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Dear Mr Kluver

Rehabilitating large and complex enterprises in financial difficulty – Discussion Paper

We refer to your request for submissions on the issues raised in the Corporations and Markets Advisory Committee's ("CAMAC") Discussion Paper on Rehabilitating large and complex enterprises in financial difficulty ("the Discussion Paper"). We appreciate this opportunity.

For ease of reference, we have included the headings, subheadings and paragraph numbering from the Discussion Paper.

Introduction

There has been a considerable amount of discussion as the lack of flexibility provided by the current legal regime to deal with large and complex restructurings of companies in financial difficulty. Members of CAMAC would be aware that there have been numerous restructurings of large and complex corporates in recent times that have been implemented by directors under the watchful eye of well resourced credit management executives of major banking syndicates with the assistance and guidance of experienced insolvency practitioners. These restructurings can and have been affected through cooperation and trust between the Directors, the Banks and their advisors. When that trust in particular is lost or tarnished, there is a need to remove legal control of the process from Directors. Only then does a formal appointment such as Voluntary Administration normally commence.

The IPAA believes the current legal framework, with minor amendments, provides an acceptable balance between informal restructurings and formal appointments.

Prior to responding to the issues raised in the Discussion Paper, the IPAA would like to clarify its general position in relation to Voluntary Administrations and the need for a Chapter 11 type arrangement in Australia. As stated in our submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Australia's Insolvency Laws:

> "IPAA members who have conducted large administrations have advised, that with the assistance of the Court, the Voluntary Administration process can be used effectively to restructure large enterprises.

Any amendments that leave an ailing enterprise under the control of its directors and does not provide a mechanism to allow ongoing trading under "creditor control" will not be effective, and we expect would not be supported by financial institutions.

As such, the IPAA is not convinced that wholesale changes are required to Part 5.3A or that a new regime is required in order to effectively restructure large enterprises.

It is the IPAA's opinion, that with amendments to the Corporations Act previously detailed in other forums and in this submission, Part 5.3A provides an effective mechanism for dealing with the restructuring of large enterprises."[1]

The IPAA continues to stand by that position.

Chapter 1 – Principles for effective corporate rehabilitation

Whether each of the general principles identified in this chapter is appropriate for assessing the suitability of any rehabilitation procedure for these enterprises?

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

The IPAA generally agrees that this principle is appropriate for assessing the suitability of any rehabilitation procedure.

1.6 *Prerequisites for initiating the procedure*

The IPAA prefers a financial stress test similar to that in place now. However, at 2.28 of the Discussion Paper it was proposed that companies be able to appoint a Voluntary Administrator where there is a "reasonable prospect of insolvency". The IPAA agreed with this proposal (refer below). However, in order to protect directors who choose to appoint a Voluntary Administrator on the grounds that there is a "reasonable prospect of insolvency" or that the company is "likely to become insolvent at some future time"[2] elements of "good faith" should apply. For example, where directors place a company into administration in good faith, genuinely believing that the company is likely to become insolvent at some future time, then the appointment should not be able to be challenged.

1.15 *Who controls the procedure*

1.17 External insolvency practitioner

The IPAA believes that the rehabilitation of a financially distressed company needs to be controlled by an independent and suitably experienced, qualified and licensed/registered third party.

[1] Point 1 of the IPAA's submission to Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Australia's Insolvency Laws dated 30 April 2003.
[2] Section 436A of the Corporations Act

At this point in time, the most obvious persons to control the rehabilitation of companies are insolvency practitioners as they are independent, experienced, qualified, adequately resourced and registered. However, this is not to say that the field could not be widened if steps were taken to put in place a system for the identification and registration of suitably experienced, qualified and resourced restructuring professionals. It is important that the stakeholders in the restructuring process have faith in the party appointed to control the restructuring and it is more likely that third party stakeholders will have faith in an independent, appropriately qualified professional.

It should be made clear that the IPAA is not trying to limit insolvency and restructuring work to the domain of accountants, however, if the field is to be widened a set of criteria for registration needs to be established and monitored. The IPAA has already been working with ASIC to facilitate changes to the system for the registration of Liquidators (see 2.35 below).

1.20 The board

The IPAA does not agree with a system where the board retains control of the company. We disagree with the argument that removal of the board results in a loss of knowledge of the business as it is usual, in large companies particularly, for the board and management to be separate and thus loss of the board does not mean loss of management expertise.

1.25 Anyone chosen by the board

Directors can currently chose who to appoint in a Voluntary Administration. Obviously that choice is limited to registered Liquidators, however, we refer to our comments above regarding the need to ensure that only independent and appropriately qualified professionals are allowed to be appointed to these companies.

1.26 Anyone chosen by the creditors

In a Voluntary Administration, creditors have the option to replace the Voluntary Administrator with another registered Liquidator at the first meeting of creditors.

1.27 Regulation of persons other than insolvency practitioners

Refer to our comments above.

1.29 Role of the Court

It is the IPAA's opinion that Australia has the right balance in relation to the role of the Court in the restructuring process. Schemes of Arrangement are available if an insolvency administration with greater Court involvement is required (for further comments refer to Chapter 3 below).

1.32 Creditors' committees

The IPAA believes that Committees of Creditors could play a more useful role in Voluntary Administrations by being able to pass resolutions – particularly in the administrations of large enterprises where the major meeting may be postponed or adjourned for a considerable period of time.

Refer also 2.112 below for a discussion of the Committee of Creditors power to approve an administrator's remuneration.

1.35 Personal liability of directors for insolvent trading

The IPAA disagrees with the proposal that directors remain in control of a company during the restructuring procedure, however, if it was to be the case, directors should attract the same personal liability that a Voluntary Administrator currently does.

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 IPAA agrees that this principle is appropriate for assessing the suitability of any rehabilitation procedure. The real difficulty relates to implementation. Admissions of insolvency or an inability to perform a long term onerous contract may empower creditors to commence proceedings against the company. Moreover if acquisition of debt at a discount occurs prior to a formal arrangement, it can lead to arguments of improper discrimination against non participating creditors who may be bound by a formal arrangement, but also creates a related party debt issue for the purposes of voting.

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 IPAA believes that, in the right circumstances, this principle may be correct. However, it would not apply generally to all companies. For further discussion on lending to companies in administration refer to 2.82 below.

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

The IPAA agrees that this principle is appropriate for assessing the suitability of any rehabilitation procedure.

However, the IPAA believes that Voluntary Administrations, with the ability for administrators to obtain extensions of time by application to Court, are sufficiently flexible to adjust to the needs of particular companies.

The IPAA agrees with the arguments put forward in paragraph 1.67 of the discussion paper supporting the Court approval process for extensions in Voluntary Administrations. The IPAA also supports the idea of creditors being able to extend the convening period at the first meeting of creditors (refer 2.74 below for further discussion on this point).

The IPAA does not consider that an implementation timeframe, such as that imposed in the UK legislation, is appropriate. Creditors, when voting for a Deed of Company Arrangement (or any restructuring plan) should have the option of approving any timeframe set down by the proposed Deed (or restructuring plan).

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.

The IPAA agrees that this principle is appropriate for assessing the suitability of any rehabilitation procedure.

Refer also 2.176 below for further discussion on corporate groups.

Whether any other general principles are relevant to this assessment?

The IPAA has no suggestions to make in this regard.

Whether, in light of the analysis of the principles in this chapter, all or some features of Chapter 11 of the United States Bankruptcy Code should be adopted in Australia for these enterprises and, if so, whether they should replace VA, be incorporated into VA to form a hybrid of the two procedures, or be an alternative to VA?

Consistent with our position outlined in the introduction to this submission, we do not believe that a Chapter 11 type arrangement is needed to replace Voluntary Administrations or to act as an alternative to them. However, we do believe that some aspects of Chapter 11, though not in the exact form, could be incorporated to enhance the operation of the Voluntary Administration regime:

- Committees of creditors - the powers of committees of creditors should be increased but not to the extent of committees in the US (refer 1.32 above and 2.112 below);
- Ability of creditors to enforce ipso facto clauses – The other party to a contract (other than a charge) should be unable to terminate or modify contract without the written permission of the administrator or the Court. If the Administrator chooses to continue with the contact, he or she should be liable to pay for that portion of the contract where benefit is obtained during the term of the Voluntary Administration (refer 2.191 below for further discussion on this point).
- Ability of creditors to exercise set-off rights – The exercise of set-off rights should be limited to pre-appointment funds. Post appointment receipts should be excluded (refer 2.168 below).
- Loan financing during rehabilitation procedure – Refer to 2.82 for a full discussion on this point.

The IPAA believes that the desire being expressed from some quarters for the introduction of a Chapter 11 type arrangement in Australia may well be as a result of a perception problem with Part 5.3A that does not exist in relation to Chapter 11. It may be that a "re-branding" of Part 5.3A would resolve this issue.

Whether, in light of the analysis of the principles in this chapter, any features of the UK legislation should be adopted for these enterprises?

It is the IPAA's opinion that the factors that drove the recent changes in the UK in relation to the rights of secured creditors to appoint a Receiver when an administrator is acting are not applicable to Australia at this point in time.

Secured creditors are generally supportive of the Voluntary Administration regime and will usually refrain from appointing a Receiver over a Voluntary Administrator, unless there are good reasons. For example, where they:

- have insufficient security; and / or
- are not happy with the company's choice of Voluntary Administrator; and / or
- do not agree with the decisions being taken by the Voluntary Administrator.

These issues are usually overcome by consultation with the secured creditor prior to the appointment and ongoing communication with the secured creditor throughout the administration.

The process also has the added benefit for secured creditors in that they do not have to offer an indemnity to the insolvency practitioner, as occurs when they appoint a Receiver.

For further discussion on the issue of secured creditors rights in Voluntary Administrations, please refer to 2.39 below.

Any other matter concerning the rehabilitation of large and complex enterprises that is relevant to this chapter?

The IPAA believes that the flexibility of the Voluntary Administration regime and the wide ranging powers available to the Courts, if Court involvement is required, make Voluntary Administrations an appropriate restructuring procedure for enterprises ranging from the largest listed company to a small private family company.

It is our opinion that a specific separate restructuring protocol for large enterprises is not required.

Chapter 2 – Voluntary Administration

2.19 Initiating an administration

2.25 Grounds for appointment

2.25 Policy option: Prohibit appointment by directors when the company is insolvent

The IPAA disagrees with the suggestion that directors of an already insolvent company should not be permitted to appoint an administrator for the following reasons:

- Once a company is insolvent, is it proposed that Liquidation be the only option available to directors? This would mean that the only path to Voluntary Administration and a Deed of Company Arrangement would be for the Liquidator to appoint the Voluntary Administrator, thus introducing a time consuming intermediate step with no apparent benefit.
- The difficulty in judging whether a company is insolvent or just approaching insolvency;
- What will be the consequences if directors appoint an administrator in the belief that the company is "likely to become insolvent at some future time", but subsequent to appointment the administrator determines that the company is really insolvent;

- It is possible for companies which are insolvent to offer Deeds of Company Arrangements to creditors which result in a better return for creditors than Liquidation. The IPAA believes that creditors should be given the opportunity to consider such options themselves;
- Currently where directors are issued with Director Penalty Notices by the ATO under section 222AOE of the Income Tax Assessment Act, if the directors wish to place the company into some form of external administration, the only form of external administration which can be commenced within the timeframe set by the 222AOE Notice is Voluntary Administration. If Voluntary Administrations are removed as an option for insolvent companies, what will directors in this situation do?

2.28 *Policy option: Permit appointment where there is "a reasonable prospect of insolvency"*

The IPAA agrees with this suggestion.

2.29 *Policy option: Permit appointment when a solvent company is in financial difficulty*

The IPAA does not agree with this suggestion. The entire premise of Part 5.3A is that the Company is or likely to become insolvent. The suggestion does not explain how the checks and balances implicit in the Part might then operate, if the Company is solvent. Why, for example, should the future of a solvent company be placed solely in the hands of a meeting of creditors?

Furthermore, we do not believe that such an amendment is necessary if the suggestion in the previous policy option is implemented, as arguably a company in serious financial difficulty has a reasonable prospect of insolvency without some form of intervention.

2.31 *Policy option: Application to corporate groups*

The IPAA agrees with this suggestion. However, it is important to ensure that the group position as a whole must be the trigger for the placing of the whole group into Voluntary Administration. Furthermore, if the group wishes to rely on this mechanism, the whole group must be placed into Voluntary Administration and not just a selection of insolvent and solvent members of the group.

2.33 ***Who should be entitled to appoint***

The IPAA disagrees with the suggestion that individual creditors should be entitled to apply to the Court for an order appointing an administrator for the following reasons:

- How is any one creditor to judge whether it is in the interests of all creditors for the company to be placed into Voluntary Administration, with the cost of meetings etc, especially where potentially the creditor could apply to the Court when there is only a reasonable prospect that the company is insolvent.
- In practise the proposal could be open to abuse in the following ways:
  - the Court application could be made by related party creditors, even though they have no board control; and
  - it could be used as a takeover mechanism which could fundamentally erode the goodwill of a business at the expense of shareholders and for the benefit of a predator;

- The VA process is dependent upon at least the initial co-operation of directors. An appointment without the directors' consent appears to change the nature of the VA process.

- Creditors already have the right to seek the appointment of a Provisional Liquidator and the Liquidator would be better placed to determine whether a VA is appropriate.

- Creditors are rarely likely to have sufficient information to realistically determine if a VA should be appointed by the Court.

2.35 Eligibility of a Liquidator to be an administrator

The IPAA does not support the restriction on the eligibility of a Liquidator to be an administrator of a large and complex enterprise as it is the IPAA's opinion that the market ensures that only appropriate Liquidators are appointed to such types of companies.

However, the IPAA has been lobbying for changes to the current class system of Liquidators. It is the IPAA's opinion that:

- There should be a single class of Liquidator, rather than the current registered and official status;
- The criteria for registration as a Liquidator or to continue registration as a Liquidator should be strengthened and should include the following categories:
  - Education (initial – IPAA Insolvency Education Program or equivalent – and continuing);
  - Skills;
  - Resources;
  - Membership of an appropriate professional body; and
  - Experience (initial and continuing).
- Any person that meets the criteria should be able to be registered as a Liquidator;
- ASIC needs to have a process in place to monitor Liquidators to ensure that they continue to meet the criteria;
- If a Liquidator no longer meets the criteria, their registration should be cancelled.

The IPAA believe that the above steps will ensure that all Liquidators meet the high standards expected by the public for a person in this position.

The IPAA does not agree with the proposal to require the Court to approve a registered Liquidator so acting. The Voluntary Administration process is one where involvement of the Courts is the exception, not the norm and the IPAA would not like to see this change. Furthermore, the IPAA believes that the Courts involvement at this point in time is unnecessary as there is review of the appointment by creditors at the first meeting.

2.39 Rights that override a VA

2.52 Policy option: Reducing the rights of secured creditors

A general point in relation to this issue is the acceptance by secured creditors of the Voluntary Administration process. The IPAA queries whether there are any statistics on the number of appointments of Receivers / Receivers and Managers to companies in Voluntary Administration. Such statistics could indicate the level of acceptance by secured creditors and whether substantial change is required to the current process. For example, if the statistics show that the level of intervention by secured creditors is high, then changes to the law might be warranted so that Voluntary Administrators are given an opportunity to save the company. However, if the reverse is the case, change may be unnecessary.

It is the IPAA's view that secured creditors are generally supportive of the Voluntary Administration regime and will usually refrain from appointing a Receiver over a Voluntary Administrator, unless there are good reasons.
None the less, even if a Receiver is appointed over a Voluntary Administrator, if a company can be saved, it should be able to be saved even with the appointment of a Receiver and Administrator.

2.53 Policy option: Amending the rights of secured creditors

The IPAA believes that the current position under the Corporations Act provides a sensible balance between allowing a secured creditor a reasonable period to appoint a Receiver and once that time passes, the VA is free to progress the administration without lingering concerns that a Receiver will be appointed over the top.

The IPAA does not agree with the final suggestion of postponement of the sale of the secured assets if that would benefit unsecured creditors. The IPAA is concerned as to who would be responsible if the market for the assets fell during the period that the sale was postponed?

2.56 Partial exercise of secured creditors' rights

The IPAA does not agree with the suggestion that a secured creditor that has a charge over all or substantially all of the property of a company should be able to exercise its rights over only some of the company's property. The IPAA believes that, in addition to the counter arguments raised in the discussion paper, this will result in increased costs for the company.

2.70 Timing issues

2.70 Policy option: Extend current time limits

Regarding timeframes for the first and major meetings of creditors, the IPAA supports the extensions to the timeframes as recommended in CAMAC's report on Corporate Voluntary Administrations.

The IPAA does not agree with a general extension of the timeframe for personal liability for rented property. If an Administrator requires further time, he/she is able to apply to the Court for an extension. It would be unfair to owners and lessors if a general extension was granted.

2.73 Policy option: Give the Court an express power to alter current time limits

The IPAA does not see the need for this amendment, given the Court's powers under section 447A.

2.74 *Policy option: Give creditors at the first meeting the power to extend the convening period*

The IPAA supports this suggestion as it was one of the recommendations made by the IPAA in its submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Australia's Insolvency Laws.

However, the IPAA suggests that the maximum extension that can be granted by creditors, whether by an extension given at the first meeting or an adjournment of the major meeting or a combination thereof, should be limited to 60 days. If an administrator requires more time than that, an application to the Court would be required.

The IPAA further suggests that the legislation in respect of adjournment of the major meeting should be changed to provide that the meeting may be adjourned for up to 60 days, rather than the current "cannot be adjourned to a day that is more than 60 days after the first day that the meeting is held"[3]. It is our opinion that the current law requires adjournment to a particular day, whereas our suggested change would give the administrator greater flexibility in that he or she would have a period within which the meeting must be reconvened.

2.75 *Policy option: Consequence of extending the time limits*

The IPAA supports this suggestion as it was one of the recommendations made by the IPAA in its submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Australia's Insolvency Laws:

> "The IPAA proposes the following solution – that the Voluntary Administration legislation be amended so that, with the Administrator's consent, creditors can resolve to place a company into Liquidation at the first meeting of creditors. If creditors resolve to place the company into Liquidation, they should also have the power to choose their own Liquidator.
>
> The proposal put forward by the IPAA will result in:
>
> - A fast and efficient commencement to a form of external administration [being Creditors' Voluntary Liquidation];
> - A viable choice for directors when they are served with a Section 222AOE Notice from the Australian Taxation Office;
> - Avoidance of the cost of holding two meetings as is currently happening – possibly resulting in a better return to creditors;
> - Not having to wait until the second meeting of creditors in a Voluntary Administration to place the company into Liquidation when it is obvious to the Administrator that Liquidation is the only alternative."[4]

2.77 Notifying pre-commencement creditors

The IPAA believes that the legislation should be amended to provide when administrators may use websites and hotlines rather than physical delivery, to provide relevant information to creditors.

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[3] Section 439B(2) pf the Corporations Act

[4] Point 10 of the IPAA's submission to Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Australia's Insolvency Laws dated 30 April 2003.

The IPAA included a recommendation to this effect in its submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Australia's Insolvency Laws:

> "Issuing reports and other notifications to creditors incurs a significant cost in insolvency administrations, particularly in relation to large companies or corporate groups. The cost of this reporting reduces the pool of funds available to meet creditor claims. It is the IPAA's opinion that there are other options available other than printing and posting reports to creditors.
>
> Over recent years there has been a significant increase in the availability of technology. It is the IPAA's opinion that this technology could be better utilised to communicate with creditors, particularly on large insolvency administrations, and thus save costs.
>
> It is the IPAA's opinion that a large proportion of creditors in insolvency administrations have e-mail accounts and communication with creditors via this means should be allowed as an alternative to issuing notices/reports by post.
>
> Accordingly, the IPAA proposes that the Corporations Act and Corporations Regulations be amended to provide alternative means of communicating with creditors and members for all forms of insolvency administrations. It would then be the insolvency practitioner's decision as to what is the most efficient and cost effective method to be used on a case by case basis."[5]

2.82 Lending to a company under Administration

The IPAA believes that the law in relation to lending to a company under administration needs to be clarified.

2.100 Policy option A: Personal liability of the administrator to the lender

The IPAA believes that the administrator should be personally liable, unless exempted by agreement between the lender and the administrator. We see no difference in the relationship between the administrator and suppliers of goods and services, and the administrator and suppliers of finance. As such, we believe that the personal liability that currently applies for the purchase of goods and services should apply to the "purchase" of finance – unless agreement otherwise is reached with the lender.

Policy option B: Indemnification rights of the administrator if personal liability applies

The IPAA believes that the indemnity rights of the administrator should be the same as for indemnification rights regarding services, goods or property.

Policy option C: The relative position of the lender vis-à-vis the other creditors

It is the IPAA's opinion that a post-appointment lender should have the same priority over other unsecured creditors as for services, goods or property supplied to the administrator. Of course, security can be granted by the administrator over assets that are not already secured or assets which are purchased with the funds provided by the lender.

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[5] Point 7 of the IPAA's submission to Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Australia's Insolvency Laws dated 30 April 2003.

2.101 Voting

The IPAA believes that the voting requirement of majority by number of creditors as well as majority by value be retained.

It is the IPAA's opinion that administrators' should retain their casting vote, however, in our submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Australia's Insolvency Laws, we recommended that administrators not be entitled to use their casting vote in a resolution in which he or she has a direct interest (for example: resolutions regarding his/her removal, resolutions regarding his/her fees). The casting vote could still be used in a resolution regarding the future of the company (for example: to accept a Deed of Company Arrangement or to place the company into Liquidation).[6]

The IPAA recognises the arguments put forward in the Discussion Paper, however, in the interests of maintaining both real independence and the appearance of independence, the IPAA is of the opinion that administrators should not use their casting vote in resolutions in which he or she has a direct interest.

In instances where a resolution fails due to the administrator not exercising his or her casting vote, either the administrator or a creditor should have the power to appear before the Court to request the Court resolve the deadlock. In the two instances referred to above (removal and remuneration), we see that creditors may seek the Courts intervention in the situation where some creditors are seeking the removal of the administrator (and this has already been the topic of many Court cases where a casting vote was used to defeat the resolution [7]) and that Administrators may look to the Courts in relation to remuneration issues (which they already have the power to do pursuant to section 449E(1)(b)).

The IPAA agrees with the suggestion in the Discussion Paper that where an administrator uses the casting vote, he or she should be required to give reasons for the manner in which a casting vote was exercised.

2.112 Remuneration of administrator

The IPAA agrees with all three options put forward in the Discussion Paper for the approval of administrators' fees. However, we would also suggest that fees for the Voluntary Administration can also be considered and approved by creditors, Committee of Inspection or the Court during any subsequent Deed or Liquidation, provided that proper notice and disclosure is given. This would remove the pressure on Administrators to make estimates on the costs of finalising the Voluntary Administration prior to the major meeting.

The IPAA agrees with the requirement for committee members to receive seven days prior written notice of the amount of the remuneration claimed together with details of how the amount claimed is comprised and calculated.

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[6] Response to Question 10 in the IPAA's submission to Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Australia's Insolvency Laws dated 23 July 2003.
[7] See *Young v Sherman* [2001] NSWSC 1020, *Cresvale Far East v Cresvale Securities* [2001] NSWSC 89.

In relation to the last two points raised on this issue:

- A Report on work still to be undertaken need only be provided if a resolution for prospective fees is to be put forward for approval. A report on work undertaken should be provided with every request for fee approval.
- A section similar to section 504 should be included for Voluntary Administrations and Deeds of Company Arrangement.

2.121 Administrator's indemnity rights

On the question of whether statutory indemnity rights of administrators adequately cover them for any debts they incur in the course of an administration, the IPAA considers that this is a commercial decision made by an insolvency practitioner prior to accepting an appointment or, if the appointment has already commenced, prior to deciding to incur a debt. In situations where the insolvency practitioner considers that there are insufficient assets available under the indemnity, he/she will either make arrangements to ensure that sufficient assets are made available or an indemnity is obtained from other sources or he/she will refuse the appointment or to incur the debt.

Regarding the issue raised in the discussion paper on the reduction in the value of indemnity assets by the appointment of a Receiver, the IPAA believes that there is no practical way of resolving this issue other than limiting instances where a Receiver can be appointed (refer our comments at 2.53 above). However, a Receiver will owe a duty of care to the company and may be liable for a breach of fiduciary duty.

2.127 Voiding antecedent transactions

The IPAA agrees that the timeframe for a Voluntary Administration is, generally, too short to pursue antecedent transactions. Furthermore, the IPAA agrees with the proposal that where an application for a winding up that has not been dismissed precedes a Voluntary Administration, the relation back powers should extend to the date of the initial winding up application.

2.134 Equity for debt swaps

2.136 Prospectus disclosure

The IPAA agrees with the proposal that offers of securities to creditors made under a Deed of Company Arrangement should be exempt from disclosure under Part 6D.2.

2.142 Financial product disclosure

The IPAA agrees with the proposal that there should be an exemption from the requirement to give a Product Disclosure Statement for an offer of a financial product made under either part 5.1 or Part 5.3A.

2.144 Effect of takeover provisions

The IPAA agrees with Policy Option 3 where the Court is given an express power to exempt a Voluntary Administration arrangement from the takeover provisions. However, this power should not mean that administrators do not have the option of approval from shareholders, ASIC or the Takeovers Panel.

The IPAA believes that the legislation should provide the Court with some guidance as to when an order is appropriate - for example, where the shares in the company are effectively worthless.

Voluntary Administrator's rights to deal with existing shares

An issue that was not raised in the discussion paper that the IPAA would like to raise is the fact that administrators currently have no ability to deal with existing shares when looking to restructure or obtain equity finance for the company.

The IPAA sees two options for legislative change:

1. Grant broader power to administrators, either Voluntary or Deed, to compel changes to existing shareholdings; or
2. Give administrators, either Voluntary or Deed, the power to be able to consolidate existing shareholdings.

The IPAA prefers option 2 as it does not affect the rights or intrinsic value of the shares. An issue the IPAA has identified is how to deal with uneven shareholdings – for example, if the administrator wishes to consolidate shares 100 for 1 and a shareholder owns 357 shares, does the shareholder get 3 or 4 consolidated shares?

2.161 Ambit of the Court's powers to give directions

The IPAA does not believe that any change is required to the current position being taken by the Courts.

2.168 Set-off

The IPAA believes that the moratorium should not extend to creditors' rights to set-off debts owed to it by a company against any funds that it holds on the company's account. However, this right of set off should not extend to post-appointment receipts.

2.173 Administrator's access to information gathered by regulators

It is the IPAA's opinion that all external administrators, including Voluntary Administrators, should be included in the same category as a lawyer who is carrying on, or contemplating in good faith, any proceeding in respect of a matter to which the examination relates.

2.176 Pooling of assets and deeds of cross-guarantee in corporate groups

2.182 Policy option: Companies subject to deed of cross-guarantee

The IPAA agrees with the submission that where a group of companies is subject to an ASIC-approved deed of cross guarantee, the assets and liabilities of those companies should be pooled at the discretion of the administrator or deed administrator without the need to obtain a Court order. Our agreement is conditional on the whole group that is subject to the cross-guarantee being placed into Voluntary Administration.

2.185 Policy option: Companies not subject to deed of cross-guarantee

The IPAA believes that the submission put forward in the discussion paper places too much power in the hands of the administrator and prefers the recommendation put forward in CAMAC's recommendation in its Corporate Groups Report.

However, the suggestion that an administrator of pooled companies only be required to prepare a single report for the group is a good suggestion and is supported by the IPAA. The IPAA also agrees that where more than one deed is proposed, separate explanatory statements should be provided.

2.191 Ipso facto clauses

2.202 Policy option: Retain the current law

The IPAA does not agree with this option as we believe that amendments are required in relation to this matter.

2.203 Policy option: Total prohibition on enforcing ipso facto clauses without Court approval

Please refer to the discussion at 2.206 below.

2.204 Policy option: Limited prohibition on enforcing ipso facto clauses

The IPAA does not disagree with this suggestion. However, we believe that if the administrator is made personally liable for any future debts incurred under the contract then there is little risk to the lender or creditor (refer 2.206 below for further discussion on this point).

2.205 Policy option: Temporary freeze on enforcing ipso facto clauses

The IPAA does not believe that this policy option would satisfactorily resolve this issue.

2.206 Policy option: Administrator's personal liability for overriding ipso facto clauses

The IPAA made a similar recommendation to this policy option in its submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Australia's Insolvency Laws:

> "The Corporations Act currently provides that owners and lessors are unable to recover property used by the company during the Voluntary Administration without consent of the administrator or the Court[8]. It is the IPAA's opinion that this moratorium should be expanded to include contracts (other than charges). Accordingly, the other party to a contract (other than a charge) would be unable to:
>
> - terminate the contact;
> - modify the contract; or
> - repossess any property to which the contract relates;
>
> without the consent of the Administrator or the Court.
>
> Furthermore, in order to protect the other party to the contract, if the Administrator chooses to continue with the contact, he or she should be liable to pay for that portion of the contract where benefit is obtained during the term of the Voluntary Administration, similarly to section 443B of the Corporations Act.

[8] Section 440C of the Corporations Act

It is the IPAA's opinion, based on recent experiences of its members, particularly in larger Voluntary Administrations, that to achieve the objectives of Part 5.3A, an Administrator needs to have the right to continue with contracts– not have a decision made by the other party to the contract. The other party to the contract would be protected by the ability to apply to the Court and the personal liability of the Administrator.

Furthermore, the IPAA proposes a moratorium rather that the voiding of the provisions. This will provide the Administrator with the opportunity to examine all options – including the renegotiation of the contract, or finding a purchaser of the business who can renegotiate the contract, etc – without completely removing the other party's rights. This is in line with the current provisions of the Corporations Act in relation to owners and lessors.

It is also the IPAA's opinion that amendments made to the Corporations Act to expand the moratorium period to contracts should not apply to charges as there is already sufficient regulation of charges in Part 5.3A."[9]

2.207 Assigning or terminating executory contracts

The IPAA believes that the US law and Canadian recommendations on this point have merit.

In relation to assignment of executory contracts, it is the IPAA's opinion that these contracts should be able to be assigned, with the other party to the contract having the right to object to the Court if the proposed assignee is less creditworthy than the debtor was at the time of entering to the contract or reasonable assurances of payment have not been provided.

In relation to termination of executory contracts, the administrator should have the power to terminate a contract, regardless of its terms, with the counterparty having unsecured remedies in damages.

2.212 Deed compliance with priority payments

The IPAA believes that creditors should be permitted to approve deeds of company arrangement that depart from the winding up priorities and we made such a statement in our submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Australia's Insolvency Laws:

"The ATO in their submission to the Joint Committee proposed that Deeds should not be able to "discriminate" against certain creditors or classes of creditors. The IPAA disagrees with the ATO's arguments. In the cases on this point, the fundamental factor which allowed the Deed to continue was that, notwithstanding the discrimination, the Deed was no less beneficial to all creditors than a winding up[10]. It is the IPAA's view that, even if a Deed is discriminatory, if it provides for a better return to creditors than the immediate winding up of the company then the objectives of Part 5.3A have been met."[11]

[9] Point 2 of the IPAA's submission to Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Australia's Insolvency Laws dated 30 April 2003.
[10] *Lam Soon Australia Pty Ltd (Administrator Appointed) v Molit (No 55) Pty Ltd* (1996) 14 ACLC 1,737
[11] Response to Question 19 in the IPAA's submission to Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Australia's Insolvency Laws dated 23 July 2003.

We do not believe that the legislation should set out guidelines that indicate when it is appropriate to depart from the winding up priorities. However, it may be appropriate for the legislation to require administrators to provide full disclosure in their report of the effect on priority creditors where section 556 is not going to be followed. This may be particularly relevant in respect of employees as the Department of Employment and Workplace Relations Operational Arrangements state that where a Deed of Company Arrangement does not follow the priorities set down in section 556, employees will not be eligible to claim under the General Employees Entitlements and Redundancy Scheme[12].

2.215 Employee superannuation entitlements

The IPAA agrees with the recommendation in CAMAC's Corporate Voluntary Administration Report that an administrator should not be taken to have adopted any employment contract unless the administrator does so expressly in writing and that any such adoption should only relate to entitlements that accrued during the period of the administration.

2.222 Solvency under the deed

The IPAA does not agree with the suggestion that for a deed of company arrangement to be valid, the company must be solvent at the time of commencement of the deed. Although such a requirement may reduce the incidence of phoenix companies as suggested in the Discussion Paper, the IPAA suggests that it would also exclude the vast majority of companies from being able to propose a deed. If a company is entitled to enter in a Voluntary Administration in an insolvent state, as is the current criteria[13], how is it meant to become solvent prior to the commencement of a deed? It is also noted that notwithstanding the Deed, if the company recommences trading and incurring new debts, the directors will still be subject to their duties not to incur debts if they suspect or there are reasonable grounds to suspect the company is insolvent.

The IPAA believes that there may be some merit to a requirement that where a company is to continue to trade during the Deed, the company must become solvent on execution of the Deed. However, care would need to be taken when drafting legislation requiring this. The Voluntary Administrator should not be the one responsible for declaring that the company will be solvent – it should remain the responsibility of the directors to attest to the company's solvency.

2.224 Corporate Governance Issues

2.225 Financial reporting requirements

The IPAA does not believe that any further changes are required in relation to financial reporting requirements at this point in time, on the basis that ASIC is reasonable in granting exemptions and deferrals under PS 174.

2.227 Annual general meeting

The IPAA does not believe that any further changes are required in relation to annual general meetings at this point in time, on the basis that ASIC is reasonable in granting extensions under PS 174.

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[12] General Employee Entitlements and Redundancy Scheme Operational Arrangements clause 7.2

[13] Section 436A(1) of the Corporations Act

2.231 *Minimum number of directors*

The IPAA agrees that while a company is under the control of either the Voluntary Administrator or deed administrator, the company does not require the minimum number of directors as the directors have no role to fulfil at that time. However if a deed is proposed where control of the company is to return to the directors, or at the end of a deed, the company must have the required number of directors.

2.233 *Change of company name*

The IPAA agrees that administrators or deed administrators should be able to change the name of a company if it is the administrator's opinion that it desirable to do so in the interests of the administration. However, where a change of name occurs, disclosure of the former name should occur for a period of six months so creditors are made aware of the new name. This is particularly important for advertisements for meetings and dividends.

The IPAA also believes that if a name change occurs prior to any form of external administration, the same principles should apply.

2.235 *Relationship between deed of company arrangement and company's constitution*

The IPAA agrees with the suggestion that an executed deed of company arrangement should, to the extent of any inconsistency, override the company's constitution.

2.236 *Administrative issues*

Lodgement of notification of appointment

The IPAA does not believe that a differentiation is required between large and small administrations in respect of the completion and lodgement of a Form 505. It is more important that notification of the appointment is given as soon as possible.

Membership of Committee of Creditors

The IPAA agrees with the view that any statutory limitation on the number of creditors on the committee of creditors or on the number of their representatives at any committee meeting may prove unduly inflexible in particular administrations.

Company as a member of the Committee of Creditors

The IPAA agrees that a company should be a member of the committee of creditors or a committee of inspection. The current requirement that only a natural person can be a member of the committee of creditors/inspection is an ongoing source of problems for our members, particularly if an administration continues for a reasonable period of time and staff at the company creditor move on, leaving the creditor unable to participate in the committee meetings.

2.237 Other issues

2.237 *Managed Investment Schemes*

The IPAA has no further comments to make in respect of this issue.

2.238 Exchange listing

The IPAA does not agree that listed entities subject to Voluntary Administration should continue to be traded on the stock exchange. The IPAA is concerned that the administrator would be unable to comply with the disclosure obligations and that potentially sensitive information would be made available to creditors via the reporting protocol that would not be widely available to the market.

Although shares can continue to be traded in the US, the IPAA notes the following statement from the SEC website[14]:

> "A company's securities may continue to trade even after the company has filed for bankruptcy under Chapter 11. In most instances, companies that file under Chapter 11 of the Bankruptcy Code are generally unable to meet the listing standards to continue to trade on NASDAQ or the New York Stock Exchange. However, even when a company is delisted from one of these major stock exchanges, their shares may continue to trade on either the OTCBB or the Pink Sheets. There is no federal law that prohibits trading of securities of companies in bankruptcy.
>
> Note: Investors should be cautious when buying common stock of companies in Chapter 11 bankruptcy. It is extremely risky and is likely to lead to financial loss. Although a company may emerge from bankruptcy as a viable entity, generally, the creditors and the bondholders become the new owners of the shares. In most instances, the company's plan of reorganization will cancel the existing equity shares. This happens in bankruptcy cases because secured and unsecured creditors are paid from the company's assets before common stockholders. And in situations where shareholders do participate in the plan, their shares are usually subject to substantial dilution."

As such, although shares can continue to be traded in the US, they are not generally traded on the widely recognised exchanges.

Chapter 3 – Creditors' schemes of arrangement

From an insolvency perspective, Schemes and Voluntary Administrations have essentially the same purpose – they are procedures to enable arrangements to be made between a company and its creditors. They just go about reaching that purpose in different ways – in particular, Schemes are Court based, whereas Voluntary Administrations do not require Court sanction or intervention.

Feedback from members has indicated that although Schemes are perceived as being expensive time consuming and Court intensive, they have a useful role to play in the right circumstances. For instance:

- Where the Insolvency Practitioner wishes to make a distribution to stakeholders, or otherwise deal with the assets under his/her control, and considers it prudent to obtain a Court Order to validate his/her actions, to allow him/her to move forward with the administration.

- There are several, readily identifiable, stakeholder groups with widely disparate interests.

[14] www.sec.gov/investor/pubs/bankrupt.htm

- The statutory priorities and / or statutory powers given to certain stakeholder groups are considered inequitable and the Insolvency Practitioner considers that an alternate method of distribution (or method of dealing with the assets) will provide a better result for the most deserving stakeholder groups.

- Stakeholder groups with the financial clout and/or political will to promote their views have the opportunity to have their 'day in Court' when the proposed scheme is put forward to the Court for approval.

- The entity's accounting records are incomplete and /or inaccurate, and cannot be remedied within a reasonable time-frame / cost budget. Accordingly, funds tracing, although necessary to properly determine who is entitled to what, may be highly problematic and the insolvency practitioner may seek the Court's approval to put forward a scheme which deals with the funds in a different manner.

- In the administration of insurance companies, where it is desirable to shorten the timeframe within which insurance claims may be made, so that the administration can be finalised in a reasonable timeframe.

- Schemes can be used to deal with the rights of shareholders of the company / group.

It is our opinion that a Scheme is more likely to be put forward after a company has already been in some form of insolvency administration, as was the case with Confidens Investment Trust. Due to the length of time involved in getting a Scheme approved and the fact that they do not provide any protection to directors from insolvent trading risk while the scheme is developed, we believe that a Scheme is unlikely to be the initial form of administration in an insolvency situation. It is after the appointed practitioner has had an opportunity to consider the situation that a Scheme may be seen to be the answer.

It is the IPAA's opinion that Schemes should not be changed to remove Court involvement totally, as it is the Court's involvement which differentiates them from Voluntary Administrations and in the circumstances outlined above it is usually the Court's involvement which would lead to the insolvency practitioner choosing to use a Scheme.

Although Schemes are not widely used in the insolvency context, they are used more regularly to restructure solvent companies where pressures such as lack of time and insolvent trading are not an issue.

The IPAA believes that it may not be just those persons that have an interest in restructuring large insolvent enterprises that need to be consulted on this issue, but also those people involved in the restructuring of large solvent enterprises.

* * * * *

Our President, Mr Bruce Carter, would be pleased to discuss this submission with CAMAC.

Yours sincerely

B J Carter
President