Australian Bankers' Association

Submission

in response to the

Discussion Paper "Rehabilitating Large and Complex Enterprises in Financial Difficulties"

Corporations and Markets Advisory Committee 2003

20 February, 2004

Introduction

Australian Bankers' Association (ABA) represents 23 banks authorised to carry on banking business in Australia. ABA's membership includes Australia and New Zealand Banking Group Limited, Commonwealth Bank of Australia, National Australia Bank Limited and Westpac Banking Corporation together with a number of regional and foreign banks.

ABA's members are major providers of finance, secured and unsecured, to both large and small businesses operating in Australia.

The price, availability and terms of business finance provided by member banks is determined largely by their assessment of the credit risk in lending to a particular business. Part of this assessment includes an assessment of regulatory risk. This is related to the laws that determine the ability of the bank to recover the money it has lent with certainty and expedition.

Credit policies and practices of banks and the prudential supervisory regime administered by Australian Prudential Regulation Authority (APRA) have contributed to Australia's high standards of safety, security and stability in the financial system. Australia's insolvency laws have played their part in this by recognising the importance and priority of loan security.

The ABA is also concerned about any changes to insolvency laws when its members are in the process of implementing BASEL 11. At present banks are currently working through the collation of back data to support an IRB approach to loss and credit risk.

That data is dependent on the insolvency regime in force at the time the defaults took place. Importantly this data which supports the IRB approach must be validated.

Real difficulties will arise in validating data for the model if the regime which say gave certain priority to a secured creditor is displaced as the model is dependent on certain assumptions. Accordingly any change to the current regime would have wide ranging impacts in BASEL 11 implementation. This must be thought through and seriously considered.

The ABA submits that overall the voluntary administration regime, as it operates in Australia, is successful. There are some technical or efficiency type changes that could be made to the regime to improve its workability.

The ABA submits that the voluntary regime is able to effectively and efficiently deal with corporations both large and complex and small and simple without a need to treat those companies differently under the law.

Indicative data from a member bank extracted for the past 12 months confirms that the existing regime is working consistently with the regime's objectives. A summary of that data appears in the Schedule at the end of this submission.

Corporate Rehabilitation

The ABA submits that the following statements underpin any regime for effective, efficient and fair management of companies in financial difficulties:

1. Not all financially distressed companies can be rehabilitated as going concerns.

2. Where a company's financial status is such that it cannot trade without further diminishing its assets and a deed of company arrangement does not represent a viable alternative, that company should be wound up.

3. A rehabilitation regime must not be open to abuse by companies that simply want a debt holiday.

4. The legal principles governing the administration of companies in financial difficulties should be consistently applied to both large and complex enterprises and also to smaller enterprises.

5. There should be public confidence in the administration of enterprises in financial difficulty through:

   a) Administrator independence

   b) Qualifications and competence of administrators

   c) Adequacy of powers to enable efficient administrations

   d) Recognition of creditors' rights and a lender's prudential and capital requirements.

Response to matters raised in Chapter 1

Proposed Principles for effective Corporate Rehabilitation

Principle 1: The earlier a company responds to its financial difficulties, the better may be its prospects of successful rehabilitation.

The ABA agrees that this principle is fundamental.

The ABA believes that a company's early response to its financial difficulties is ultimately a corporate governance issue. Modifying the conditions as to when a company is permitted to seek relief by specifying in the Corporations Act 2001 (Act) a point earlier in time when the company may apply for that relief assumes that the directors of the company will take that opportunity at that first available time. There are countless examples in Australia's corporate history where companies having had the opportunity to seek relief have left that decision to the last and often fatal moment.

Legislating an earlier time in which a company might take action also assumes that the governance of the company is sufficiently competent to recognise the company is in the degree of difficulty where remedial action is necessary. (eg the state of a company's accounting system may prevent an accurate assessment of that company's financial position until the very end).

The ABA submits that a director of a company is best placed to determine and recognise a company's financial plight. It is therefore appropriate that directors of companies continue to have incentives to seek the assistance of an administrator if the company appears to be heading towards insolvency.

There are at least four incentives for directors of a company that is in financial difficulties to take early action to appoint an administrator:-

1. Under the Income Tax Assessment Act directors will be personally liable for unremitted group tax if after having received 14 days notice of demand by the ATO for payment of the tax the company either fails to pay the tax, enters into an agreement with the ATO to pay the tax or fails to appoint an administrator to the company or to place the company in liquidation.

2. Under the Act directors have a duty to prevent insolvent trading by a company and, in default, incur personal liability for debts so incurred.

3. Under the voluntary administration (VA – acronym also used to refer to a voluntary administrator) provisions of the Act, the appointment of an administrator to the company protects directors from actions by creditors under guarantees given by directors to secure the company's debts for the period of the VA.

4. Under the Corporations Act directors are liable for civil penalties for failing to exercise their powers and discharge their duties carefully and diligently, in good faith and in the best interests of the company.

The test in section 436A (1) of the Act that a company must be insolvent or likely to become insolvent at some future time before a VA can be appointed is preferred. The test establishes a suitable point in time where there is an identifiable risk that the company will fail. If there was an earlier time specified under the Act or the test was changed so that if the company "might" become insolvent rather than being "likely" to become insolvent this may increase the risk of abuse because the VA regime can be commenced without the involvement of the court and could create circumstances whereby a company obtains an unwarranted or unreasonable debt holiday.

Also, a "may" rather than "likely" to become insolvent test would be a speculative test creating an increased risk of litigation over whether the company was entitled to take VA action.

Under a voluntary filing of Chapter 11 bankruptcy protection in the United States, the administration is usually commenced by application to the court on a "good faith" test. The determination of a company's solvency (or lack of solvency) is based on three definitions or tests of solvency:

1. the fair value of the company's assets exceeds its book liabilities;

2. the company is capable of paying its debts as they mature; and

3. the company does not have unreasonably small capital.

The US does not have insolvent trading laws as apply in Australia. Under Chapter 11, three unsecured creditors can force the directors to put the company into an involuntary Chapter 11 proceeding and petition the bankruptcy court to displace the board.

In the U.S., a voluntary filing of Chapter 11 is available to protect the company from enforcement of a creditor's rights and remedies, including the foreclosure under a security. In practice it would seem that such a voluntary filing of Chapter 11 bankruptcy protection is unlikely to produce any earlier insolvency regime intervention into the management of the financially distressed company than the VA regime. In fact the VA regime permits intervention at a much earlier stage than the company's default under a security including an anticipation that the company might breach the terms of a creditor's security. Chapter 11 filings on a voluntary basis could be seen to undermine the principle that the earlier the directors take account of the company's financial position the better are its prospects for rehabilitation.

Under the UK Enterprise Act 2002 the position is largely the same as with the Australian VA regime where the company, the directors or a secured creditor holding a floating charge over the whole or substantially the whole of the company's property can initiate an administration. A similar test of insolvency applies as is the case in Australia i.e. that the company is or is likely to become unable to pay its debts. The administrator's duty is to be satisfied that the company will be able to achieve a better return for creditors than if it were wound up. The right of the secured creditor to appoint an administrator, like in Australia, is not dependent on the insolvency or likely insolvency of the company. However, the charge must be enforceable at the time of the appointment and contain a power to appoint an administrator or a receiver and the charge or series of charges cover the whole or substantially the whole of the company's property.

The objective of Pt 5.3A of the Act appears in section 435A:

> *"The object of this Part is to provide for the business, property and affairs of an insolvent company to be administered in a way that:*
>
> 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 - result in a better return for the company's creditors and members than would result from an immediate winding up of the company."*

This is virtually the same objective as under the Enterprise Act except that the objective of the Enterprise Act has a different context in that the Enterprise Act initially focuses on the survival of the corporate entity rather than the business. The objective behind a series of legislative measures culminating in the Enterprise Act was the Blair government's desire for the UK to be the enterprise hub of Europe. It was suggested that banks had not supported businesses that were viable and had appointed receivers, in some cases prematurely, who sought to see their appointors paid and nothing else. Enterprise and entrepreneurial flair, it was said, then suffered. Unlike in Australia, utilisation of the UK administration regime had never really become well used in that country. Australian banks have, by and large, supported the VA system in Australia. This might explain why the Australian VA system is reportedly working well (see "The Enterprise Act 2002: Pioneering a brave new world in insolvency law in the United Kingdom?" Prof. Andrew Keay (2003) 11 Insolv LJ 163).

Who Controls the Procedure?

When a company is experiencing financial difficulties, the appointment of an independent, suitably qualified and competent insolvency practitioner, to assume control of the company as its voluntary administrator, has certain advantages for the company and for the directors. In addition to avoiding further liabilities for insolvent trading, the company is independently assessed as to its capacity to continue as a going concern. While the company trades in administration, the directors cease to have any managerial role in the corporation.

The member banks of the ABA would have little confidence in a regime where the directors of an ailing company remain in control as is the case under the US Chapter 11 regime. Australian experience is that the main contributing factor to the failure of most companies is poor management and lack of adequate corporate governance. It is rare that directors who caused or contributed to the financial difficulties of a company have the ability or objectivity to take the necessary remedial action. The added costs of court supervision of the "debtor in possession" administration may lead to the dissipation of assets that might otherwise be available for the creditors. Also, judges in Australian courts are usually reluctant to substitute their own discretion for that of the directors and will not make decisions on commercial issues.

In the matter of Ansett Australia Limited and Mentha [2001] FCA 1439, Goldberg J. cited with approval a passage by Street CJ in *Re Mineral Securities Australia Ltd (in liq)* [1973] 2 NSWLR 207 at 232:

> *"When the court is required to pronounce upon the commercial prudence of a transaction, it enters upon a slippery and uncertain field. Apart from the lawyer's disclaimer of expert qualifications in matters of business prudence, the very process of litigation and the necessary limitations upon the scope of admissible evidence restrict the available material to far less than is necessary for the making of a commercial decision."*

Goldberg J went on to conclude that courts will not pronounce upon the commercial prudence of a particular transaction (*In the matter of Ansett Australia Limited and Mentha* [2001] FCA 1439).

The ABA agrees with the CAMAC observations about directors' potential self interest and the risk that this creates for creditors in the administration of the company. The same risk would exist if the directors were able to appoint a third party to act in their stead.

These are general corporate governance issues and where a company is in serious financial trouble the ABA submits that it would be unsafe to permit the directors to continue to control the affairs of the company directly or indirectly through a non-arms length appointment of a third party.

Leaving directors in charge of the company whilst it is potentially insolvent is not supported by the ABA. It ignores the possible contribution by the directors to the state of affairs of the company that caused it to seek administration protection in the first place and could lead to a worsening of the company's position whilst acting to protect their own self interests .

In Australia the voluntary administrator must be a registered liquidator and certain persons who have had prior dealings with the company (eg officers of the company, auditors etc) are automatically disqualified from acting as administrators. Additionally, the Court, on an application by ASIC or a creditor, has the power to replace an administrator and this provides a sufficient safeguard to address creditors concerns if the administrator is considered to be lacking independence from the company's directors.

Principle 2 – The prospect of a financially distressed company being rehabilitated may be improved if it can be encouraged to enter into discussions with its major creditors as early as possible on how best to rectify its financial position.

The ABA agrees with this statement of principle.

The fundamental question in the rehabilitation of any financially distressed enterprise is for an early assessment to be made of the enterprise's future prospects as to whether it can survive as an economically efficient and viable enterprise.

The ABA submits that this should be a precondition to the prospect of any negotiation with creditors where deferred payment terms with creditors are contemplated. However, if the company is seeking to compromise or reduce debts the ABA submits that the company should submit to a VA rather than administer its own form of administration so as to avoid inequities to creditors.

One critical issue is the position of the secured creditor. The rights of the secured creditor should be preserved as they currently exist under the VA regime (subject to some greater flexibility in time limits) because

a) the secured creditor is likely to be the major financier to the company;

b) the prospects of further financing are more likely from the incumbent financier than a new financier;

c) certainty over the rights of secured creditors may ensure continuity of availability of finance to businesses generally on the same or similar terms and conditions as currently apply in the market;

d) banks, as secured creditors, are likely to be the principal financier to the company being owed the single largest amount by the company and as prudentially supervised institutions have the responsibility to prudently manage their assets in the interests of their depositors and more broadly their shareholders;

e) a weakening of banks' security might:

   i. cause a change in the amount and the terms and conditions on which corporate finance would be made available and affect the flexibility of banks' decision-making with respect to the company,

   ii. be likely to encourage earlier intervention by the financier on the occurrence of an event of default under its charge through the appointment of a receiver before the right of the company to appoint an administrator has arisen,

iii. would be likely to cause the regulator APRA to impose higher capital requirements on banks thereby affecting the cost of finance to the business community, and

iv. be likely to detrimentally affect asset securitisation programs and investors' interests in securitised assets.

Apart from the protection of the rights of the secured creditor, negotiations by a financially distressed company with its unsecured creditors should be based on the principle that insolvency procedures are designed to ensure rateable distribution of property among unsecured creditors in situations where full repayment is unlikely.

Where the financial condition of the company is so bad that the company is either insolvent or likely to become insolvent, the ABA submits that this negotiation should be undertaken by an independent qualified person such as a VA. Left to the company, there could be situations where a company does not negotiate with all creditors transparently or seeks to prefer some creditors over others. To ensure that these negotiations are conducted equitably the ABA submits that these negotiations should be undertaken by an independent qualified person such as a VA.

The objective of the VA procedure is, of course, designed to bring about this result.

Clauses 1.53 to 1.55 of the Discussion Paper suggest that voluntary Chapter 11 proceedings might improve the prospects of a favourable outcome for the company through the combined operation of a freeze on creditors' rights together with "cramdown" rules to bring about a reorganization package. Under the VA process there is no reason why the same result could not be achieved with the support of the greater number of creditors. Making it possible for a secured creditor to enforce its charge over a specific part or parts of the company's property instead of once over all of the property covered by that charge could facilitate this outcome.

Also, it is not absolutely clear under Section 440B whether the written consent of a VA to the chargee enforcing its charge can be given by the VA during the decision period so that the chargee is free to act upon that consent at a later time after the decision period has expired. If the Act were amended to confirm that this flexibility exists this could provide greater reassurance to secured creditors to forestall possible pre-emptive action by enforcing their charges over the company.

The ABA submits that by an appropriate amendment to Section 440B together with an amendment to the Act to enable a chargee to enforce a charge over only part of the property of the company secured by the charge this should increase the prospects of secured creditors participating in the VA.

Encouraging ongoing financing

Principle 3; A company may have a better prospect of successful recovery if it can obtain new loan or equity finance during the rehabilitation period.

The ABA agrees with this principle provided it is applied according to the individual circumstances of each company. The ABA does not accept the principle as a "one size fits all" proposition.

Loan Finance

Under the law as it stands in Australia, it seems that a VA is not personally liable for loan funding obtained during the course of the VA. The Act should be amended to make it clear that as is the case with other goods and services acquired by the VA in the course of the administration, loan funding should attract the personal liability provisions. The VA should have a right of indemnity from the company's unencumbered assets. It is most likely that further funding will come from the existing financier rather than a new financier.

A new funder to the company that is able to rely on a super priority such as under Chapter 11 is likely to approach the funding with a different interest and outcome to the incumbent funder. The incumbent funder has had a prior relationship with the company and an exposure that the incumbent funder will be seeking to extinguish or reduce through the company's recovery. An incoming funder is more likely to be concerned how much money it will provide against the security of its super-priority (and the pricing it will attach to such a facility) rather than how much is needed for the company to trade on.

If it is clear that the VA is personally liable for loan funding this would obviate the more complex arrangements such as under a voluntary Chapter 11 where a post-petition debtor-in-possession financier in a bankruptcy proceeding gains a super priority over an existing pre-petition secured lender. Further. the VA's personal liability with a right of indemnity against the company's assets effectively creates a super priority as the repayment of the loans funds would be a cost in the administration which has the highest priority under the Act. This approach fits well with the structure and application of the existing insolvency provisions of the Act.

The VA, by becoming personally liable for loan funding obtained in the course of the VA, in order to be fully indemnified by the company in respect of this personal liability, must make sure that the borrowings are in the interests of the company and the creditors, the company is able to meet the additional loan funding repayment and that the position of the secured creditor is not adversely affected.

Equity Finance

The ABA supports, in principle, a proposal by which debt could be swapped for equity and for facilitating the ability of a company coming out of a VA under a deed of company arrangement to raise equity. There is nothing under current law that prevents this happening now.

If the proposal is to develop a more defined legislative basis for equity funding a broad consultation with relevant sectors including the banking and finance industry and insolvency professionals would be necessary to develop such as proposal in detail. The ABA would welcome the opportunity to participate.

Timetable for completing the procedure.

Principle 4; the procedural timetable needs to be sufficiently flexible to adjust to the needs of particular companies.

The ABA agrees with this Principle 4.

The ABA's submission dated June 2003 to the Parliamentary Joint Committee on Corporations and Financial Services' (PJC) inquiry into Australia's insolvency laws recommended that;

1. the decision period for a secured creditor to decide whether to enforce its security should be extended to 15 business days;
2. if, during the decision period the administrator forms the intention to seek an extension of time for convening the second meeting of creditors, the administrator must notify secured creditors;
3. the convening period for the first meeting of creditors should be extended for up to seven business days; and
4. it should be made clear in the Act that the court has the power to order an extension of the convening period for the first meeting of creditors.

The ABA made these recommendations in support of its submission that with sufficient flexibility, where necessary under direction of the court, any possible difficulties that might arise in the administration of large and complex enterprises could be dealt with under a VA without the need to import overseas regimes. The ABA believes that the debtor in possession regime under Chapter 11 and the time within which a rehabilitation plan could be developed for a financially distressed company to be accepted by creditors is unduly lengthy.

The VA regime benefits from;-

1. The VA being an independent qualified person having statutory duties under the Act compared with debtor in possession regime under a voluntary Chapter 11 where it is the court that oversees that administration. It is noted, however, that in extraordinary circumstances, such as the Enron Corp. Chapter 11 proceeding, existing management was replaced with an outside consultant who served as interim CEO and Chief Restructuring Officer. In addition, the bankruptcy court appointed an independent examiner. However these appointments added significantly to the costs of the

administration. The issues for companies in VA are predominantly commercial and financial and courts in Australia are not equipped to deal with such issues.

2. The decision by the VA as to whether the company can or cannot trade out of its difficulties to become a viable enterprise being able to be made quickly so as to avoid prolongation if the company is hopelessly insolvent. Importantly, the VA has the ability to propose to creditors a restructure of the company's debts in order to ensure the company can continue as a viable enterprise.

3. The ability of the VA to seek directions from the court.

The recommendations made by the ABA to the PJC would allow sufficient time for the VA to review the financial affairs of a large and complex enterprise with the court protecting the interests of creditors and other parties.

Also, in the ABA's submission to the PJC it was recommended that a deed of company arrangement developed under the VA provisions should contain performance standards or indicators so that creditors can monitor the DOCA and be confident the company is meeting those standards accordingly. There is evidence that this type of provision is now included in DOCAs. This makes directors more accountable to creditors with directors reporting to them at appropriate intervals on the company's performance under the DOCA. Australia could take a lead over its UK and US counterparts in ensuring that there is adequate supervision and accountability of implementation of the rehabilitation under a DOCA.

The ABA refers CAMAC to and repeats its submissions made in the submission to the PJC.

Methods of dealing with corporate groups

Principle 5; the process of rehabilitating a corporate group may be assisted if that group can be dealt with collectively rather than on a company-by-company basis.

Whilst it is the responsibility of the directors of each of the entities within a corporate to determine whether the entity of which they are directors should enter VA, once a VA has been initiated there should be no automatic collective grouping of the entities under VA. The ABA submits the "pooling" of companies in a corporate group is a decision that should be made by the creditors of the relevant companies.

The ABA's comments in dealing with Principle 5 appear later in this submission under "Pooling of assets and deeds of cross-guarantee in corporate groups".

Voluntary Administration

Initiating an Administration

Grounds for appointment

1. The ABA supports retention of the current position under the Act where the directors, chargees and liquidators have the right to decide when to initiate a VA and whether the company's financial condition warrants the appointment of a VA.

2. It is consistent with sound corporate governance principles that the directors who have prevailed over the management of the company and who face personal liability for allowing the company to continue to incur debt whilst insolvent should retain the responsibility to place the company into VA at a time when it is insolvent or likely to become insolvent;

3. The point in time when a company is solvent and insolvent is ultimately a legal judgment but for the avoidance of doubt the responsibility to make this judgment should fall on the directors who are best placed to make that decision;

4. Changing the current test for appointment of a VA to a more speculative test of "a reasonable prospect of insolvency" creates the risk that companies could abuse the test and seek a debt holiday where that is not warranted;

The ABA does not support the automatic initiation of the VA regime to corporate groups. The ABA reiterates that it remains the right of the directors, chargees and liquidators to decide when to initiate a VA. An unsecured creditor should be permitted to vote only on matters that affect the company of which the creditor is a creditor after the company is placed in VA. Otherwise, to do so could discriminate against solvent entities within the group and the creditors of those entities. Also it could create possible conflicts of interest where one VA assumes responsibility for all of the group entities.

Eligibility of a liquidator to be an administrator

The qualifications and standards should be developed by ASIC having regard to competency criteria including experience and educational qualifications.

The ABA does not support the requirement to obtain Court approval of a registered liquidator so acting. This would be unnecessary if the standards for eligibility were introduced and is expensive and time consuming.[Inserted at suggestion of ANZ]

Rights that override a VA

The ABA supports the option for the initial decision period for appointing a receiver by a secured creditor to be extended from 10 to 15 business days for the following reasons:-

1. extending the decision period to 15 business days would give a secured creditor greater insight into the likely course of the VA and this could benefit the company;

2. secured creditors rights are created by contract between the creditor and the company and should not be diluted without taking account of the consequences;

3. the secured creditor (usually the major funder to the company) is likely to be the largest creditor and should be free to determine when to enforce security and the timing of the ultimate realisation of the secured assets in order to manage its exposure risk;

4. the Act contains the requirement for the receiver who is realising secured assets to realise those assets at not less than their market value or otherwise the best price that is reasonable obtainable in the circumstances which means there is no detriment to creditors generally.

The suggestion in paragraph 2.55 of the discussion paper of possibly requiring a receiver to postpone a sale of secured assets in the interests of unsecured creditors is not supported by the ABA. It would introduce a speculative element over the future realisable value of the assets and the state of the market, require the court to make a business judgment and would increase the costs and duration of the receivership to the possible disadvantage of creditors generally.

Partial exercise of secured creditor's rights

In the interests of the company, the VA and the secured creditor itself, the law should be amended to allow a secured creditor that holds a substantial charge (as defined in the Discussion paper) to be able to enforce that charge against some or all of the property covered by the charge for the reasons set out in Paragraph 2.59 of the Discussion Paper. If the secured creditor is in doubt over whether or not to enforce the charge because the charge must be enforced in toto, there is the risk that without the flexibility to enforce the charge as to part of the secured property the secured creditor will enforce the charge for the avoidance of doubt.

Timing Issues

The ABA submits that in the interests of providing flexibility to the VA:-

1. The decision period should be extended to 15 business days;

2. The period for convening the first meeting should be extended to seven business days;

3. The period for convening the second meeting be retained

with the court being given an express power to alter current time limits as much as is justifiable.

In this way the VA regime would be more even more readily adaptable to handle both large and small, complex and relatively straightforward VA's.

The ABA believes that this power, (which apart from the time from convening the first meeting) which is already exercisable by the court ensures that all interests in the VA are adequately taken in to account in deciding whether the relevant period should be extended.

The ABA does not support the proposal in Clause 2.74 for the creditors to be able to determine the convening period for the second meeting at the first meeting. This is because it is difficult for creditors to get a clear picture of the company's plight due to the lack of adequate information about the company.

The attraction of the VA is it can be completed in a relatively short period of time once there is sufficient information available about the company and its prospects. The current law allows flexibility to extend the convening period for the second meeting by an application to the court. This works for both large and small enterprises and keeps the VA accountable for his/her actions. The risk in ceding power to the creditors at the first meeting to determine the time for convening the second meeting is that the VA may continue longer than is necessary simply because the decision by the creditors was made without important information about the company being available.

Also, the VA has expertise in running a VA and the VA's judgment about the administration's likely course is an important element to retain.

The ABA supports the proposal that at the first meeting, creditors having a majority in value and number should be able to resolve to have the company wound up, end the VA with the company being returned to the control of the directors or for the company to propose a DOCA for the reasons stated in Paragraph 2.75 of the Discussion paper provided there is sufficient information available to the creditors upon which to base a reasonable decision.

Notifying pre-commencement creditors

The ABA supports the VA having power to utilize the commerce facilities such as websites and hotlines as an alternative delivery of information to creditors.

Evidence available in the Ansett administration indicated a substantial amount of money involved in notifying all creditors personally where more efficient ecommerce delivery would result in a potentially better return for creditors.

Utilisation of ecommerce facilities by advertisement could be available, for example, where the creditors to be notified exceed a specified number.

Lending to a company under Administration

The ABA supports augmenting the existing VA regime to provide that a VA is automatically personally liable to repay money lent to the company during the administration period in the same way as the VA is personally liable for goods, services and property acquired in the course of the administration. The administrator should have a right of indemnity against the unencumbered assets of the company.

The VA replaces the existing management of the company. If the VA is held personally liable for the amount borrowed this will contribute to prudent and sound decision making of behalf of VA's. The ABA sees this more as a corporate governance issue because the objective should be to ensure that sufficient monies as are needed for the company's operations is at the basis of the VA's decision to borrow and that the company will be able to repay those monies.

By making a VA personally liable and clarifying the VA's right of indemnification will ensure that the VA is encouraged to make prudent and sound decisions concerning the company's funding arrangements.

Voting

Consistent with the purposes of the VA which are to:-

a) maximize the chances of the company's continuing to be in existence, or

b) otherwise produce a better return for the company's creditors by avoiding an immediate winding up of the company –

the ABA submits that voting based on a majority by value should predominate.

This means that the ABA does not support retention of the administrator's casting vote unless that power is confined to a casting vote in support of creditors that have a majority in value and where it is clear that related parties of directors claiming as creditors are voting as directed by the directors.

Of the suggested options in paragraph 2.111, the ABA supports the first option where the priority is given to the majority by value thereby making voting by number irrelevant.

Remuneration of Administrator

For a VA to remain flexible, the ABA supports any change to the law which would enable a meeting of creditors or a committee of creditors, held at any time to fix or agree on the VA's remuneration.

Advanced notice that the VA's remuneration is to be considered at the meeting would be necessary.

The ABA supports the court continuing to have a supervisory or review role in connection with a VA's remuneration.

Administrators' Indemnity Rights

The ABA supports the VA being held accountable for his or her actions.

The VA replaces the management of the company and the VA's right of indemnification should be confined to the available assets of the company should the indemnity continue to apply.

The fact that assets are secured and the actions of a receiver might reduce the available assets to which the right of indemnification might apply is an important reminder to a VA about liabilities that a VA might wish to incur on behalf of the company. The VA should be exercising sound and prudent business judgment.

Voiding Antecedent Transactions

The ABA does not support the ability of VAs and deed administrators to recover antecedent transactions in the same way as liquidators can.

There could be unintended consequences and inequities if this power is made available. Whilst there might be cases where the existence of this power is useful, the ABA believes that further consideration of the proposal is required. For example, if the company emerges as a viable entity from the VA the question arises whether the nature of the company's revived existence warrants, on policy grounds, some antecedent transactions being overturned.

It is noted that the period of a VA may be relatively too short for an antecedent transaction claim to be litigated through the court and the period of the VA might have to be extended to the overall disadvantage of the creditors and the company.

Disclosure to the creditors by the VA of the existence of potentially voidable transactions is an important element in arming creditors with relevant information upon which to base their decisions.

By empowering a deed administrator to pursue these antecedent transactions and, if the company is placed in liquidation following the VA, the liquidator is able pursue these transactions, the ABA notes that the operative date for challenging the transactions will extend back from the date of the appointment of the VA.

Where a DOCA continues for an extended period and the company despite the DOCA goes into liquidation, the ABA suggests that provision should be made under the Act to extend the period for the liquidator to go back to claim pre-VA voidable transactions.

Equity for Debt Swaps

The ABA supports an approach which balances time and costs of putting together a revival plan for a company under VA and the need to protect creditors who are to become investors by providing them with important information needs.

The ABA submits that these matters should be the subject of detailed discussions between insolvency practitioners, ASIC and the Commonwealth government in order to arrive at a workable model.

Ambit of the Court's Power to Give Directions

The ABA submits that there is no reason to augment the court's powers in this respect as a close reading of the decisions of Goldberg J mentioned in Paragraphs 2.163 and 2.164 of the discussion paper indicates that there will be circumstances where a court will approve the business decision of a VA where there is an issue calling for the exercise of legal judgment.

The ABA supports the principle that VA's should accept responsibility for business decisions in the same way as the management of the company is required to do so. VAs are officers of the company and are subject to the same duties as officers are subject under the Act.

If the Court became the ultimate determinate of a VA's business judgment, this could create a trend where VA's delegate their business judgment to the court, which the ABA submits would be undesirable. There would also be adverse time and costs consequences.

Set-Off

The ABA agrees with the proposition in Paragraph 2.172. of the discussion paper that set-off rights are already an established exception to the equality principle in a winding up.

The ABA supports the VA obtaining access to information gathered by regulators provided that the right of access is limited to a proceeding contemplated by the VA in good faith or to assist the VA in complying with an obligation to investigate and report on the affairs of a company.

Pooling of Assets and Deeds of Cross-Guarantee in Corporate Groups

The VA is an administration primarily directed to an assessment and plan for the rehabilitation of the company through a DOCA. This could apply on a group basis. This should not alter creditors' rights against a particular entity unless those creditors agree. Creditors that have contracted with an entity should have the right to recover from that entity's assets. Those creditors might have assessed that entity as credit worthy at the time the contract was made. If there were to be a change to the creditor's right of recourse to that entity or to the assets available to meet the creditors claim because of pooling of claims and assets of other entities of the group the creditors should receive to full information about the pooling proposal and a right to vote on the proposal.

Ultimately, the court would be available to settle contested allocations of liabilities and cross claims within the group.

The ABA has considered CAMAC's earlier report and recommendations in its Corporate Groups Report of May 2000 and notes that the relevant recommendation 20 has not been taken up by the government.

The court has previously approved of joint meetings of creditors of related companies where creditors have unanimously agreed provided creditors confine their voting only to matter affecting the company/ies of which they are creditors.

The ABA believes that there is no present need to extend the Act to these cases and that court approval or the unanimous approval of creditors to a joint administration of related entities (and/or pooling of assets and liabilities) strikes an appropriate balance between the interests of creditors and the need to ensure a VA proceeds efficiently and effectively.

The ABA has not sighted the Ferrier Hodgson submission and believes that the complexity of the issues in jointly administering a group of companies as a single VA where there are deeds of cross guarantee in place warrants greater consideration. If necessary this should be the subject of a separate inquiry.

Ipso Facto Clauses

The ABA supports the recognition of ipso facto Clauses as a "trigger" for enforcement action under a security. In fact, the Act, in recognizing under a VA that a secured creditor may take enforcement action under a security within the decision period acknowledges that such ipso facto clauses may be contained in security documentation.

Also, the Act currently provides for a VA to consent to the enforcement of a creditor's security but again, the contractual right to enforce the security must arise from the terms and conditions of the security not simply the administrator's consent.

To restrict a creditor's right to rely upon an ipso facto clause is an interference with freedom of contract and is not supported by the ABA.

Assigning or Terminating Executory Contracts

The ABA does not support the power of a VA to assign or terminate a company's executory contracts other than in accordance with the terms and conditions of the contract or the consent of the contractual counterparty.

The role of the VA is different to that of a liquidator whose obligation is to wind up the company, cease its business and end its future obligations. The purpose of the VA is to determine whether the company can be re-established and if this entails variations to contractual rights and obligations, they must be negotiated rather than arbitrarily varied, assigned or terminated inconsistently with the terms of the contract.

Although not raised in the discussion paper, it is important that the VA retains the ability under the Act not to adopt contracts so as to become personally liable under those contracts. Uncommercial contracts can adversely impact the ability of the business to survive (eg supply contract at uncommercial rates). Clearly if aspects of an uncommercial contract are required by the company then these would need to be negotiated fresh by the VA. Contracting parties' remedies for breaches of such contracts are damages that may be provable in any subsequent DOCA or liquidation.

Deed Compliance with Priority Payment

The ABA supports providing additional flexibility so that creditors can approve deeds of company arrangement that depart from winding up priorities.

Aggrieved creditors should be able to seek a review by the court.

Employee Entitlements

The ABA makes no submission to CAMAC on this matter and refers CAMAC to the ABA's submission to the Parliamentary Joint Committee on financial services and security.

Solvency under the Deed

If imposing a solvency prerequisite for a deed of company arrangement to be valid would be to reduce the incidence of phoenix companies, the ABA would support this.

Effectively, though, a company that enters into a DOCA must be solvent in order to meet its revised obligations under the DOCA to pre-VA creditors. If the company cannot meets its DOCA obligations the deed administrator would call a meeting of creditors to terminate the DOCA and place the company into liquidation.

If the company continues to trade under the DOCA and incurs debts that it is unable to pay as they fall due the company would be insolvent and liable to be wound up or again placed under VA. The deed administrator would call a meeting of creditors to determine the fate of the DOCA. (See Brash's case)

Corporate Government Issues

The ABA supports the following measures:

a) a company's financial reporting requirements should be suspended during the period of the VA.

b) The VA should be given a discretion whether to hold an annual general meeting where in the VA's opinion there is no remaining shareholder value.

c) Because the VA is simply an interim step and does not permanently replace the role and authority of the company's directors, retention of the minimum number of directors rule should be retained as directors will be required to run the company if a DOCA is in operation.

d) If a VA seeks to change the name of the company in the interests of the administration the requirement for shareholder approval should be retained as the prospect of the company continuing would be expected to be highly probable.

e) Where an executed deed of company arrangement is inconsistent with a company's constitution, the ABA does not support the view that the deed provision should automatically prevail. For example, if the deed were to alter the specified purposes and powers of the company within the company's constitution this would be a substantive change to the shareholders' contract with the company in which the shareholders have a legitimate interest.

Administrative Issues

The ABA makes the following points:

a) It is unnecessary to distinguish between a large and complex administration and other administrations. The ABA queries the justification for proposing a doubling of the time limit from 24 to 48 hours;

b) Creditors should remain entitled to participate in the committee of creditors whether they are large or small creditors as their interests are the same i.e. they are creditors of the company. It is noted that in the U.S., only unsecured creditors are represented on the creditors' committee in a bankruptcy proceeding. Participation of secured creditors in a creditors' committee in a VA may help to retain a secured creditor's participation in the VA.

c) The ABA agrees that it should be made clear that a company through its duly appointed representative may be a member of the committee of creditors.

Other Issues

The ABA has no comments on the matters raised unde this heading.

Creditors' Scheme of Arrangements

The ABA has no substantive comments to make on the matters raised in this chapter.

Concluding Comments

The experience of ABA's members indicates that the VA regime in Australia is working effectively but there is room for improvement as has been indicated in this submission.

Regimes in operation overseas such as Chapter 11 in the United States and the Enterprise Act in the UK are, in general, responses to failed or failing companies that suit those local conditions and are not an improvement on the VA regime currently in place in Australia.

Statistics which are gathered by ASIC indicate an increased use of VA's in Australia since their inception in 1993. Unfortunately ASIC does not gather sufficiently detailed statistics to give a clearer picture of the success of VAs in meeting the objectives of the legislation. For example there does not appear to be sufficient statistics to show whether VAs actually assists the revival of many companies and so avoid the company's liquidation. The ABA submits that without this type of evidence substantive alteration of Australia's insolvency laws would be unwise.

The ABA believes that there is an opportunity in the current review of Australia's insolvency regime for ASIC to gather more specific detail on the operation of VA's in Australia and in particular their outcomes in averting what otherwise would be almost certain liquidation for those entities.

The ABA is appreciative of the opportunity to respond to CAMAC's discussion paper and commends CAMAC on the high quality of the research and the manner in which the issues have been presented for consideration.

The ABA would appreciate the opportunity to meet with CAMAC at its convenience to discuss any issue in the submission and to act as a sounding board in the development of the options paper which is to be released in or about the first quarter of 2004.

Ian Gilbert

20 February, 2004