's report, (although it will be paid for from the assets of the company). It will often be in the secured creditor's interest that either the directors appoint an administrator, sooner rather than later, or that the secured creditor itself nominates an administrator in whom it has confidence.

In conclusion, it is submitted that effective use of the voluntary administration provisions will often result in a better return for all creditors, including the secured creditor. However, voluntary

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52 Section 442C.

53 Sections 444D(2) and (3). See the discussions in relation to the "Flexibility of the Voluntary Administration Procedure" in this regard.

54 Section 442D.

55 In this regard see P Lipton "Voluntary Administration: Is there Life after Insolvency for the Unsecured Creditor?" (1993) 1 Insolvency Law Journal 87 at p 95.

administration reflects the changing nature of insolvency management, and thus tends to be met with some reluctance. It requires secured creditors to relinquish their control over the company's property and insolvency practitioners to rid themselves of the traditional view that they are not paid to take risks. The creation of the new insolvency procedure recognises that the consequence of realising assets at liquidation prices is frequently destructive, and that the continuation of the company is often in the interests not only of unsecured creditors, but secured creditors and members alike. In the Brashs administration for example, the administrators recognised that plant and equipment value in the Brashs books as in excess of $40 million on a going concern basis, would not fetch more than $2 million on the Groups liquidation. Voluntary administration aims to change the focus of insolvency management to an emphasis on value enhancement. In so doing, it requires the stakeholders of the company and the insolvency practitioners to take certain risks. It is submitted that this changing face of insolvency management should be endorsed, and even celebrated, as the voluntary administration provisions may, when combined with a flexible and practical approach taken by administrators, their legal representatives and the courts, successfully enable companies to continue in existence, in fulfilment of the stated objectives of Part 5.3A. There is no doubt that, but for the new voluntary administration provisions, the Brashs Group would neither have remained intact nor been recapitalised.