Corporations Act Part 5.3A and the administration of complex corporate groups

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Introduction

Part 5.3A of the *Corporations Act 2001* (Cth) was not designed to deal with large and complex corporate groups. This much is obvious from the timetables for activity within the administration provided by the *Corporations Act*.

A complex corporate group is, as the expression suggests, a group where there is a large number of subsidiaries of a parent company where the companies in the group trade with one another and there are complex interlinkages of a commercially sensitive and strategic nature that dictate the continued operation of two or more companies. The group may have foreign operations, held in entities not subject to Australian law. It will usually have a large number of employees, many of whom belong to unions.

This paper will consider some aspects the operation of Part 5.3A in the context of the complex corporate group administration. It will consider the objectives of Part 5.3A and how they are achieved. Particular reference will be made to the administrations of the Ansett and Pasminco groups, both of which are complex corporate groups.

The paper will examine the role of the court in these administrations. It will consider the extent of the administrator's powers and the extent to which those powers are adequate for their purpose and the operation of the statutory and equitable liens. Consideration will also be given to some of the procedural issues that face administrators of complex corporate groups, in particular, in dealing with the company's shares and the obligation to comply with the financial reporting and meeting requirements imposed by law.

Legislative Background and Objects of Part 5.3A

The first creditors' meeting must be held within five business days after the administration begins.[54] During the administration period, the administrator is required to report on his investigations into the company's business, property, affairs and financial circumstances, and the options available to the company and its creditors and give his or her opinion with reasons on those matters.[55] This report must be provided to creditors when the administrator convenes the second meeting[56] of creditors and the administrator must if a deed of company arrangement is proposed provide a statement setting out the details of the proposed deed.[57] The second meeting of creditors at which the creditors of the company decide on its

[54] Corporation Act 2001 (Cth) s. 436E
[55] s439A(4)
[56] s439A(3)(a)
[57] s439A(4)(c)

future must be convened by the administrator within 21 days of the appointment.[58] The second meeting must be held within five business days after the end of the convening period.[59]

The courts have recognised the time constraints this timetable places on administrators in performing their functions.[60] The time limits and the speed of the administration does not excuse an administrator from carrying out a full and proper investigation. It may be necessary for the second meeting to be adjourned or an extension of the convening period sought from the court to enable this to be achieved. Appropriate resources need to be deployed by the administrators to enable the task to be completed.[61]

When considering the performance of their functions by the administrators, it is appropriate to bear in mind the object of Part 5.3A. The objectives are set out in s 435A of the Act. The object of the Part is to provide for the business, property and affairs of the insolvent company to be administered in a way that either:

(a) maximises the chances of the company, or as much as possible of its business, continuing in existence (trade on); 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 (improved wind up scenario).

Improved wind up

The improved wind up is an objective that can be met in a number of ways through a Part 5.3A administration. One way is to speed up the entry into liquidation, thereby reducing the incurring of unnecessary expenses if the business were to trade on and only move to liquidate after a meeting of the company's creditors, usually convened on 14 days' notice.

If the company or its business cannot continue in existence, there is also the initial benefit of the moratorium provisions contained in Division 6 of Part 5.3A. These are designed to protect the company's property during administration. As far as practicable, they aim to give the company a short breathing space and preserve the status quo, to protect the company from action that could cause it severe harm, such as the loss of its place of business as a result of re-entry by the landlord.

The period of moratorium invoked when an administration under Part 5.3A commences is short. Having regard to the improved wind up object of the Part, if the administrator can be satisfied that a sale of a company's business is required then, bearing in mind the administrator's powers, he or she should take the necessary steps to ensure there is a better return through disposal in administration than proceeding to wind up and waiting to dispose of the business then.[62] It is not uncommon for there to be a sale of the business during the period of the

[58] s 439A(1) and (5) (or 28 days (if the administration starts in December or less than 28 days before Good Friday))
[59] s 439A(3)
[60] *Hagenvale Pty Ltd v Depela Pty Ltd & Anor (1995)* -17 ACSR 139
[61] *Linen House Pty Ltd v Rugs Galore Australia Pty Ltd* [1999] VSC 126 (Gillard J)
[62] s_437A, 442A

administration and either an extension of the convening period, or the adjournment of the second meeting of creditors, to enable a contract for the sale of the business to be completed.

Part 5.3A contains no provisions that actually deal with the distribution of proceeds of realisation of assets to the company's creditors. For there to be a distribution to creditors by an administrator there must either be a deed of company arrangement passed by the company's creditors which provides for it, or the proceeds must be dealt with in the winding up, which can follow in the transition from administration.[63]

Trade on

The first object of Part 5.3A is the trade on objective. By and large that objective can only be achieved through the use of a deed of company arrangement given the timeframes imposed by the Part. A deed of company arrangement was described by the High Court as a document that effects a change in the company's status - from administration to subject to a deed of company arrangement. It also binds all creditors so far as concerns claims arising and covered by the deed, through the combined operation of the deed and the law.[64]

Whether a deed of company arrangement is to commence is determined exclusively by the creditors[65] at the second creditors' meeting.[66] The fate of the company is in the hands of the creditors and no one else.[67]

A deed of company arrangement between the company and the Deed Administrator, once signed, is binding on creditors so far as concerns claims arising on or before the date the deed specifies.[68] Generally that date will be fixed as the date the administrators were appointed.[69] It also binds the company, its officers and members and of course the deed administrator.[70]

The role of the Court

It is against this background that the role of the court in administration of the complex corporate group needs to be considered. The contrast with a restructure implemented through a scheme under Part 5.1 of the Act is marked, as will become obvious.

Part 5.3A provides for a much lower level of court involvement, as far as controlling the implementation of a restructuring, than is required under Part 5.1 arrangements and reconstructions.

One judge has said of the court's role: [71]

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[63] s 446A;
[64] *MYT Engineering Pty Ltd v Mulcon Pty Ltd* (1999) 195 CLR 636, 649,
[65] s 43C;
[66] s 43A;
[67] *Linen House Pty Ltd v Rugs Galore Australia Pty Ltd* [1999] VSC 126, [65] (Gillard J)
[68] s 444D(1);
[69] s 435C(1)(a)
[70] s 444C
[71] *Cawthorn v Keira Constructions Pty Ltd* (1994) 33 NSW_LR 607, 611 (Young J)

> *' ... whilst the court is to keep on the sideline as much as possible, it is to be involved in a supervisory capacity, it is to be involved to ensure that secured creditors are not prejudiced and, indeed, it is to be involved and to use its powers to tailor make a procedure for each company, so that the spirit and objects of the Part will be implemented.*

In the uncontroversial administration followed by a deed of company arrangement, the court may have no role to play at all. It is a matter for the creditors alone. The same cannot be said in the larger or more complex corporate of group administration. This follows because of the dynamics of Part 5.3A. The process has a number of phases or periods when the court's role assumes a greater or lesser significance.

It is useful to divide the administration into its different phases of activity to consider the court's role:

Period of Activity	Duration
Initial Period:	From the date of the Administrators' Appointment to the date of first meeting of creditors.
Investigation and reporting period:	This period runs from the first meeting of creditors, where the administrator is not replaced, to the end of the convening period.
Creditor consideration and voting period:	This period runs from the date when creditors receive the report and other information provided to them by the administrator until they vote on the future of the company or are of the options contemplated by Part 5.3A, winding up, a deed of company arrangement on return to the directors.
Deed Signing Period:	Runs from when the creditors resolve that the company should enter into a deed of company arrangement.
Deed Period:	This is the period of the deed's operation until the completion of the deed is certified by the Deed Administrator and the deed terminated.

Initial Period

The initial period rarely attracts much court activity, although even at this stage the court may be approached for an order declaring whether or not the administrator's appointment was valid.[72] Recently, the Federal Court has used the powers in s 447A of the Act to fill a vacancy in the office of the administrators caused as a result of the resignation of one of two joint administrators. A gap in the legislation was noted because the board of the companies concerned had not met to pass a resolution to fill the vacancy. The court's power to fill a vacancy is confined to situations where no administrator is acting, which is not the case where one of two joint administrators

[72] s 447C

remains in office. Section 449C(1) permits the appointor of an administration to appoint a replacement if the appointee resigns. Section 447A was used by the court so that s 449C(1) was modified to provide that when an administrator resigns, the court (as opposed to his or her appointor) may appoint someone else in his or her place.[73]

Investigation and Reporting Period

In the administration of complex corporate groups, court involvement will almost be mandatory, when regard is had to the requirement for administrators to ensure creditors are provided with adequate information to enable them to make an informed decision on the group's future.

The court will generally be called on by administrators during the investigation and reporting period. This is the phase of the administration when the administrators will be involved in gathering information to enable them to express an opinion and report to the creditors on what should happen with the company.[74] The court, when it becomes involved, will have to consider what the administrator is doing as far as that is reported to the court by the administrator.

Part 5.3A imposes two relevant restraints that will almost certainly dictate there is a role for the court in the early stages of an administration of a complex corporate group. Firstly, there is the length of the convening period which can be either 21 or 28 days.[75] In that time period, calculated including the day of appointment, the administrator must investigate the company's business, property, affairs and financial circumstances and form a view about the company's future and put to creditors the three statutory mandated alternatives with his recommendation on them. Secondly, there is the maximum period of 60 days that creditors can vote to adjourn the second meeting of creditors[76]. In total, the convening period and the adjournment of the second meeting allows a period of up to 90 or 97 days from the start of the administration to bring matters to a conclusion by entry into a deed, termination of administration or winding up.

In the complex corporate group administration, this is an extremely short timeframe, bearing in mind that the administrator by and large will have very little background or detailed knowledge sufficient, to enable sensible recommendations to be made to creditors. Courts are suspicious of administrators whose antecedent contact with a company indicates a role for the company or one of the company's lenders. This is not to suggest that the suspicion is inappropriate, or unwarranted in certain circumstances, but it clearly means that the time it will take for even the most experienced insolvency practitioner to become familiar with the company's operations and consider the alternatives cannot start until the appointment is made. This increases the likelihood that a court will be called upon to extend either the convening period or the period for which the company's creditors may adjourn the second meeting of creditors.

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[73] *National Express Group Australia (Bayside Trains) Pty Ltd Receivers and Managers appointed and Administrators Appointed and Wallace-Smith* [2003] FCA 764.
[74] s 438A
[75] s 439A(5)
[76] s 439B(2)

There is a tension that arises in a corporate group administration between the statutory time limits prescribed by the Act for the investigative and reporting functions and the time required by the administrator to properly complete these tasks. The intention of the Part was to provide a more expeditious and less expensive way of assisting creditors and members than under the greater formality of a winding up or of the entry into a scheme of arrangement. One result, however, is that an administrator, constrained as he or she is by the time limits imposed under the Part, cannot carry out as detailed investigation of a company in the same way as can a liquidator, and accordingly the administrator's actions must be looked at in the light of that more restricted range of activities which are available to him.[77]

Once the court's jurisdiction to consider extending the convening period the court is enlivened by application, the court will perform a supervisory role which requires the administrators to demonstrate that it is in the creditors' interests to have the administrators given more time to perform their statutory functions of investigating, reporting and recommending to creditors, bearing in mind the objects of the Part.[78]

To put this into context in the Pasminco Group, the administrators were appointed on 19 September 2002. The first administrator's report to creditors under s 439A ran to 119 pages with another 40 or so pages of annexures. It was dated 1 July 2002, and was issued following three separate extensions of the convening period, each of 90 days. In support of all of these applications, extensive affidavits were filed on behalf of the administrators.

The obligation to convene meetings of creditors raises other practical issues for administrators in the complex corporate group, particularly how to adequately inform the body of creditors regarding the matters on which the administrator is required to report under s 439A(4) and the progress of the administration. In the administration of the complex corporate group, the reports to creditors will generally be voluminous. There is the practical difficulty of ensuring that all creditors receive the necessary information. It is the creditors who determine the company's future but they must have the necessary information to enable them to make an informed decision. The Act requires the provision of accurate information to creditors in a timely fashion; an obligation that should not be underestimated. The Act enables a deed of company arrangement to be terminated if creditors are given false or misleading information or there is a material omission from the administrator's reports.

In the Ansett Group administration, the Federal Court was asked to consider an application to enable the administrators to avoid strict compliance with the provisions of s 439A(3) and (4) and reg 5.6.12(1A), which govern the information required to be sent by an administrator to creditors in respect of the second meeting of creditors and the method of delivery of that information.

The numbers of creditors involved in Ansett were substantial. There were, for instance, 7,000 trade creditors, 6,000 employees, the members of the airline's Frequent Flyer Program were estimated at 2.7 million and Golden Wing program members were estimated at 1.3 million. Depending on the method of despatch chosen and the size of the material to be sent, the cost varied enormously, from $28 million, if four million persons were provided with the 150 pages of material down, to

[77] *Hagenvale Pty Ltd v Depela Pty Ltd & Anor (1995),* 17 ACSR 139, 145,
[78] *Mann v Abruzzi Sports Club Ltd* (1994) 12 ACLC 137, (1994) 12 ACSR 611.

$60,000 covering the cost of advertisements in various newspapers together with the placing of various documents on the website.

Ultimately, the Court was not satisfied that it was appropriate to dispense with giving written notice to all creditors of the meeting as required by s 439A(3)(a), as the cost of doing so was not so disproportionate to the objective of giving the creditors proper notice of the meeting, details of the time and place of the meeting and the issues to be raised. The Court was however, prepared to use s 447A to limit the material actually sent. In addition to advertisements in the press, it required notice to be sent to each creditor giving details of how they could obtain copies of reports, outlines of deeds of company arrangement and proxy forms. The pertinent documents were also to be available on the internet.[79]

Creditor consideration and voting period

The court has no active role in Part 5.3A in vetting or approving the deed of company arrangement before creditors vote on it.

In contrast to Part 5.3A of the Act, the court under Part 5.1 of the Act has a large number of powers and essentially is given control of the organisation of the process of reconstruction. In the case of insolvency, it controls, for example, the convening of meetings of creditors.[80] It also has the final say in approval of a compromise or arrangement.[81] In exercising the jurisdiction to authorise the convening of the meetings, the court can take account of matters of 'public policy and commercial morality'. It is unlikely to order the calling of meetings of creditors to consider a scheme where the proposed reconstruction involves the informal liquidation of the company[82] or where the failure of the company has been inadequately explained or warrants investigation.

Importantly however, even where the creditors have voted to approve a s 411 proposal, the court has the ultimate discretion to grant approval to a s 411 proposal. The court may impose conditions or even alter the scheme approved by the creditors. The jurisdiction of the court is essentially supervisory. The court must be satisfied that the proposal is at least so far fair and reasonable as that an intelligent and honest man, who is a member of that class, might approve it.[83]

Indeed it is fair to say the court under Part 5.3A is not entitled to substitute its judgment for the commercial judgment of creditors on a deed proposal.[84] Unlike Part 5.1 schemes, a deed of company arrangement under Part 5.3A is not scrutinised by a court before it is put to creditors for their consideration. While the rigour of courts approaching Part 5.1 schemes seems to have reduced somewhat in some respects in recent years on this issue, there is no doubt that it is still a guiding principle of a scheme under Part 5.1 that the Part cannot be used to achieve a result that can be obtained under another Part of the Act, for example liquidation.[85]

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[79] *Re Ansett Australia Ltd & Ors (all administrator appointed) and Mentha & Korda (as administrators) (2002)* 40 ACSR 419.
[80] s 411(1)
[81] s 411(4)((b).
[82] *Re Tillers ty Ltd* [1970] 3 NSWR 202; *Re Brian Cassidy Electrical Industries Pty Ltd* (1984) 9ACLR 140.
[83] Re *Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213, 247 (Fly LJ).
[84] *Young v Sherman (2001)* 40 ACSR 12, 35-6.
[85] Renard and Santamaria, *Takeovers and Reconstructions in Australia*, fn 40 [1521].

The same concern with process does not trammel Part 5.3A. While the court clearly has an overview role to prevent Part 5.3A from being abused, this overview cannot be used to stop a deed of company arrangement which is designed to complete a realisation of the company's assets and the distribution of those assets to the company's creditors.[86] Providing it is a scheme or proposal designed to improve the return to creditors over what might be expected in a winding up, then it is within the spirit of the Part.

One of Part 5.3A's objectives implicitly recognises that Part 5.3A can be used to deal with an insolvent company where liquidation will produce a worse return for the company's creditors and members than use of a deed of company arrangement or administration itself. In *Young v Sherman*, at first Austin J could find no basis for holding that it is improper to use the deed of company arrangement procedure to achieve an outcome that might have been achieved, perhaps less efficiently and flexibly, by the use of some other procedure such as winding up.[87] The decision at first instance was reversed on appeal.[88]

The Court of Appeal's decision turned on the fact that the deed provided for a premium to be paid to some creditors but not others. The payment of gratuities or premiums to achieve objects other than those of Part 5.3A was the Court of Appeal found contrary to the policy of the Act and the public interest. The Court criticised Austin J's findings on the evidence regarding the premium and his finding that the deed was not proposed by the directors to protect themselves from scrutiny or to shield a beneficiary of a voidable transaction. The Court of Appeal did not however directly criticise Austin J's analysis of the objects of Part 5.3A and the use of an arrangement under the Part to achieve what might be achieved in a winding up. We must await another case for this principle to be clearly established, but it seems with respect that the principle expressed by Austin J is correct having regard to the objects of Part 5.3A.

The court will generally not get involved in approving a deed of company arrangement. In *Mentha and Others v GE Capital Ltd,*[89] the Federal Court was prepared to give a direction to the administrators that it was proper to enter into some documents associated with a restructure, but was not prepared to give a direction in respect of the entry into a deed of company arrangement. The deed of company arrangement with the other documents provided for pooling of assets and liabilities in a corporate group. The Court was not however, prepared to sanction the proposed deed of company arrangement because s 444A(3) imposes on the administrators the obligation to prepare the deed and s 444B(2) and 444B(5) requires each of the company and the administrators to execute the deed. Given the existence of the mandatory obligation to ensure the deed comes into existence, the Court found that no purpose would be served by giving a direction that the administrators execute the deed.

In both the Ansett[90] and Pasminco[91] administrations, orders were made by the Court to facilitate voting at the second creditors meeting by employees. In both cases, the

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[86] S.447A
[87](2001) 40 ACSR 12, 36.
[88] (2002) 20 ACLC 1559.
[89] (1997) 27 ACSR 696
[90] *Re Ansett Australia Ltd (Administrator Appointed); -Rappas & Ors v Ansett Australia Ltd (Administrator Appointed) & Ors (2001)* 39 ACSR 296.

Court used s 447A to have various nominated officials of unions whose members were employed by the companies appointed as the employees' attorneys for their members pursuant to reg 5.6.31A of the Corporations Regulations 2001. In the Pasminco case there was an opt out mechanism for any employee who turned up in person at a meeting to vote. The Court was concerned to ensure that any inhibitions or barriers which might exist on creditors being able to have their voice heard or vote cast at a creditors meeting should be overcome. This was particularly the case where there are a large number of creditors.[92]

Deed signing period

Once the creditors resolve at the second meeting of creditors that the company should execute a deed of company arrangement, but before the deed is executed, a person who would be bound by the deed if it had been signed is not to act in a manner inconsistent with it[93]. The person will also be prevented from starting or continuing a winding up application, any other proceeding or enforcement process.[94]

The deed of company arrangement must be signed within 21 days of the end of the second meeting of creditors.[95] This time can be extended by the court if application is made within the 21 days. The consequence of non-execution of the deed within the 21 day period, or the extended period allowed by the Court is draconian. Section 435C(3)(f) provides that the administration of a company will end automatically if the company contravenes s 444B(2) by failing to execute the proposed deed of company arrangement within 21 days. It seems however that the consequence of non-execution in accordance with s 444B(2) can be ameliorated by use of s 447A which will permit an extension to be made after the expiry of the initial 21 day period despite the words of the section.[96]

In Pasminco, there were three extensions for a total of 21 days although the deeds were ultimately signed on the 14th day, being the last day of the second extended period. These extensions were sought in the context of ongoing discussions and negotiations between the Administrators, persons who were to provide finance for the deed period and creditors with a proprietary interest in some of the Group's property.

The discretion to be exercised under s 444B(2)(b) will not be exercised for the purpose of prolonging the administration in order to avoid a result which execution of the deed may bring about. According to Goldberg J, the focus of the exercise of the discretion should be to enable the administrators to finalise the drafting, preparation and execution of the deed.[97] In Pasminco, the extensions were to enable the negotiation and finalisation of financing arrangements critical to the trade on period during the deed.

The court will be concerned to ensure that the process is not unduly extended. In both Pasminco and Ansett, orders were foreshadowed by the judge that would have had the effect of giving the parties a court-imposed deadline to conclude what were obviously difficult negotiations.

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[91] *Re Pasminco Ltd* (2003) 45 ACSR 1.
[92] Ibid 5 (Goldberg J).
[93] s444C(2)
[94] s444E
[95] s444B(2)(a)
[96] *Australasian Memory Pty Ltd v Brien* (2000) 200 CLR 270
[97] *Re: Ansett; Mentha v Sydney Airports Corporation (2002)* 41 ACSR 352 (Goldberg J).

Deed Period

Once a deed of company arrangement commences, no longer is there the statutory protection in a subsequent liquidation for actions of the administrator taken in good faith.[98] The deed of company arrangement will govern the company's operations particularly where it is a trade on deed or a restructure deed. The creditors control the terms of the deed of company arrangement, the trade on and the restructure. The court is not necessarily involved.

Administrators' Powers

Complex corporate groups often throw up difficult challenges for their administrators both before and after entry into deeds of company arrangement. Administrators are charged with running the corporation to the exclusion of the directors during the voluntary administration period and may be so charged during the deed period. Their powers are extensive and arguably permit them to do everything they need to do to enable the business to be run and make all decisions.

Administrators are given, by s 437A of the Act, control of the company's business property and affairs. The administrator has the power to carry on the company's business to the exclusion of the directors. The administrator has the power to do this even though the company is insolvent. The High Court has recognised this and explained the nature of the administrator's power as one which must be exercised impartially ' ... as among all parties having or claiming to have an interest in the present or future assets of the company and must make those decisions which, in the light of contemporary circumstances, best serve those interests'.[99] The protection for creditors dealing with the administration is the personal liability of the administrator.

Administrators are able to get directions from the court.[100] The relevant principles the court will apply are those governing the right of liquidators to seek directions under s 479 of the Act.[101]

Administrators cannot ask the court to make a commercial or business decision for them. Before the court will consider giving directions, there has to be an issue calling for the exercise of legal judgment. The only proper subject of an application for directions is to give advice on the manner in which the administrator should act in carrying out his functions. The only binding effect of such a direction will be that if the administrator has made full and fair disclosure to the court of the material facts, he or she will be protected from liability for any alleged breach of duty in respect of anything done to him in accordance with the direction.[102]

In the Ansett administration the Administrators sought directions under s 447D that they might properly and justifiably continue to operate the Ansett business in circumstances where the business was trading at a loss of approximately $6 million per week. Depending on the outcome of a sale agreement there would be a return to unsecured creditors but without a sale there would not.

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[98] s451C

[99] *Patrick Stevedores Operations Pty Ltd v Maritime Union of Australia (No 3)* (1998) 195 CLR 1, 38; (1998), 153 ALR 643, 663,

[100] s447D

[101] *Ansett Australia Ltd and Others (all administrators appointed) and Korda & Another (As administrators)* (2002) 40 ACSR 433;

[102] *Re: GB Nathan & Co Pty Ltd (in liquidation)* (1991) 24 NSW LR 674, 1679 (McLelland J)

The Court refused to give the direction sought despite the fact that the continuation of the business would lead to the incurring of further losses. The Court recognised that an administrator may have to operate a business at a loss in order to further the objects of Part 5.3A. But the Court was not convinced that was enough to warrant giving the administrators directions approving of what were essentially business or commercial decisions in circumstances where no legal issue arose in relation to the propriety or reasonableness of the decision made.[103]

Liens - statutory and equitable

The Act provides administrators with a right of indemnity out of the company's property for the debts for which the administrator is liable under s 443A, certain taxation payments the administrator must make because of deductions made by the administrator under various provisions of the *Income Tax Assessment Act 1936* (Cth) and the administrator's remuneration.[104]

The administrator is given a statutory lien to secure that right of indemnity.[105] Subject to the provisions of s 556 of the Act, the administrator's lien will have priority over all the company's unsecured debts and the debts secured by the floating charge,[106] unless the chargee has appointed a receiver before the administrator was appointed or where the charge is over the whole, or substantially the whole of the assets of the company, the chargee enforces the charge during the decision period.[107]

The effect of the words 'subject to section s 556' which appear to qualify the priority for the administrator's lien was considered by Austin J in *Weston & Anor v Carling Constructions Pty Ltd (in prov liq) & Anor.*[108]

His Honour concluded the administrator's priority ranked ahead of unsecured debts and claims, including those mentioned in s 556. However, the operation of the words *'subject to s556'* was to qualify the administrator's priority to those assets recovered by the administrator during the course of the administration, but if any additional assets are recovered by a subsequently appointed provisional liquidator or liquidators, the administrator's priority to payment out of those additional assets is governed by s 556.[109]

In reaching this conclusion, Austin J applied the Full Federal Court decision of *Shirlaw v Taylor,*[110] where the Court considered the impact of the statutory priorities then prevailing in respect of a provisional liquidator's right of indemnity, secured by an equitable lien. In essence, the Federal Court held that the introduction of the statutory priorities, which in that case postponed the provisional liquidator's remuneration and expenses to other claims in the winding up, did not warrant the conclusion that an equitable lien should be postponed.

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[103] Ansett Australia Ltd and Others (all administratiors appointed and Korda & Another (As administrators) (2002) 40 ACSR 433, 456,
[104] s443D
[105] s443F(1)
[106] s443E(1)
[107] s443E(3)
[108] *Weston & Anor v Carling Constructions Pty Ltd (in prov liq) & Anor (2000)* 35 ACSR 100
[109] Ibid 106;
[110] (1991) 31 FCR 222; (1991) 102 ALR 551;

The factors considered pertinent by the Full Court were the circumstances of the appointment of a provisional liquidator where it was intended to be obtained speedily, like an interim injunction. The Court considered it would be anomalous if the lien depended on there being no winding up and noted that the provisional liquidator would not always be the liquidator. Justice Austin applied this logic to administration under Part 5.3A which he noted was not a curial remedy, noting that directors need to be able to make an appointment rapidly and the administrator needs to act without undue concern about the recoverability of his reasonable fees and expenses.[111]

Justice Austin also followed the decision in *Commonwealth Bank of Australia v Butterell.*[112] In that case, Young J of the Supreme Court of New South Wales held that the introduction of the statutory lien by the equivalent of s 443E of the Act does not lead to a conclusion that any equitable lien of the administrator was to be excluded. The Act does not clearly override pre-existing rights and without a clear expression of that intention by the legislature must be considered *not* to do so.

Justice Young drew authority for the proposition that an equitable lien must exist for an administrator from the High Court decision in *Re Universal Distributing Co Ltd.*[113] That was a decision of Dixon J, who held that the expenses incurred by a liquidator in the actual realisation of assets subject to a security constituted an equitable lien on those proceeds to which the receiver for the secured creditor took subject. However, if the expense involved was not incurred for the sole purpose of preserving or realising the property, then it will not form part of the expenses protected by the lien.

The Court in *Butterell's* case recognised that while the principle was clear what was difficult was the question of what was actually covered by lien.[114] The consequence of not having an entitlement to priority ahead of the priorities in s 556, means that the administrator's right of recoupment in the respect of a particular debt or liability might drop down the priority hierarchy to s 556(1)(dd) as any other expense. This may have significant personal ramifications for the administrator.

The question arose recently in the Ansett administration when the Court was asked to consider an obligation by Ansett to a defined benefits superannuation fund on the retrenchment of employees who were members of the fund.

Ultimately, the judge found that the obligation to pay the contributions was incurred by Ansett prior to the date of the appointment of the administrators and hence must be proved for as an unsecured claim with no priority under s556(1).[115] The decision is subject to an appeal.

Difficult questions may still arise in an administration as to whether an administrator is entitled to claim an equitable lien in respect of a particular expense or liability where that expense does not fall under the statutory lien in s 443E. For the expense or liability to fall under the equitable lien, the test seems to be the expense must be incurred exclusively in respect of preservation or realisation of an asset.[116]

Administrators and their power to borrow

[111] *Weston* & Anor v Carlin Constructions Pty Ltd (in *prov liq) and Anor (2000) 35 ACSR 100,* 105,
[112] (1994) 35 NSWLR 64; (1994) 14 ACSR 343;
[113] (1933) 48 CLR 171;
[114] *Commonwealth Bank of Australia v Butterell (1994)* 14 ACSR 343, 349
[115] *Ansett Australia Ground Staff Superannuation Plan Pty Ltd v Ansett Australia* [2002] VSC 576;
[116] *Re Universal Distributing Co Ltd (1993) 48 CLR 171*

Administrators will quite often need to borrow working capital to enable the company to trade until a deed of company arrangement is executed. There are doubts about whether an administrator who borrows money will have a personal liability for that borrowing.

Section 443A provides a list of debts that an administrator will be personally liable for. They are:

(a) services rendered;

(b) goods bought; or

(c) property hired, leased, used or occupied.

Borrowing does not fall within (b) goods bought, or (c) property hired, leased, used or occupied.

The question is whether the administrator's borrowing falls within (a) services rendered. Any doubt that it might was removed when the Federal Court held that the lending of money does not constitute the rendering of services in the context of administration under Part 5.3A.[117]

This issue arose in both the Pasminco and Ansett administrations. In Pasminco it arose in respect of borrowings from financiers for working capital during the administration period and in Ansett for borrowings from the Commonwealth of Australia by the administrators for the payment of employee entitlements.

The answer in both administrations was to utilise the power under s 447A so that in each case s443A(1)(a) was adjusted to operate such that when the administrators incurred the particular debts, the administrators were thereby incurring a debt in the performance and exercise of their functions and powers as administrators for services rendered.

A complication for administrators wishing to minimise personal exposure for any such borrowing is the operation of s 443A(2) which provides that personal liability applies despite any agreement to the contrary.

Therefore, if a lender were prepared to rely on the security of the administrator's personal lien, for borrowings under s 443A(1) for which the administrator has personal liability, then unless there is some limit on the right of recourse, s 443A(2) means it is not possible to restrict the obligation of the administrator to pay. The answer to this risk for the administrator is to limit the obligation of the administrator by limiting the right of recourse to the administrator to the extent of the administrator's right of indemnity out of the assets and to the extent the right of indemnity was insufficient the administrator would have no further obligation to repay the borrowing. This was done in the Ansett administration and in Pasminco where the borrowings during the administration period were extended into the deed period.

[117] *Re: Ansett Australia Ltd and Ors (All Administrators appointed/and Mentha and Another (as admin)(2001)* 40 ACSR 389;

Procedural matters

Given the nature of the complex corporate group, there will often be a large number of companies in a corporate group placed into administration contemporaneously and this will raise a number of logistical and procedural issues for administrators and deed administrators. Where the principal company in the corporate group is publicly listed, this will add to the tasks of the administrators, particularly where the administration is extended as a result of court approved extensions of the convening period and where a deed of company arrangement is voted for by the company's creditors.

Shares and takeovers

There seems to be little doubt that under an appropriately drafted deed of company arrangement, a deed administrator can issue or allot new shares in the company in administration.[118] It will not however be enough if the deed simply gives the deed administrator the powers set out in the prescribed provisions contained in Schedule 8A clause 2.[119] These provisions will be included in the provisions of a deed of company arrangement unless they have been expressly excluded. Clause 2(zc) of the prescribed provisions includes a power 'to enter into and complete any contract for the sale of shares in the company'. Despite some early views to the contrary, it seems this does not constitute a power to allot and issue shares.

The power in clause 2(zc) cannot be used to bind a shareholder to a contract to the sale of his or her shares unless the shareholder agrees.[120]

Where the company controlling a corporate group is placed in administration, it is not uncommon for a deed of company arrangement to be proposed that provides for the issue of new shares, to facilitate a swap of debt for equity or simply to reflect the contribution of new capital made by a party under a deed of arrangements such as these are possible under deeds of company arrangement even where they might have the effect of diluting existing shareholders.[121] If an arrangement is proposed which provides for any of these where the company is a listed company or an unlisted company with more than 50 members, the provisions of Chapter 6 of the Corporations Act, which deals with takeovers, must be borne in mind.

In general terms, the law prohibits the acquisition of a relevant interest in issued voting shares of a listed company or an unlisted company with more than 50 members where as a result of the transaction the person's voting power in the company increases to above 20 per cent or goes from more than 20 per cent to less than 90 per cent.

There are a number of exemptions to this prohibition. These are contained in the table that forms part of s 611 of the Act. There is no exemption for an issue of shares under a deed of company arrangement to a party that crosses the thresholds in s 606. Despite this, an acquisition that results from a compromise or arrangement

[118] *Cresvale Far East v Cresvale Securities(2001)* 37 ACSR 394, 434
[119] s444A(5)
[120] *Mulvaney vWintulich* (unreported, FCA, O'Loughlin J, 29 September 1995, BC-9507-347);
[121] Cresvale Far East v Cresvale Securities (2001) 37 ACSR 394 431 (Austin J)

approved by the court under Part 5.1 of the Act is exempt from the operation of takeover rules.[122]

It is possible for the Australian Securities and Investment Commission (ASIC) to exempt a person from complying with a provision of Chapter 6 or declare that Chapter 6 applies to a person as if specified provisions of the Chapter were omitted, modified or varied.[123] The Takeovers Panel has the power to review any decision of the ASIC made under s 655A and s 656A.

In Pasminco, the provisions of s 606 provided a potential hurdle to one of the possible restructure alternatives for the company. One of the possible restructure alternatives was to issue and allot shares to provide creditors with a debt for equity swap. Without an exemption or a waiver from the Takeover provisions the debt for equity swap would require the members to vote on it as another way of gaining an exemption from the Takeover provisions.

Given the economic value of the shareholders interest and the total unlikelihood of any return to members, should the members have a vote? The Administrators thought not and sought to have the ASIC waive the requirements of Chapter 6 in respect of restructure of the Pasminco Group which involved a debt for equity swap. ASIC refused to grant relief under s 655A.

Pursuant to s 656A the Takeovers Panel was asked to review the decision of ASIC to refuse relief from the takeovers provisions in respect of an anticipated deed of company arrangement.[124] The proposal would have permitted creditors to acquire shares issued by the administrators under the proposed deed in a debt for equity swap. These creditors would have a controlling interest in Pasminco with existing shareholders being substantially diluted.

The Takeovers Panel's view of the economic interest of the existing shareholders of Pasminco can be seen from its reasons given for approving the exemption:-

(d) *The fact of the creditors allowing existing shareholders to retain an interest is not a benefit which is given as consideration for the Pasminco shareholders giving anything up (and therefore requiring to be considered for fairness), but is a windfall to shareholders resulting from a device or arrangement which the creditors have chosen for the creditors' own convenience and to reduce their losses.*

(e) *It is anomalous and perhaps also unreasonable that the reconstruction, involving about $3 billion of creditors' money, should be subject to a veto by shareholders with essentially no value at stake.*

(f) *It is anomalous that Chapter 6 should apply to acquisitions of shares by the creditors, after they have legitimately taken control of Pasminco. Chapter 6 is designed to prevent people getting control of companies by coercion, or rushed, uninformed or selective dealing. The law has placed Pasminco under the control of the creditors by means which neither contravened nor avoided Chapter 6.*

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[122] *Corporations Act 2001 (Cth) s 611 Item 17 Table.*
[123] s655A
[124] Takeovers Panel (BC 200208527, 22/04/02)

(g) *A vote under item 7 of section 611 is in effect dispensation by the non-associated shareholders from making a bid. However, as there is essentially no value left in the equity of Pasminco, making a bid would not address the issues of sharing in the benefits which a takeover is designed to preserve.*

(h) *It is anomalous that the existing shareholders should be able to veto one particular restructuring of Pasminco, when their shares are essentially worthless, all of the company's assets and powers are at the disposal of the administrators, who are essentially answerable only to the company's creditors, and they have no interest which the administrators are obliged to preserve or respect.*

The Takeovers Panel decision in Pasminco is of course limited to its facts, but it does recognise the limited value attaching to members' interests once the company becomes insolvent and is likely to remain so. It recognises the primacy of the creditors' interest once insolvency occurs.

Annual reports and AGMs

Despite the lack of value attaching to the equity of members in an insolvent company, the law still requires a company to hold an annual general meeting and file its annual financial returns.

The Act contains a number of ongoing financial reporting obligations in respect of corporations which require lodgment of audited annual financial reports and directors reports with ASIC during the life of a corporation.[125] There is also the obligation to hold an annual general meeting required by Part 2M.2, Division 8 of the Act.

The fact the company is in administration under Part 5.3A does not remove these obligations. The obligation to prepare and have audited the company's financial reports may be onerous and of dubious value, particularly where the value of members' interests are considered, because on insolvency those interests will have little or no economic value.

ASIC has under s 340 of the Act power to relieve the directors, the company and its auditors from the need to comply with Part 2M.2. ASIC has recently released an Interim Policy Statement 174 which deals with the financial reporting and annual general meeting obligations of externally administered companies.

According to the Interim Policy Statement, ASIC seeks to achieve a balance between the statutory objectives of Part 2M.3 and Chapter 5. It applies to all forms of external insolvency administration, but relevantly applies to companies in administration under Part 5.3A and companies subject to deeds of company arrangement.

ASIC has made a class order[126] granting relief from the financial reporting obligations for companies in administration. This relief permits a deferral for six months after the administrator's appointment from the obligation to lodge and distribute the Part 2M.3 reports. It is also possible to use alternative methods for distributing an annual report to members at the end of the deferral period. The company may be required to advertise the fact that the report is available free of charge from the company's website or the administrators firm.

[125] s 292(1), 298, 301;
[126] CO 03/392,

The class order relief does not apply to companies under a deed of company arrangement.[127] But it is still possible for a company subject to a deed of company arrangement to apply for individual relief where it considers that compliance with the financial reporting obligations would impose unreasonable burdens. ASIC considers that the mere fact of administration alone does not justify non-compliance. Indeed it considers that creditors should be told of the costs of meeting the financial reporting obligations when considering resolutions about the company's future.[128]

ASIC can on application still grant an exemption from the financial reporting obligations. To do this, ASIC must be satisfied that (a) compliance would impose unreasonable burdens, or (b) the reports produced would be misleading or inappropriate and that relief is appropriate. According to its Policy Statement, ASIC is likely to grant an exemption from all financial reporting obligations where:

(a) the external administrator exercises all or most of the management functions and powers; and

(b) the application for relief contains a declaration by the external administrators that in their reasonable opinion the members have no ongoing economic interest in the company; and

(c) if the external administrators is a deed administrator appointed to the whole or substantially the whole of the company's property, ASIC is satisfied that the company's business will be carried on only so funds are necessary to enable an orderly disposal of the whole or substantially the whole of the company's business and property.[129]

The period of exemption will vary but for a company subject to a deed of company arrangement, it will generally be until the earlier of two years or termination of the deed of company arrangement.[130]

In addition to exemption, ASIC will also grant deferrals for up to six months from the financial reporting obligations, in certain circumstances where it is uncertain whether members have an ongoing economic interest in the company or the company needs additional time to lodge the financial reports deferred in the initial administration period as well as the next batch of reports required under Part 2M.3.[131]

If the relief provided does not extend to all financial reporting obligations, it is possible for ASIC to grant parties exemptions which provide relief, for example, from providing a director's declaration under s 295 or s 303 or director's report under s 298 or s 306. There are other reporting obligations for which exemptions may be given.[132]

ASIC will not be deterred from refusing exemption by matters of cost, although it will have regard to the fact that the cost of compliance will be borne by the creditors.[133]

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[127] PS174.22
[128] PS174.29
[129] PS174.31
[130] PS174.33
[131] PS174.34
[132] PS174.37
[133] PS174.47

Nor will it be enough to put to ASIC that the financial reports filed will not truly reflect the position because of the external administration. ASIC expects the true position can be demonstrated in the accounts by use of appropriate disclosures and appropriate accounting treatment for post-reporting date events.[134]

In the context of the obligation to hold an Annual General Meeting and its power to do so under s 250P of the Act, ASIC will grant extensions of time to hold this meeting. The length of the extension of time will vary depending on the extent of the relief granted from the financial reporting obligations. In some instances, it will run for the period of the financial reporting relief plus three months (relief from all financial reporting obligations) or may just be an extension of three months from the time the company must hold its AGM in the ordinary course.[135]

There is also the possibility for ASIC to grant a no-action letter even where it has not exempted the company from its financial reporting obligations. ASIC may grant such a letter where the external administrator exercises all or most of the management functions and powers and the costs of arranging and holding an AGM during the administration period would be borne solely by the creditors.[136]

ASIC concedes that the AGM as a safeguard for members declines, particularly where members have no ongoing economic interest in the company.[137] In ASIC's view, members will have an 'ongoing economic interest' if the monetary value of, or rate of return for, each share in the company is, or is likely to be, more than nominal or the company is likely to cease being externally administered and to carry on business under the control of the directors.

This is not the place to determine the appropriateness of this definition of 'ongoing economic interest', but in the case of Pasminco where the Takeovers Panel was satisfied that the members had no ongoing economic interest, ASIC still required the company to comply with its financial reporting obligations and hold an AGM. Clearly for all deed administrators where the company will trade on under the deed for any period of time, the need to ensure compliance with the company's financial reporting obligations will be something that they must ensure is discharged. Penalties exist for breach of financial reporting obligations[138] and the failure to hold an AGM[139].

Conclusion

Administration under Part 5.3A of the Act can and does work for complex corporate groups. The legislative framework provided for by the Act is, however, by and large, too short. The 21 or 28 day convening period is not long enough to enable administrators of complex corporate groups to even gather the information necessary to start preparing their report. The 60 day maximum adjournment period may also be too short in some instances, depending on what has gone before. Invoking the court's jurisdiction to extend these periods will bring with it scrutiny of the administrators actions, but courts will not and cannot make judgments that are by the Act required to be left to the creditors.

[134] PS174.53
[135] PS174.66
[136] PS174.71
[137] PS174.74
[138] s314
[139] s250N(2A)

It is of course possible for administrators to seek directions from the court on matters arising during the administration period and this is more likely to occur in the administration of a complex corporate group.

Administrators have adequate powers to achieve the objects of Part 5.3A and this applies even in complex corporate groups. The Part is flexible enough to be used to accommodate different types of restructuring from the basic compromise deed, to more complicated debt for equity swaps that provide the opportunity for the company or the group to trade on, thereby meeting the object of Part 5.3A.

Where administrators experience difficulties in obtaining certainty is where the administration process intersects with the rights of third parties, where what is proposed by way of reconstruction of the group affects accrued or future rights. Section 447A is a critical provision in the operation of the Part. It is unique, but courts have shown a willingness to use it to overcome obstacles or solve problems faced by administrators of complex corporate groups.

There is no doubt that the administration of a complex corporate group provides great challenges to administrators. Regulators have shown a willingness to accommodate restructures where an alteration in the capital of the listed group is required as a consequence of its insolvency and the future of the group. While ASIC is prepared to grant some leeway to the administrator in matters of financial reporting and holding annual general meetings, there is a limit to that leeway and ultimately it seems administrators and more particularly deed administrators will be required to comply with normal financial reporting and meeting requirements. There is a higher likelihood of this being required where the company trades on under a deed of company arrangement for any length of time.

It will be interesting to observe the role administration under Part 5.3A will play in the reconstruction of insolvent complex corporate groups over the years ahead.

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