Arnold Bloch Leibler
Lawyers and Advisers

Level 21
333 Collins Street
Melbourne
Victoria 3000
Australia
DX38455 Melbourne
www.abl.com.au
Telephone
61 3 9229 9999
Facsimile
61 3 9229 9900

24 December 2003

By email and facsimile (02) 9911 2955
john.kluver@camac.gov.au

Your Ref
Our Ref LZ: DMM
File No. 010444444
Doc No. 262826

Contact
Leon Zwier
Direct 61 3 9229 9646
lzwier@abl.com.au

Mr John Kluver
Executive Director
Corporations & Markets Advisory Committee
GPO Box 3967
Sydney NSW 2001

Dear Mr Kluver

Rehabilitating Large and Complex Enterprises in Financial Difficulties - CAMAC Discussion Paper 2003

I refer to the Corporations and Market Advisory Committee ("**CAMAC**") discussion paper on Rehabilitating Large and Complex Enterprises in Financial Difficulties ("**Discussion Paper**").

I appreciate the opportunity to make submissions on the matters raised in the Discussion Paper and for CAMAC granting me the indulgence to make these submissions late. I set out below my submissions.

INTRODUCTION

1 In my submission, subject to the matters raised in the remainder of this letter, Part 5.3A of the *Corporations Act* 2001 (Cth) ("**the Act**") generally provides an effective mechanism for dealing with the restructuring of large and complex enterprises and no wholesale changes are required to the Act. The recent case law in the Ansett and Pasminco administrations demonstrates the flexibility of the Part in adapting to large and complex administrations and the importance of the Court's general supervisory role.

2 There is, in my opinion, a perception problem with Part 5.3A of the Act which does not exist in relation to Chapter 11 of the US Bankruptcy Code ("**Chapter 11**"). Where as Chapter 11 is perceived as rehabilitative, Part 5.3A is perceived merely as a precursor to liquidation. In my submission, Part 5.3A should be re-branded to dispel the negativity associated with such a perception and to align itself with the true rehabilitative objects of the Part.

CHAPTER 1 - PRINCIPLES FOR EFFECTIVE CORPORATE REHABILITATION

3 I generally agree with the principles identified in Chapter 1 of the Discussion Paper as appropriate for assessing the suitability of any rehabilitation procedure for large and complex enterprises, namely:

- encouraging the company to take early remedial action;

- encouraging the company to negotiate with its creditors;
- assisting ongoing financing of the company during the rehabilitation period;
- providing a flexible rehabilitation timetable according to the needs of the company; and
- providing methods to deal with corporate groups.

4 In relation to the first principle: *encouraging companies to take early remedial action*, I prefer a 'financial stress test' and in particular, changing the requirement for appointment of a voluntary administrator to a reasonable prospect of insolvency and prohibiting appointment once the company is actually insolvent (see further paragraph 9 and following below).

5 However, I would also like to see aspects of the 'good faith' test applied to prevent abuse by solvent companies seeking to obtain a debt holiday on the one hand and to give protection to those companies genuinely seeking to respond to a reasonable prospect of insolvency by commencing discussions with creditors early on the other hand.

6 In relation to the second principle, *encouraging companies to negotiate with creditors*, many of my submissions as to the proposed amendments to Part 5.3A of the Act in Chapter 2 below would support this principle. For example, adopting the provisions of Chapter 11 which allow the debtor company to freeze all creditors' rights during the rehabilitative period together with the 'cram down' rules would provide an added incentive for creditors to negotiate a reorganisation programme with the directors of a financially distressed company earlier and without necessarily having the invoke Part 5.3A of the Act.

7 As a general rule, the moratorium or 'freeze' on creditors rights that applies during the voluntary administration period should apply across the board with only limited exceptions for secured creditors and property owners on application to the Court. This would ensure consistency and equality of treatment among creditors in line with the US model. Further, these changes would restrict the power of secured creditors under Part 5.3A of the Act, which, in my view, is disproportionate. In my experience, voluntary administrators are often beholden to secured creditors because of their importance in the market place including as a source of future and unrelated work.

8 In terms of implementation of the second principle, however, I am concerned that admissions of insolvency or an inability to perform a long term onerous contract prior to the commencement of the voluntary administration process may expose directors to accusations of improper conduct by creditors. Further, the acquisition of a debt at a discount as part of any pre-administration compromise may lead to allegations of improper discrimination against non-participating creditors and creates a related party debt issue for the purposes of voting at any subsequent

meeting of creditors. These issues will need to be considered further as a part of the implementation of a strategy to encourage companies to negotiate with creditors prior to the commencement of the voluntary administration process.

CHAPTER 2 - SPECIFIC AMENDMENTS TO PART 5.3A OF THE ACT

(i) Initiating an Administration

9 ***In my submission, the best way to implement the principle of encouraging companies to respond earlier to financial hardship is to restrict the ability of directors to appoint Administrators under Section 436A of the Act to a time when there is a reasonable prospect of insolvency or wherever a solvent company is in serious financial difficulty. Directors of an already insolvent company should be prohibited from appointing an Administrator. There should also be a requirement of 'good faith'. Consequential amendments may be required to Section 435A of the Act.***

10 I have previously stated that a company should be encouraged by the legislative scheme to respond earlier to financial difficulties in order to increase its prospects of successful rehabilitation. From my experience, for example in the Brash and Ansett administrations, companies often stagger on in the honest but mistaken belief that their financial position will improve until the company is denuded of cash, debtors, morale and goodwill. The ability to appoint Administrators where there is a reasonable prospect of insolvency or when a solvent company is in financial difficulty will encourage early negotiation with creditors and implementation of a reorganisation before it is too late.

11 Whether or not the proposed amendments are made, some amendment is in my submission required to Section 435A of the Act. As the legislation currently stands, there is a tension between the objects of the Part as expressed in Section 435A of the Act and an inconsistency between section 435A of the Act, which is expressed to apply only to an *'insolvent'* company and Section 436A of the Act, which allows the Part to be invoked both in the case of insolvency and in the case of *'likely insolvency'*. In order to meet the principle of rehabilitation, Section 435A of the Act should be amended to make it unambiguously clear that the rehabilitation principle is paramount and that a solvent company in financial difficulty can be rehabilitated.

12 If a company is actually insolvent, it should be placed into liquidation. A Liquidator can convert the liquidation into a voluntary administration if the Liquidator makes a decision to do so (see Section 436B of the Act). A Liquidator's decision can be appealed by the person aggrieved (see Section 1321 of the Act).

13 The requirement of 'good faith' will limit the ability of those directors who seek to improperly use Part 5.3A of the Act, for example, as a step to liquidation or for the purpose of establishing a 'phoenix company' while

also protecting directors who invoke the Part in good faith when the company is actually insolvent.

14 I do not believe Schemes of Arrangement are a serious option. They are slower, more cumbersome, administered by the Courts technically and afford no protection during the negotiation. I also do not believe an ordinary unsecured creditor should be able to appoint an administrator by Court application.

Eligibility of a Liquidator to be an Administrator

15 ***Only senior insolvency practitioners with the requisite degree of experience and skills should be permitted to manage large and complex administrations.***

16 In my experience, only practitioners from large accounting firms or specialist insolvency firms have the requisite knowledge and experience to manage large and complex administrations. While the market appears to informally direct itself to these sorts of practitioners in the case of large and complex administrations, it may be that Part 5.3A could be amended in the manner referred to above to ensure inappropriate appointments are not made in the future. In my submission, it is not sufficient that the practitioner has a certain number of years of experience. It should also be a prerequisite that they have the requisite skills, education and expertise to manage large and complex administrations.

(ii) Rights that Override a Voluntary Administration

17 ***In my submission, the rights of secured creditors to appoint a receiver ought to be significantly curtailed along the lines adopted in the UK by the Enterprise Act 2002 (UK).***

18 The ability of Receivers to appoint over a voluntary administrator detracts from the objects of Part 5.3A of the Act. Secured creditors are self-interested where as the objects of Part 5.3A of the Act require a voluntary administrator to maximise the chances of the company's business remaining in existence or if that is not possible, to increase the return to all other creditors. Secured creditors want their money repaid as quickly as possible and they desire to control all aspects of the voluntary administration process to ensure that they get this result.

19 If secured creditors are entitled to override a voluntary administration, will they be held accountable where they force a sale of the assets of the company in circumstances where, if the sale had been postponed as proposed by the Administrators, the market value of the assets would have increased in value substantially? This scenario is not dissimilar to a scenario that might have occurred if the Ansett Administrators were forced by a Receiver to sell the aircraft assets immediately post-September 11, 2001 when the world aviation market was depressed. In such a scenario, the provisions of Section 420A of the Act would offer little comfort for ordinary unsecured creditors.

(iii) Timing Issues

20 ***In my submission, the time by which an Administrator must convene the major meeting of creditors under Section 439A(5) of the Act in the case of large and complex administrations ought to be extended by another 60 days. The creditors' rights to adjourn the major meeting for a period of up to a further 60 days ought to remain. However, creditors ought not be allowed to extend the convening period of the major meeting at the first meeting of creditors. The Court's power to extend the convening period for the major meeting pursuant to Section 439A(6) of the Act and to extend the time by which the company must execute a deed of company arrangement pursuant to Section 444B(2)(b) of the Act ought to remain.***

21 The current provisions of the Act are generally sufficiently flexible to cater for the timing requirements of large and complex enterprises. The ability of the Court to make orders extending the convening period pursuant to sections 439A(6) of the Act, extending the time by which a deed of company arrangement must be executed pursuant to section 44B(2)(b) of the Act and pursuant to the general supervisory power under Section 447A of the Act on a case by case basis works well.

22 These provisions were all successfully relied upon by the Ansett Administrators *e.g. Re Ansett; Intrepid Aviation Partners VII LLC v Ansett Australia Ltd* (2001) 115 FCR 175 (extension on seven day lease); *Re Mentha; Ansett Australia Ltd v Sydney Airports Corp Ltd* (2202) 120 FCR 310 (extension of time to execute DOCA's).

23 Nevertheless, the proposed extension of the time by which the major meeting of creditors is convened for large and complex administrations would assist the Administrators of such enterprises as invariably the time currently allowed under the Act is insufficient. However, I disagree with the proposal that creditors could extend the convening period of the major meeting at the first meeting of creditors. Generally in large corporate collapses, the voluntary administrators, let alone the creditors, have little understanding of the extent of the financial difficulties of the company and will not be in a position to make an informed decision in the first five business days of the commencement of the voluntary administration process.

Notifying Creditors

24 ***In large and complex administrations, the notification requirements of the Act ought to be satisfied by the placement of prominent advertisements in major newspapers nationally, the establishment of websites and a telephone hotline for the benefit of creditors. An acceptable alternative is to maintain the requirement to notify all creditors in writing of the time, place and date of the meeting and of the availability of supporting documentation on the website or by telephoning a toll free number. Any such amendment ought, in my***

submission, to allow for any adjourned meeting of creditors to be notified in the manner set out above.

25 The latter proposal was the effect of the decision of Goldberg J in *Re Ansett Australia Ltd & Others (All Administrators Appointed) & Mentha* (2002) 40 ACSR 419. The Ansett experience shows that such measures can save tens of millions of dollars in printing and postage costs in the case of administrations with a large number of creditors, which funds would otherwise be available for the benefit of creditors.

(iv) Lending to a Company Under VA

26 ***In my submission, Section 443A of the Act should be extended to include monies lent to an Administrator for the purpose of the Administration so that personal liability attaches to such loans. However, the parties to the loan ought to be able to contract out of personal liability by agreement. Further, personal liability ought to apply only up to the value of the company's assets. In addition, the indemnification rights of the Administrator should be the same as for the indemnification rights in relation to services rendered, goods bought or property hired leased used or occupied under Section 443D of the Act. As a consequence of these amendments, there would be an appropriate priority for repayment under Section 556 of the Act above ordinary unsecured creditors.***

27 The proposed amendments would encourage the provision of debt financing to companies in financial difficulty enhancing the ability to successfully reorganise without the need for a Court order as in the *SEESA case* ((2002) 40 ACSR 389).

(v) Voting

28 In the case of large and complex administrations, it is in my submission appropriate that there be a majority in number as well as value of creditors in order to pass any resolution of creditors. Further, it is appropriate that Administrators should have a casting vote where there is a deadlock between a majority in number and value of creditors. I would however support the recommendation that where the Administrator does exercise a casting vote, he or she should be required to give reasons for the manner in which that vote is exercised.

29 The proposed amendments would ensure certainty in the case of large and complex administrations while at the same time making the Administrator accountable in the requirement to give reasons for the exercise of any casting vote. Further and adequate protection is in my opinion given to creditors where an Administrator inappropriately exercises their casting vote by established case law (*e.g. Young v Sherman* (2001) 40 ACSR 12) and by the provisions of Section 600A, 600B and 600C of the Act. The case may be different in the case of smaller administrations where the

costs of an application to the Court to set aside the decision of an administrator may be prohibitive.

(vi) Remuneration of Administrator

30 ***In my submission, Section 449E of the Act should be amended to permit the Committee of Creditors or the Court to fix the Administrator's remuneration in large administrations. Where the Administrator's remuneration is fixed by the Committee of Creditors, the Committee members should receive at least seven days prior written notice of the amount of the remuneration claimed together with details of how the amount claimed is comprised and calculated. Finally, the Court could have an overriding power of veto in an appropriate case, as is currently the position in respect of a Liquidator's remuneration under Section 504 of the Act.***

31 These amendments are consistent with the decision of Goldberg J in *Re Ansett Australia & Others (All Administrators Appointed) & Mentha* (2002) 40 ACSR 409. They would allow the Committee of Creditors in the case of large and complex administrations to fix the remuneration of Administrators on an informed basis prior to the major meeting of creditors (which will often be too late in the case of large and complex administrations where the major meeting is delayed) and without the expense and delay of a Court order. In the case of large and complex administrations, the creditors comprising the Committee of Creditors will tend to be sophisticated creditors well equipped to make such decisions. The ability to make an application to the Court to override the decision of the Committee of Creditors will form an appropriate safeguard against any actual or perceived abuse.

(vii) Administrator's Indemnity Rights

32 The existence of broad personal liability may be a disincentive to an Administrator continuing to trade on the operations of the business in accordance with the objects of Part 5.3A of the Act in the case of large and complex administrations where the decision to trade on can cost millions of dollars per week. The Administrator's right of indemnity out of the company's assets is an important counter-balance to such a liability. The actions of a receiver have the ability to reduce the value of the company's assets to below those required to meet the indemnity of the Administrator thereby jeopardising the position of the Administrator. This creates a further reason to curtail the ability of a secured creditor to appoint a Receiver as recommended at paragraphs 17 to 19 of my submissions above.

(viii) Equity for Debt Swaps

33 I support the proposal that equity for debt offers to creditors under a deed of company arrangement should be exempt from the disclosure requirements of Part 6D.2 of the Act (prospectus type disclosures), Part

7.9 of the Act (product disclosure statement) and from the takeover provisions (20% takeover threshold). The rationale for such exemption would be the safeguards already provided under Part 5.3A of the Act such as the requirements that the Voluntary Administrators act in the best interests of creditors, the liability for misleading and deceptive conduct/ statements and the safeguards contained in Sections 445D and related provisions of the Act to ensure that unfairly discriminatory deeds are not propounded.

(ix) Ambit of the Court's Powers to make Directions

34 ***In my submission, the Court's exercise of its discretionary power to supervise large and complex administrations under Sections 447A and 447D of the Act is sufficiently clear and appropriate and no specific amendment is required to the Act in this regard. In particular, there ought not be any restriction or prohibition on the Court's exercise of its discretionary powers to approve the actions of Administrator's in appropriate cases.***

35 In the Ansett administration, the Administrators made several applications to the Court for orders or directions pursuant to Sections 447D and 447A of the Act that it was proper for them to enter into an agreement or act on a commercial decision in circumstances where the Administrators were concerned that without such protection, they would be open to subsequent allegations of breach of duty. The Court made the direction sought in 3 of the 4 cases. While the Court would not give its imprimatur to a purely commercial decision of the Administrators, it would give them the protection of a direction where some question was raised as to the propriety or reasonableness of the decision provided full and frank disclosure had been made. These cases are more fully discussed in the following an article at (2003) *Insolvency Law Journal* 27.

36 The recent case law on Sections 447D and 447A of the Act provides an appropriate balance between encouraging Administrators to take appropriate risks to fulfil the objects of Part 5.3A of the Act by offering protection against subsequent allegations of breach of duty by disgruntled creditors and leaving Administrators accountable for purely commercial decisions. Such protection is warranted in the administration of large and complex enterprises where so much is at stake and personal liability attaches to the Administrators decisions.

37 The Court process provides a fair, open and transparent forum to deal with such matters. Creditors are adequately protected by the requirements of proper notice, full and frank disclosure and an opportunity to appear and make submissions as contradictor. Each case is decided on its merits. The cases make it clear that the Court will not give its imprimatur to a business decision simply to alleviate an administrator's feeling of apprehension or unease (*e.g. Re Ansett Australia Ltd & Ors and Mentha and Anor* (2002) 41 ACSR 605 at 616). In my submission, the only sensible way to balance the interests of creditors in large administrations is

on a case by case basis under the general supervisory discretion of the Court.

(x) Set-Off

38 ***In my submission, the moratorium on creditors in reclaiming property during the voluntary administration period ought to extend to banks and financial institutions that have a contractual or other right of set-off.***

39 The exercise of a contractual right of set-off during administration by a bank or financial institution is contrary to the spirit and intent of Part 5.3A of the Act. The exercise of a contractual or other right of set-off after the commencement of a voluntary administration is akin to the enforcement of a security against the company's property. Retention of title creditors cannot take back their stock during an administration. Similarly, landlords cannot take back their premises. Why should a bank holding the cash of the company be treated differently and allowed to sweep it?

40 If the objects of Part 5.3A of the Act are to be pursued, set-off ought to be curtailed as the chances of rehabilitation are slim when the company is denuded of all cash. If financiers and bankers are entitled to exercise a contractual right of set-off after the appointment of Administrators, they are effectively being preferred to all other creditors.

41 Further, the current ability to exercise a contractual right of set-off during the voluntary administration period is inconsistent with and wider than the statutory right of set-off on a liquidation under Section 553C of the Act. Under a contractual right of set-off, there is no requirement that there be mutual dealings between the company and the creditor nor is there a prohibition on a creditor claiming the benefit of a set-off where the creditor had notice of the appointment of Administrators thus allowing a creditor to exercise the right in respect of post-appointment receipts.

(xi) Pooling of Assets & Deeds of Cross-Guarantee in Corporate Groups

42 I would support the recommendation that Administrators should be permitted to pool the assets and liabilities of companies comprising corporate groups in the manner proposed by Ferrier Hodgson and outlined in paragraphs 2.182 and following in the Discussion Paper. In particular, I support the submission that in the case of companies subject to ASIC approved Deeds of Cross-Guarantee, the assets and liabilities of those companies should be pooled at the discretion of the Deed Administrator without the need to obtain a Court order and in the case of companies not subject to ASIC approved Deeds of Cross-Guarantee, a special resolution of creditors would suffice to approve the pooling.

43 I also agree with the proposed consequences of pooling outlined at paragraph 2.188 of the Discussion Paper including for:-

- joint creditors meetings;
- deeds of company arrangement that bind more than one company; and
- the variation, termination and avoidance of multi-company deeds of company arrangement.

44 In general, I agree with the proposal to permit all companies in a corporate group to go into voluntary administration where the group overall would satisfy a prerequisite notwithstanding that some group companies treated in isolation may not. Such a proposal is extremely important for large corporate groups.

(xii) Ipso Facto Clauses

45 ***In my submission, ipso facto clauses ought to be rendered void except with the agreement of the Administrator or with the leave of the Court in certain defined circumstances. Furthermore, the prohibition should extend to default provisions short of insolvency or likely insolvency including 'material adverse change' clauses and clauses which would capture a reorganisation of the type effected in a deed of company arrangement.***

46 In my submission, such an amendment is required in order to achieve the objects of Part 5.3A of the Act and also to encourage early negotiation with creditors. Extending the prohibition of ipso facto clauses to capture reorganisations would also protect against the type of scenario that occurred in Ansett where the Sydney Airports Corporation Limited ("**SACL**") threatened to repossess the Sydney domestic terminal lease, one of the Administrations most valuable assets, at below market value upon the Administrators executing a deed of company arrangement in accordance with the objects of the Part. The ability of SACL to rely on the default clause in the Sydney terminal lease severely hampered the ability of the Ansett Administrators to sell clear title to the asset. The facts are indirectly referred to in *Re Ansett Australia Ltd* (2002) 41 ACSR 605.

(xiii) Discriminatory Deeds & Compliance with Priority Payments

47 ***In my submission, creditors ought to be permitted to approve deeds of company arrangement that depart from the order of priorities that apply on a winding up under Section 556 of the Act or to otherwise enter into a discriminatory deed of company arrangement where the Deed is in the overall interests of creditors as a whole or otherwise complies with the objects of Part 5.3A of the Act.***

48 A Deed which purported to demote the priority of superannuation trustees in the Ansett administration to the overall benefit of employees was the subject of recent proceedings in the Federal Court (V3107 of 2002). The Court in that case was not able to rule on the matter as a settlement was reached and subsequently approved by the Court (the reasons for

judgment are expected to be handed down shortly). However, the law remains unclear in this area and it is submitted that a minority ought not be able to veto a discriminatory Deed where the creditors vote overwhelmingly in favour of it and which otherwise meets the objects of Part 5.3A of the Act.

49 The proposed amendments would be consistent with the principle of encouraging earlier remedial action in the case of financially distressed companies and are consistent with the US 'cramdown' rules which permit the court to approve a reorganisation despite the objection of one or more impaired classes of creditors provided at least one class agrees and the proposed arrangement is generally fair and equitable. .

(xiv) Employee Superannuation Entitlements

50 I acknowledge that CAMAC does not seek to replicate the review by the Parliamentary Joint Statutory Committee on Corporations and Financial Services which sought submissions on the issues concerning employee superannuation entitlements. However, in my submission, it is imperative that the question of the priority of the superannuation entitlements on a winding up under Section 556 of the Act that were raised in Supreme Court V3121 of 2002 and then in the Court of Appeal but which remain unresolved, be clarified. The litigation surrounding these issues resulted in extensive delay in the distribution of employee entitlements in the Ansett administration and was at considerable cost to the administration and yet the matter remains unresolved.

(xv) Solvency Under The Deed

51 I support the submission that there be a requirement of solvency immediately after a company enters into a deed of company arrangement. In my submission, such a requirement would reduce the incidence of 'phoenix' company arrangements and is consistent with the principle that companies be encouraged to take early remedial action prior to the company becoming insolvent.

I would be pleased to discuss any of the submissions raised in this letter in greater detail should the opportunity arise.

Yours faithfully
Arnold Bloch Leibler

Leon Zwier
Partner