KordaMentha

Large and Complex Administrations
The Courts and Ansett

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The KordaMentha Research Unit
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There is no doubt that the sheer size and complexity of the Ansett Administration tested the Australian Voluntary Administration regime to its limits. This paper outlines some of the commercial issues we faced on the Ansett Administration and how the Courts dealt with our applications on these issues.

1. Appointment as Administrators

Commercial Issue: Mark Korda and Mark Mentha were asked to Consent to Act as Administrators of the Ansett Group of Companies by a major creditor group. Due to Corporations Act restrictions, we were unable to Consent because Andersen (with whom we were partners at the time) was the prior auditor of one of the recently acquired subsidiaries of the Ansett Group.

Court Application: We applied for and received leave of the Federal Court to Consent to Act as Administrators of all but the Hazelton Airlines Group of Companies, which was the recently acquired subsidiary.

2. Extension of 7 Day 'Rent Free' Period

Commercial Issue: Where a company has existing arrangements in place at the commencement of an administration to use or occupy a third party's property (eg property leases, aircraft and equipment leases), an Administrator has 7 days within which to decide whether or not he or she wishes to use or occupy the property. Ansett had more than 600 such leases.

After the 7 day period, unless the existing agreement is disclaimed, the Administrator is liable for the rent and other amounts payable under the agreement.

Court Application: Given the sheer number of lease arrangements to be dealt with, we successfully applied to the Court for a short extension of time (7 days) to determine whether we wished to continue to use or occupy third party property.

3. Memorandum of Understanding (MOU)

Commercial Issue: On appointment, we faced a number of significant hurdles:

- we had no available cash to trade the business;
- Ansett's senior management and financial records were in New Zealand, leaving a management and information vacuum in Australia;

- the terrorist attacks on 11 September 2001 had decimated the aviation industry, destroying the market for assets and reducing Ansett's ability to compete in a fiercely competitive market (the Ansett Administration began on 12 September 2001);
- the Ansett fleet consisted of 134 aircraft, 53 of which were subject to lease and finance arrangements;
- Ansett leased about 350 properties;
- Ansett employed 15,000 workers, most of whom were members of unions;
- we faced serious backlash from Global Rewards (ie frequent flyer) creditors; and
- a Federal election was imminent.

As Administrators, it was clear that the sale of the Ansett mainline business in accordance with the object of Part 5.3A of the Act would be highly unlikely unless we resumed flight operations quickly. The object of Part 5.3A is effectively to maximise the chances of the company, or as much as possible of its business, continuing in existence. To do this, we needed an injection of capital and the opportunity to change Ansett's outdated work practices. Due to the operations, records and assets of Ansett and Air NZ being intermingled, it was necessary to disentangle Ansett from Air NZ. This was achieved through negotiation of a compromise with Air NZ.

On 8 August 2001, Air NZ wrote a Letter of Comfort to three Ansett companies confirming its policy to take such steps as were necessary to ensure that it's wholly owned subsidiaries could meet their debts as and when they fell due. Importantly, the Letter of Comfort also provided that Air NZ would make available, on request in writing from time to time, advances for the sole purpose of enabling the three Ansett companies to pay working capital liabilities incurred by them in the ordinary course of business. The maximum aggregate of all such advances was not to exceed AUD $400 million.

We concluded that if we could negotiate a prompt commercial settlement of any claims (including the Letter of Comfort) the Ansett Group may have had against Air NZ, Ansett had the best chance of receiving cash for its claims and continuing to exist. If legal proceedings were commenced for recovery, Air NZ may itself have been forced into administration (statutory management in NZ) precluding any recovery by us as Administrators.

After intense negotiations, Air NZ agreed to pay AUD $150 million, to waive its right to prove in the Ansett administration and its right to AUD $32 million in priority payments advanced to Ansett for wages; a total of AUD $182 million. In return, Ansett and the Administrators would release Air NZ and its directors from certain 'theoretical' legal claims. The terms of the agreement were set out in a Memorandum of Understanding which was signed on 4 October 2001.

Court Application: The MOU was conditional upon the Federal Court approving its terms or making orders or directions to the same effect. We were concerned about compromising, albeit in a limited way, claims against the Air NZ/Ansett directors in circumstances where we had not had the time or opportunity to conduct any detailed investigations into the claims being released.

Before signing the MOU, we informed key stakeholders including the Federal Government and Priority Creditors of its proposed terms. At a meeting held on 3 October 2001, the Committee of Creditors did not object to the Administrators entering into the MOU.

As Administrators, we clearly had the legal authority to enter into the MOU pursuant to Section 437A of the Act. However, we were seeking protection against any subsequent claims that we may have acted inappropriately or unreasonably by entering into the MOU. Hence, our transparent approach.

On 12 October 2001, the Court made orders and directions pursuant to Sections 447A and 447D of the Act to the effect that, as Administrators, we could properly and justifiably perform and give effect to the MOU. The Court was satisfied on the basis of the material placed before it that we were acting in accordance with the object of Part 5.3A of the Act by entering into the MOU. The Court saw that we had been presented with a "window of opportunity" which would be lost if the MOU could not be given effect to.

In his reasons for judgment, Justice Goldberg said that in compromising the claims and entering into the MOU, the Administrators "exercised a commercial judgment" and that it was "not the role of the Court to make a commercial judgment for the liquidators or administrators or to substitute its judgment for their judgment." However, while it was not the Court's role to pronounce upon the commercial prudence of a particular transaction, the Court would act in an appropriate case to protect administrators from claims that they have acted unreasonably by entering into a particular transaction provided full and frank disclosure was made.

4. Employee Entitlement Safety Net

Commercial Issue: Following the collapse of Ansett, the Federal Government announced its intention to guarantee that Ansett's employees receive their entitlements to wages, annual leave, payment in lieu of notice and redundancies up to the community standard of eight weeks. To do this, the Government established the Special Employment Entitlement Scheme for Ansett employees ('SEESA') for the purpose of making these safety payments to Ansett employees if there was a shortfall in asset realisations.

As Administrators, we believed it could take several years to complete the realisation of Ansett's assets. Accordingly, we attempted to reach agreement with the Government to ensure that employees who had been made redundant could receive their entitlements as soon as possible. Furthermore, after intense negotiation, the Government maintained that SEESA was established for the benefit of employees and insisted it be given priority for the repayments of any advances made by it to the Administrators as if the Government 'stood in the shoes' of the employees and be repaid ahead of ordinary unsecured creditors.

Court Application: In early December 2001, we applied to the Court for directions and orders to the effect that we acted appropriately by agreeing that the SEESA payments to be made by the Government to redundant employees would rank in priority equal to those of employees in a winding up and that SEESA payments were debts incurred by us as Administrators in the ordinary course of exercising our powers and functions. In the absence of an order from the Court, if as Administrators we borrowed the money there would not be a right of indemnity over the assets of the companies to repay the borrowings. The Government and the unions supported our application to the Court.

On 14 December 2001 the Court made orders pursuant to Section 447A of the Act to the effect that Part 5.3A of the Act was to operate in relation to the Ansett companies as if:

- the SEESA payments to redundant employees would rank according to the priority provided for under Sections 556 and 560 of the Act; and
- the SEESA payments were debts incurred by the Administrators in the performance and exercise of their functions as Administrators and for which they would not be personally liable to repay (except to the extent that they had assets available for the Administration to do so).

5. Notification of Second Meeting of Creditors

Commercial Issue: In accordance with the Act, each creditor of Ansett (including Global Rewards members, employees and unused ticket holders) was entitled to written notice of the second meetings of creditors together with the Administrators' Report, Proxy Form and outline of the proposed Deed of Company Arrangement.

Such a mail out would have cost AUD $28 million, so we applied to the Court seeking an exemption from the normal notice requirements.

Court Application: The Court stressed that whilst expense may be a relevant consideration, it should not outweigh the primary consideration which is that creditors be notified of the convening of the meeting and their right to receive the necessary information.

The Court ordered that at least 10 days before the meeting, a one page notice be posted to all creditors notifying them of the meeting and that the report could be obtained from the Administrators' web sites. Furthermore, notices had to be published in newspapers throughout Australia in the form of large advertisements. The Administrators had to maintain a creditor hotline and deliver to any creditor, at his or her request, a copy of the Notice, Report and Proxy Form. The collective cost of these requirements was only AUD $1.8 million.

The court also provided relief from posting Notices to all creditors should the meeting be adjourned and the same relief should apply for all other subsequent reports and meetings, but without posting any further one page notices.

6. Administrators Continuing to Trade

Commercial Issue: The second meetings of creditors were held on 29 January 2002 (Part 1 of the Second Meetings). The primary purpose of Part 1 of the Second Meetings was for creditors to approve the sale of the mainline airline to Tesna Holdings Pty Ltd (Tesna) and to approve the extension of the completion date by up to 30 days to allow Tesna more time to complete.

At this meeting, creditors overwhelmingly passed resolutions approving the sale and the completion date extension by up to 30 days.

Court Application: We subsequently applied to the Court for a direction to the effect that we could properly and justifiably continue to operate the Ansett mainline airline for a further period of up to 30 days pending finalisation of the sale of the mainline airline to Tesna. We were concerned that if we continued to trade the business during the extension period and the Tesna sale did not complete, we would have reduced the pool of funds available to creditors by incurring trading losses and would therefore be open to allegations of breach of duty.

We accepted that the issue was not one of legal authority, but whether in a complex administration, Administrators were justified in incurring trading losses for a defined period in an attempt to secure the inherently uncertain prospect of the sale of the airline as a going concern.

After a thorough review of the authorities, Justice Goldberg declined to give the direction sought. The court said:

"There must be something more than the making of a business or commercial decision before a court will give directions in relation to, or approving of, the decisions. It may be an issue of legal substance or procedure, it may be an issue of power, propriety or reasonableness, but some issue of this nature is required to be raised. It is insufficient to attract an order giving directions that the liquidator or administrator has a feeling of apprehension or unease about the business decision made and wants reassurance."

However, and most importantly for us, the Judge commented that "No issue as to the power of the administrators to make this decision has been raised. It is within their power to make the decision. No issue has been raised as to the propriety or reasonableness of the decision, nor has any issue been raised which requires the Court to make a judgement on a legal issue."

No creditors challenged our decision to continue to trade.

By contrast, in the MOU application, the Court could approve our decision to enter the MOU because:
"…there were legal issues involved relating to causes of action by the administrators….In particular, there were legal issues involved in the release of claims under the Letter of Comfort."

7. Extension of Time to Execute DOCAs

Commercial Issue: The Act specifies that if Creditors vote and approve a Deed of Company Arrangement (DOCA) at the second meeting of creditors, the DOCA must be executed within 21 days of that meeting. There were a number of drafting issues relating to the Ansett DOCAs which required further time to resolve.

Court Application: An application was made to the Court to extend the time in which we were required to execute the DOCAs approved at a meeting of creditors held on 27 March 2002, by a period of 7 days. The application was opposed by 2 creditors.

After the application was heard, but before orders were granted, the 2 creditors withdrew their opposition to the application and the Court made orders granting a 7 day extension. This enabled us to resolve drafting issues with various parties relating to the DOCAs.

8. Further Extension of Time to Execute DOCAs

Commercial Issue: Before the expiry of the 7 day extension granted by the Court in the first application, we applied to the Court for a further extension of time to execute the DOCAs. The purpose of this second application was to preserve the status quo for a period of time to enable us to dispose of the Domestic Terminal Leases (DTLs) in an orderly fashion.

Sydney Airport Corporation Ltd (SACL) and other DTL lessors maintained that the 'buy-back' provisions in the DTLs, which were the Ansett Group's most valuable assets, would be triggered by executing the DOCAs. The 'buy-back' provisions enabled the DTL lessors to 'buy-back' the DTLs at 'fair market value' which would be significantly less than the amount which could be obtained in a competitive market. By extending the time to execute the DOCAs to enable us to sell the DTLs, we would avoid the dispute arising and maximise realisation of the DTLs value.

Court Application: On 29 April 2002, the Court dismissed the application on the basis that it was not an appropriate exercise of discretion to extend the time to execute the DOCAs for the purpose of prolonging the administration in order to avoid a result which execution of the DOCAs may bring about. However, an interlocutory order made on 24 April 2002 had the result of extending the time by which the Companies must execute the DOCAs for a further period after judgment was deferred until 2 May 2002. Within that time, we were able to sell the Sydney DTL.

9. Sale of Sydney Terminal

Commercial Issue: In order to avoid a dispute as to whether execution of the DOCAs triggered the 'buy-back' provisions under the Sydney DTL, we negotiated its sale to SACL prior to expiration of the period to execute the DOCAs (as extended by the Court in the first and second extension applications). Effecting the sale was a commercial decision made by us in order to maximise the return to creditors from the disposal of the Sydney DTL. In our view, the sale of the Sydney DTL to SACL in a competitive market yielded more than what may have been achieved under the 'buy-back' provisions of the Sydney DTL.

The sale was negotiated at break-neck speed. We did not comply with the sale process for the sale of the Sydney DTL with which we had previously announced we would undertake (ie advertising, due diligence etc). In addition, SACL had submitted in the second extension application that it was inappropriate for us to sell the assets prior to the execution of the DOCAs where there had been a resolution of the creditors that the DOCAs be executed and where a principal objective of the DOCAs was to enable the sale of the assets. In these circumstances, we made an application to the Court for approval of the sale of the Sydney DTL.

Court Application: Justice Goldberg held that in all the circumstances it was appropriate to give a direction that we may properly perform and give effect to the agreement of the sale of the Sydney DTL. Although our decision was a commercial one, the issues raised by SACL in the second extension application went to its propriety.

10. Superannuation

Commercial Issue: The Ansett Group has a defined benefit superannuation plan with a shortfall of up to $175m. Most of the shortfall occurred because the Plan provided that if an employee is retrenched, that employee is entitled to a special benefit on termination (up to 15% extra) and that was not funded. The entitlement to the special benefit is dependent upon a declaration being made by the employer that the member has indeed been retrenched.

This case was very important. What potentially occurring here is that a creditor whose claim we would normally regard as 'unsecured' is was seeking elevate its claim to become a cost of the Administration under Section 556(1)(a) of the Act, which means its claim would be paid in priority to all other claims (or alternatively s556(1)(e).

Court Application: We made an application to the Federal Court to determine the declaration of retrenchment question and related issues. The Trustees commenced separate proceedings in the Supreme Court of Victoria. Accordingly, our Federal Court Application had been adjourned until the final outcome of the Trustees' application is known.

The Trustees sought the Court's determination of three key issues, namely:

- Have employees been retrenched within the meaning of the deed of the particular Superannuation Plan?
- Is Ansett liable to pay any shortfall to the particular Superannuation Plan?
- If Ansett is liable to pay, would those payments be a priority payment if the Ansett Group is liquidated?

The Supreme Court determined that the answers to the above questions were respectively, Yes, Yes and No – the payments rank as ordinary unsecured claims. On Appeal, the Court found that the Supreme Court should not have heard the case because it was "hypothetical".

The case was then heard in the Federal Court. Concurrently mediation was held.

The mediation was successful. The Court approved the terms of settlement and made an order to vary the Ansett Deed of Company Arrangement. No amounts were paid directly to the Superannuation Plan to reflect the terms of settlement. Again, this shows the Court can be used to resolve major issues on large and complex administrations.

About The KordaMentha Research Unit

Background

KordaMentha partners undertook the first voluntary administration in Australia, the largest voluntary administration in Australia (Ansett with 42 companies, 15,000 employees and >$1 billion assets), the largest group of voluntary administrations in Australia (Stockford with 84 companies) and more voluntary administrations than any other insolvency firm in Australia to date in 2003.

The strength of the KordaMentha experiences and our expertise makes us well placed to monitor and evaluate issues and developments in the insolvency industry and to recommend changes.

Statement of Direction

The KordaMentha Research Unit aims to:

- Develop intellectual property
- Share our knowledge of specialist topics with insolvency stakeholders
- Develop balanced solutions for issues in the industry. We will do this by preparing position papers on topics of interest, and encouraging discussion with a view that changes to the industry will result.

Personnel

The KordaMentha Research Unit is headed by Leanne Chesser. All KordaMentha Partners and Directors contribute to the KordaMentha Research Unit.

Current Research

The KordaMentha Research Unit has conducted research in a number of areas, including:

- 301: Ansett - Part 5.3A and Chapter 11
- 302: Large and Complex Administrations – The Courts and Ansett
- 303: Regulatory Review of Australia's Insolvency Laws
- 304: Employee Entitlements
- 305: Rehabilitating Large and Complex Enterprises in Financial Difficulty