



Turnaround Management Association of Australia

Submission to Treasury

2 March 2010

Supplementary Submission in Relation to Government Discussion Paper

**Insolvent Trading: A Safe Harbour for Reorganisation Attempts Outside of
External Administration**

Contact:
Adrian Loader
TMA President
Turnaround Management Association of Australia
info@turnaround.org.au
Ph: 1300 042 811

1. INTRODUCTION

- 1.1 The Turnaround Management Association of Australia (**TMA**) is a not for profit organisation providing a forum for professionals practising in the field of "Turnaround Management", which is aimed at restoring value to struggling enterprises and avoiding terminal insolvency. Our membership is made up of professionals practising in turnaround management, law, insolvency, accounting, management consulting, banking, finance and private equity.
- 1.2 We welcome the opportunity to provide submissions in relation to options outlined in the Government's paper dated January 2010, titled "Insolvent trading: A safe harbour for reorganisation attempts outside of external administration" (**Discussion Paper**).
- 1.3 The TMA supports the introduction of a business judgment rule for insolvent trading. Our main submission in relation to the Discussion Paper is contained in the Joint Submission dated 2 March 2010 by the Law Council of Australia, Insolvency Practitioners Association of Australia and the TMA.
- 1.4 In this supplementary submission, the TMA expands on issues raised in the Joint Submission and outlines some additional reforms that would be beneficial to improving the turnaround framework in Australia. We believe that these changes will enhance the Government's proposed reform to the insolvent trading laws, so as to assist in the rehabilitation of financially distressed companies.

2. EXECUTIVE SUMMARY

- 2.1 The TMA's vision includes assisting its members to restore and create value in distressed businesses.
- 2.2 Key issue for all stakeholders is preserving enterprise value whilst a business is dealing with financial distress.
- 2.3 Prior to the implementation of a formal external administration – we support the business judgement rule for insolvent trading.
- 2.4 Post external administration – we suggest 3 key changes:
- (a) a moratorium on "ipso facto" clauses;
 - (b) an administrator be permitted to convene a meeting of creditors within 5 business days of appointment to consider a deed of company arrangement proposal; and
 - (c) a person not be disqualified from being appointed as an administrator by reason only of providing services or advice prior to his or her appointment.
- 2.5 We also consider that it may be time to review the interaction between the voluntary administration and receivership regimes, to ensure the objectives of each process are being met.

3. MORATORIUM ON "IPSO FACTO" CLAUSES

Summary of proposal

- 3.1 We submit that a moratorium should apply in voluntary administrations to cover the operation and enforceability of ipso facto clauses, with the effect that certain ipso facto clauses cannot be enforced until at least after the end of the voluntary administration process. The rights of chargees acting before the end of the decision period, counterparties to derivatives, swaps, ADIs with set-off, combination, acceleration, other rights under s440JA of the *Corporations Act 2001* (**Corporations Act**), statutory and contractual rights of set off and the operation of the Payment Systems and Netting Act, 1998 (Cth) (**Netting Act**) should remain unaffected by this moratorium.

- 3.2 An extension of the moratorium against ipso facto clauses which would otherwise alter property rights is highly desirable for financially distressed companies to successfully rehabilitate, the primary object of the voluntary administration process.¹ This is because a company may be subject to a number of key contracts essential to the continuation of its business, including leases and supply contracts. The automatic termination of such contracts upon an administrator being appointed is highly likely to burden the continued operations of that company. We alluded to some of these issues at paragraph 2.6 of the Joint Submission.

IpsO facto clauses

- 3.3 IpsO facto clauses are contractual clauses that create a default, impose additional or modified obligations or dispossesses a party of a property right on the happening of certain events such as the appointment of administrators, changes to capital structures and renegotiation of material contracts. These steps are usual precursors to a workout. The clauses in issue may also provide for accelerated repayment of borrowed funds. Termination may be automatic or at the option of the counterparty.²

History of reform

- 3.4 The Australian Law Reform Commission in its *General Insolvency Inquiry* (ALRC 45) (**Harmer Report**) recommended that 'ipso facto' clauses should, unless the court otherwise ordered, be void against a liquidator or administrator. In 2003, CAMAC released a discussion paper titled *Rehabilitating large and complex enterprises in financial difficulties* (**CAMAC 2003 Paper**) which considered various submissions in relation to the issue and recommended that there be no statutory restriction on enforcing ipso facto clauses.³
- 3.5 More recently, the issue was discussed in the Joint Parliamentary Committee's Inquiry into Australia's Corporate Insolvency Laws entitled *Stocktake on Corporate Insolvency Laws* (**JPC Paper**), where it was proposed that creditors should be prohibited from enforcing ipso facto clauses unless the court grants leave in certain defined circumstances. In Treasury's response to this inquiry, it indicated its stance against the extension of the moratorium to cover ipso facto clauses. The final report of the Joint Parliamentary Committee concluded that it is more appropriate for a court to consider whether a particular contract should be kept on-foot rather than introducing legislation to automatically override ipso facto clauses.
- 3.6 The TMA submits that the issue deserves renewed attention in light of the recent spate of failed companies during the global financial crisis, where many companies which otherwise would, in better economic times, have likely continued to prosper after a corporate reconstruction, have rather failed due to their counterparties' insistence on enforcing the ipso facto clause in a contract. We also point to recent discussions in the industry that the law in relation to ipso facto clauses in periods of voluntary administrations is inadequate.

Proposed reform

- 3.7 The TMA accepts that financial based, or synthetic equivalent, events (eg: non payments, failure to settle deliveries under ISDA derivatives instruments) should, subject to existing Pt 5.3A Corporations Act provisions, still be enforceable after the appointment of voluntary administrators to a company. Similarly, rights of acceleration, combination, set-off and the other rights described in s440JA

¹ Refer s 435A of the Corporations Act.

² IpsO facto clauses are valid, and were upheld by the High Court in *Pan Foods Co Importers & Distributors Pty Ltd v ANZ Banking Group Ltd* (2000) 74 ALJR 791.

³ Refer CAMAC 2003 Paper at paragraph 2.198 and recommendation 21.

Corporations Act are not to be subject to the moratorium. The integrity of financial markets requires parties to remain bound by the terms of their financing arrangements.

- 3.8 The US Courts have recently recognised that counterparty positions in ISDA derivative instruments may be characterised as ipso facto clauses if rights to participate in cashflow waterfalls automatically swap to different parties on the bankruptcy event triggering⁴.
- 3.9 Accordingly, the TMA proposes that the limited extension of the moratorium be dealt with as an extension of s437D of the Corporations Act, in which case the Netting Act will continue to provide the framework for credit exposure netting in swaps, derivatives and similar instruments⁵.
- 3.10 As a result, the moratorium extension shall be limited to deal with those ipso facto clauses that genuinely affect, alter or modify property rights of the company simply by reason of the appointment of a voluntary administrator. The counterparty would be unable to terminate, modify or collect any contracted property held by the company under administration. To balance rights, the counterparty may rely upon the administration as an event of default (avoiding complications concerning mutuality and crystallisation when dealing with contractual set-off rights) and may enforce the operation of the ipso facto clause only with the consent of the voluntary administrator or the court.
- 3.11 This would preserve entitlements of set-off (and combination in the case of ADIs), while also preserving both accrued and crystallised claims. Provisions regarding mutuality and set off in insolvency (s553C) occur automatically, so remain unaffected by the proposed extension of the moratorium to non-financial ipso facto clauses.
- 3.12 We submit that the total prohibition on enforcing ipso facto clauses, excepting those described in s440JA Corporations Act, without court or administrator approval will appropriately facilitate the rehabilitation of companies whilst protecting the interests of creditors. The TMA proposes that the rights of a counterparty would only be affected to the same limited extent as lessors and owners under the current regime. The voluntary administrator shall, if they continue with the relevant contract, be liable to perform the contract and assume the usual payment obligations referable to the benefit derived by the company in continuing the contract, with rights of indemnity to meet such liabilities under s443D of the Corporations Act.

Reasons for our submissions

Impediment to the rehabilitation of the company

- 3.13 The key reason for imposing a restriction on the enforcement of non-financial ipso facto clauses during the voluntary administration process is that automatic termination of obligations, merely because the company appoints an administrator, has the potential to impede significantly on the ability of the administrator to take steps towards the rehabilitation of the company.
- 3.14 Such clauses are likely to operate as a burden to maintaining the trading operations of the company at a time when the continuation of the company's business is paramount to its survival. It can effectively obliterate the business of the company overnight as it leaves open the risk of counterparties terminating key agreements essential to the continued operation of the company. For example, it would be extremely difficult for a company to continue operating if, for example, its key lease or supply contracts are terminated.

⁴ Lehman Brothers Special Financing, Inc. v. BNY Corporate Trustee Services, Ltd (25 January 2010)

⁵ Refer sections 5, 14 of the Payment Systems and Netting Act, 1998.

- 3.15 In turn, this has the real potential to complicate negotiations with stakeholders and therefore creates significant reduction in enterprise value. It considerably reduces the opportunities an administrator may have to negotiate a sale of business and/or assets, and may leave companies and any proponents of a deed of company arrangement with less scope in formulating an attractive (or even effective) rehabilitation proposal.
- 3.16 By way of illustration, the appointment of voluntary administrators to One Tel Limited (**One Tel**) in 2001 resulted in the immediate termination of One Tel's reseller contracts with Optus and Telstra, which was a major factor in its eventual demise.
- 3.17 This effect may be exacerbated if the ipso facto clause contains accelerated payment terms, effectively giving rise to a large and unexpected debt against the company. (For example, a company with 20 years of its lease remaining may be obliged to, under accelerated payment terms, pay for the remaining 20 years' worth of lease payments without having actually utilised the property for a large portion of that term).
- 3.18 Extending the moratorium in this manner may also help to stabilise the asset base of a company (by avoiding a sudden crystallisation of the company's contingent or prospective liabilities) once it goes into voluntary administration.

Encouraging early intervention for rehabilitation

- 3.19 A prohibition on enforcing non-financial ipso facto clauses (with the exception of court or administrator approval) may encourage financially distressed companies to enter into earlier negotiations with their creditors on a possible voluntary administration, or some other form of reorganisation.⁶ This is because the risk of a counterparty enforcing an ipso facto clause upon the appointment of an administrator operates as a deterrent to companies entering into voluntary administration for fear of their major contract(s) being terminated. Such earlier negotiations are highly desirable. Indeed, one of the key issues discussed in the JPC Paper, and also raised in the CAMAC 2003 Paper was the need for early intervention for rehabilitation.
- 3.20 This may also lead to companies seeking appropriate advice from specialist insolvency practitioners in a timely manner, thereby avoiding further financial decline.

Prejudice to creditors as a whole

- 3.21 It cannot be disputed that the interests of creditors is a primary concern of the voluntary administration process. Overall, the interests of creditors as a whole may be prejudiced by the enforcement of ipso facto clauses. This is because it leaves the fate of the company (and thus many creditors' debts) in the hands of the one party. It is the primary interest of the creditors to be repaid the full amount of their debt, and in many instances, this is most likely to occur if the company continues as a going concern. It is certainly not likely to occur if an ipso facto clause contains accelerated payment terms creating a large, unexpected debt for the company.

Freedom of contract

- 3.22 At the centre of the lack of a prohibition over the enforcement of ipso facto clauses is the concept of 'freedom of contract'. It has been argued that a counterparty's decision whether or not to exercise the ipso facto clause should be left to the individual to determine in light of their and the insolvent company's circumstances. If a counterparty forms the view that the company can be turned around, they may not exercise their ipso facto rights. It has also been said that market forces should

⁶ This was recognised in the CAMAC 2003 Paper at paragraph 2.203.

determine whether companies are permitted to continue to trade, rather than administrators and the courts.

- 3.23 However, the operation of market forces have always been subject to legislation and the courts where this is desirable for public policy reasons. The moratorium restricting the enforcement of creditor claims (including after a breach by the company of its obligations) during the period of voluntary administration is an example of this. It is only a small extension to make to widen this moratorium to also temporarily suspending a counterparty's freedom to enforce its rights under an ipso facto clause.
- 3.24 In addition, the need for some sort of moratorium has previously been recognised through the enactment of s 301 of the Bankruptcy Act, which provides that an ipso facto clause triggered upon an individual becoming bankrupt or committing an act of bankruptcy, or the execution of a personal insolvency agreement in the Bankruptcy Act, is void. That section also applies to contracts entered into or granted before the commencement of that Act.
- 3.25 We do recognise that concepts of freedom to contract need to be balanced against the objects of the voluntary administration process and the high desirability of affording distressed companies the opportunity to rehabilitate. We note that other contractual rights are available and should be sufficient to protect the solvent party, and that the voluntary administration process operates only for a limited duration, after which ordinary rights of enforcement will be re-instated.

4. SHORTENING TIME PERIOD FOR DEED OF COMPANY ARRANGEMENT & ADMINISTRATOR'S INDEPENDENCE

Summary of proposal

- 4.1 This submission considers whether the time period for conducting a voluntary administration should be abridged to accommodate the expedient restructure of financially distressed companies in appropriate circumstances. This would enhance the ability of a company, prior to entering into an external administration, to formulate an agreement or compromise aimed at rescuing it from financial distress or maximising returns to members and creditors. The rescue plan may then be implemented quickly through the external administration process so as to minimise loss of value to the business.
- 4.2 Under the current law, an administrator must comply with the strict time periods imposed by the Corporations Act. Compliance with these time periods often has the unintended effect of protracting the process of an insolvency process, thereby undermining its commercial benefit and making the strategy outlined in the paragraph above difficult to achieve.
- 4.3 In this submission, we propose that a mechanism be put in place which allows a deed of company arrangement to be proposed and approved by creditors at an early point in time.

Current provisions that impact on proposal

- 4.4 The Corporations Act imposes a strict timetable for the conduct of a voluntary administration. The administrator must convene a first meeting of creditors within 8 business days after the commencement of the administration in order to determine whether to appoint a committee of creditors and to allow creditors to replace the administrator. Following the first meeting, the administrator must convene a second meeting of creditors, ordinarily within 15 to 25 business days after the commencement of the administration, at which the creditors may resolve:
- (a) that the company execute a deed of company arrangement;
 - (b) that the administration end; or

- (c) that the company be wound up.
- 4.5 While the Court may extend the time period for convening the second meeting of creditors, there is currently no ability for the Court to shorten the convening period if the circumstances so require. Hence if an administrator wished to implement a sale or restructure almost immediately after appointment through a deed of company arrangement, he or she would need to wait at least 15 business days after the commencement of the administration before putting the proposal to creditors.
- 4.6 One of the major attractions of announcing a relevant sale or restructure immediately or very soon after the commencement of a formal insolvency process is the creation of certainty for suppliers and customers. The benefit of this is that enterprise value is preserved during the administration period, thereby reducing job losses and increasing the likely returns to creditors. Such measures, effected within moments of, or even simultaneously with, the commencement of an external administration process avoids a rapid destruction in goodwill, customer base and other business assets during the course of the administration and helps preserve business value.
- 4.7 Consequently, at present, the mandatory time periods in the Corporations Act do not allow the full commercial benefit of formal insolvency processes such as voluntary administration to be realised in Australia.
- 4.8 It would seem theoretically possible, on the current state of the law in Australia, for an administrator to implement a rapid sale of assets without having to wait for the second creditors' meeting. Section 437A(1)(c) of the Corporations Act provides that while a company is under administration, the administrator may terminate or dispose of all or part of the business of the company and may dispose of any of the company's property. It has been held that this provision empowers an administrator to dispose of all the company's business and property without the need to obtain the consent of members at a general meeting, provided that it is the appropriate course of action to take in the circumstances.⁷ However, in practice, it would be unlikely that an administrator would effect a rapid sale of the business or assets without creditor approval.
- 4.9 A simple sale may not be the best means of protecting and even enhancing the business and/or deriving value for creditors and other stakeholders. Rather a more extensive restructure, including of the company's capital composition, may deliver a significantly better outcome.
- 4.10 The existing mechanism in the Corporations Act for effecting such a restructure of a company in administration is through a deed of company arrangement. One notable benefit is the release or compromise of creditors' claims, which can only be achieved through a deed of company arrangement. Proceeding by way of deed of company arrangement would enable a more extensive restructure of the existing entity as opposed to a mere asset sale. That, of course, requires the holding of the second creditors' meeting.
- 4.11 Accordingly, absent the proposed reforms, it is not possible for a company to implement a comprehensive restructure by way of deed of company arrangement without it first languishing in formal administration for a few months. This is the case even where agreement on the restructure has already been agreed by the vast majority of creditors.

International experience

United States

- 4.12 In the United States, Chapter 11 of the Bankruptcy Code makes special provisions for expediency in formal insolvencies. In order to appreciate the significance of these concessions, it is important to

⁷ *Brash Holdings Ltd v Shafir* (1994) 14 ACSR 192 per Beach J

first note some key features of Chapter 11 of the Bankruptcy Code, which differs in crucial respects from the voluntary administration regime in Australia. Ordinarily, a Chapter 11 bankruptcy commences by the debtor company filing a bankruptcy petition with the Court. The filing of a petition is followed by an immediate and automatic stay on the enforcement of judgments, collection activities, foreclosures and repossessions by creditors. The debtor then must file with the Court a plan for reorganisation. The Court conducts a hearing and if it forms the view that the company has provided adequate information for the creditors to properly consider the merits of the proposed plan, creditors vote on whether or not to accept it.

- 4.13 Chapter 11 allows for procedural shortcuts in certain circumstances. For instances, a plan for reorganisation can be filed at the same time as the petition. It is possible under Chapter 11 for the support of creditors to be secured even before the petition is filed.

United Kingdom

- 4.14 In the UK, sales of assets and business often proceeds as a management buy-out of the company's business. The business is then transferred to a new entity usually operated by the previous management, and the proceeds of the sale are applied to discharge the liabilities of the debtor company.
- 4.15 In *Re Transbus International Ltd (in liq)* [2004] 1 WLR 2654, it was held that it is permissible under the Enterprise Act 2002 for administrators to execute a business sale without the sanction of a creditors' meeting or directions from the court.

Administrator's independence

- 4.16 As noted above, an administrator can in theory dispose of the assets of the company immediately upon (or soon after) appointment. However, in practice, it would be unlikely that an administrator could, bearing in mind his or her duties, effect a rapid sale of the business or assets without properly investigating the affairs of the company, familiarising himself or herself with the proposed plan, and being satisfied as to the proper value of the business or assets to be sold.
- 4.17 Therefore, for an expedient sale or restructure to work most effectively, the administrator would ideally need to have had some previous involvement with the company and its directors so as to acquire the requisite degree of knowledge about the company's financial circumstances and the proposed sale or restructure prior to his or her appointment. However the current laws and regulations concerning the requisite independence of an administrator could potentially preclude an insolvency practitioner who has provided prior professional services to a distressed company from being appointed as an administrator of that company.
- 4.18 In *Bovis Lend Lease Pty Ltd v Wily* (2003) 45 ACSR 612, Austin J held that administrators are bound by three separate duties of independence and impartiality:
- (a) administrators must be, and be perceived to be, independent of the company, its directors and shareholders, and individual creditors;
 - (b) administrators must act, and be perceived to act, impartially in discharge of the duties and responsibilities of their office; and
 - (c) administrators must ensure they do not place themselves in a position where there is, or might be, a conflict between their duty to creditors and their personal interest.
- 4.19 A prior association with the company will not, of itself, infringe these requirements of impartiality and independence. However substantial involvement with a company prior to administration will, generally speaking, disqualify a person from appointment as an administrator: see *Re Central Spring Works Australia Pty Ltd; Tubemakers of Australia Ltd v McLellan* (2000) 34 ACSR 169. In *Re*

Monarch Gold Mining Co Ltd; Ex Parte Hughes [2008] WASC 201, Sanderson M commented at [19] that where an administrator has provided professional services to the company prior to the administration, the issue to consider is whether the services were of such a degree of magnitude to the company over a long period and of such a nature as to put in doubt their capacity to independently discharge their office.

- 4.20 Further, the Insolvency Practitioner Association Code provides that practitioners must not take an appointment if they had a professional relationship with the insolvent company during the previous two years, unless certain exceptions apply. The exception to pre-appointment advice is quite confined.
- 4.21 We submit that the Act be amended to clarify that an administrator cannot be disqualified simply by virtue of the fact that they provided prior professional services to the company to assist in preparing and implementing a sale or deed of company arrangement proposal to be effected through the administration of the company.
- 4.22 The interests of creditors may be balanced against this concession by ensuring that the administrator provide full details of his or her prior involvement and the proposal that is to be voted on by creditors, including:
- (a) a detailed disclosure of the administrator's prior involvement with the company;
 - (b) the alternative courses of action that were considered by the administrator;
 - (c) a detailed analysis of the proposal, including why the proposal is appropriate;
 - (d) consultation with creditors if any;
 - (e) the identity of the proposed purchaser; and
 - (f) details of relevant relationships between the company and its management and that of the purchaser.

Suggested reform

- 4.23 We propose that consideration be given to amending the Corporations Act to provide that:
- (a) An administrator be permitted convene a meeting of creditors within 8 business days of appointment, to consider a deed of company arrangement proposal, upon satisfying certain notice requirements to creditors. At this meeting, the administrator can propose a deed of company arrangement or other relevant proposal that has been negotiated prior to his or her appointment. Creditors at that meeting would be able to choose:
 - (i) to accept that deed of company arrangement and end the administration period; or
 - (ii) to continue the administration process as is currently prescribed under the law.
 - (b) A person will not be disqualified from being appointed as an administrator by reason only of providing services or advice prior to his or her appointment in relation to an asset or business sale or deed of company arrangement proposal to be effected through the administration process.
- 4.24 The TMA would not be advocating any change to the voting requirements under the Corporations Act.
- 4.25 Nothing in the proposal would affect the current duties of an administrator.

5. RECEIVERSHIP AND VOLUNTARY ADMINISTRATION

- 5.1 Given the similarities and overlapping professional costs incurred where there is a simultaneous voluntary administration and receivership of a company, the TMA feel it would be prudent for the government to consider the interaction between the two regimes as part of its review of the current insolvency laws aimed at enhancing Australia's corporations law to assist with successful corporate rehabilitations.

Current relevant provisions

- 5.1 Pursuant to section 440B of the Corporations Act, during the administration of a company a person cannot enforce a charge on the property of the company unless the administrator has provided its written consent or the court has granted leave. However, section 441A provides that where the charge is over the whole, or substantially the whole of the property of a company under administration, the secured creditor may, within 13 days, elect to enforce the charge. Such a decision to enforce the charge overrides section 440B and allows the secured creditor to appoint a receiver for the purpose of realising the security.
- 5.2 The effect of section 440B is that from the commencement of the administration of the company, a secured creditor has 13 days in which to decide whether they will appoint a receiver. If the secured creditor elects not to appoint a receiver within this time period, they are then prevented from doing so during the course of the administration (without the consent of the administrator or leave of the Court).
- 5.3 Recent amendments to UK insolvency law have seen secured creditors lose the ability to appoint a receiver to companies which have entered the equivalent of voluntary administration. This is further discussed below. It was suggested that the purpose of that reform was to shift the emphasis onto the corporate recovery of the company in voluntary administration and allow for the interests of all creditors to be considered.
- 5.4 One of the main concerns regarding the appointment of a receiver by a secured creditor is that the appointment may not in all the circumstances produce a result which maximises the enterprise value of the company for the benefit of all stakeholders. A receiver owes its primary loyalties to the secured creditor appointing them.⁸ The predominant goal of a receiver is to recover the secured property for the benefit of the secured creditor, which in some instances, but certainly not all, can conflict with the objectives of the voluntary administration regime.
- 5.5 Section 435A of the Act provides that an administration is to be conducted in a way that maximises the chances of a company recovering and, if that is not possible, to ensure a better return to all the company's creditors and members than would result from an immediate winding up. Some commentators have raised a concern that a concurrent appointment of a receiver and an administrator can stifle the performance of an administrator's duties.
- 5.6 However, the right of a secured creditor to appoint a receiver reflects the significant exposure of major financiers. It is a natural right that flows from the fact that the secured creditor has from the time it takes senior security over all or substantially all assets of the company, a clear interest in, and a degree of control over, the secured assets for repayment of its debt.

Interaction between receiver and administrator

- 5.7 A receiver and an administrator are often granted similar powers. An example is the power to manage and control the business of the company. Sections 437A(1)(a) and (b) of the Corporations

⁸ Re B Johnson & Co (Cuillers) Ltd [1955] 1 Ch 634; Downside Nominees Ltd v First City Corporation Ltd [1993] AC 295

Act provides that while a company is in administration, the administrator has control of the company's business, property and affairs and may carry on that business and manage that property and those affairs. As to a receiver's power, most charges expressly provide receivers with the power to carry on the business of the chargor company. In addition to any express power that may be included in the charge instrument, section 420(2)(h) of the Corporations Act provides that a receiver may carry on any business of the company, provided that this is done for the purpose of attaining the objectives for which the receiver was appointed. In this example, there is an obvious potential conflict between the administrator's power and that of the receiver. The conflict is resolved in favour of the secured creditor and its receiver by section 442D(1) of the Corporations Act, which provides that where a secured creditor enforces its charge during the "decision period", the administrator's functions and powers are subject to the functions and powers of the chargee and any receiver appointed for the purpose of enforcing the charge.

- 5.8 Another example is the power to retain the books and records of the company. Receivers are usually granted a power under the charge to retain any documents that are necessary to support the chargee's title. Further, it is generally accepted that the chargee's proprietary interest gives the receiver a general law right to access the books and records of the company: see *Re Geneva Finance Ltd*; *Quigley v Cook* (1992) 7 WAR 496 at 513-514. As to an administrator's right of access, section 438C of the Corporations Act provides that a person is not entitled, as against the administrator of a company, to retain possession of the company's books. This does not apply to a secured creditor entitled to possession of the books.
- 5.9 In practice, these problems arise quite often. As explained above, the general rule is that a secured creditor cannot enforce its charge during the administration without the written consent of the administrator or leave of the Court. The exception is where the creditor holds a charge over all, or substantially all, of the company's property. In practice, it is common for creditors to take comprehensive security over all of the company's assets to safeguard their position in a voluntary administration (such as taking a "feather-weight" floating charge).

Overseas experience

- 5.10 In 2002, the *Insolvency Act 1986* (UK) was amended (by insertion of section 72A) to restrict the ability of a floating charge holder to appoint a receiver during the course of an administration. Section 72A(1) provides that the "holder of a qualifying floating charge in respect of a company's property may not appoint an administrative receiver to the company". "Qualifying floating charge" is defined in the Act as including the common form of a charge which purports to grant the chargee power to appoint a receiver over the whole or substantially the whole of the company's property.
- 5.11 The amendment was enacted following proposals made by the Government in its White Paper "Insolvency – Second Chance", published on 31 July 2001. The White Paper explained the policy behind the amendment at [2.5]:
- "The Government's view is that, on the grounds of both equity and efficiency, the time has come to make changes which will tip the balance firmly in favour of collective insolvency proceedings – proceedings in which all creditors participate, under which a duty is owed to all creditors and in which all creditors may look to an office holder for an account of his dealings with a company's assets. It follows that we believe that administrative receivership should cease to be a major insolvency procedure..."
- 5.12 The amendment carves out a number of exceptions to the general prohibition, which apply to specific kinds of transactions such as capital market arrangements, public-private partnerships, project financing and urban regeneration projects.
- 5.13 While the UK legislation precludes the holder of a floating charge from appointing a receiver during an administration, it does not abrogate or prejudice the chargee's proprietary rights. Paragraph 70 of

Schedule B1 to the *Insolvency Act* provides that the administrator of a company may dispose of or take action relating to property which is subject to a floating charge as if it were not subject to the charge. However where property subject to a floating charge is disposed by an administrator, the holder of the floating charge shall have the same priority in respect of acquired property as he had in respect of the property.

- 5.14 In Australia, sections 442B and 442C of Corporations Act provide that where a charge was a floating charge at the date of creation but has subsequently become a fixed or specific charge, an administrator may dispose of the relevant property in the ordinary course of business. There is no express provision in the Corporations Act which provides that the administrator must distribute any proceeds from the realisation of floating charge property in the order of priority which would otherwise be afforded by the charge. A provision to this effect would be important from the perspective of a secured creditor. It would ensure that the interests of secured creditors are not unfairly prejudiced and the secured property is protected or at least realised in the interests of the secured creditor. Any change towards a collective insolvency approach should not result in the erosion of the rights of secured creditors over secured property.

Issues for discussion

- 5.15 If any thought is given to adopting the approach of permitting only a single appointment during the external administration of a company, we consider that any such change should ensure that:
- (a) proceeds from the realisation of secured property, including floating charge property, must be used to repay the secured debt in accordance with the terms of the relevant charge;
 - (b) fixed charge assets may only be realised with the consent of the secured creditor;
 - (c) a secured creditor may always be entitled to appoint a receiver if:
 - (i) creditors vote that the company be wound up
 - (ii) the secured creditor does not vote in favour of a deed of company arrangement proposed after the appointment of a voluntary administrator.
- 5.16 The secured creditor should also be entitled to replace the relevant appointee, at its sole discretion, within 13 business days, except in circumstances where the secured creditor is a related party.

6. Concluding remarks

- 6.1 The TMA supports the introduction of a business judgement rule for insolvent trading and suggests the following 3 key changes to post external administration:
- (a) a moratorium on "ipso facto" clauses.
 - (b) an administrator be permitted to convene a meeting of creditors within 5 business days of appointment, to consider a deed of company arrangement proposal.
 - (c) a person not be disqualified from being appointed as an administrator by reason only of providing services or advice prior to his or her appointment.
- 6.2 The objectives of the proposed reforms are to help provide greater returns to creditors and shareholders of a business before and after administration. This may be achieved through a regulatory framework which creates greater certainty as to the value of a business and fosters an environment which allows stakeholders to reach agreement in a timely manner.

- 6.3 The result of these changes will be that troubled companies are able to attract capital or sell assets, even when financially distressed. It will also allow directors to properly perform their duties in the comfort that provided they adhere to the required procedures, they will have an appropriate defence to an insolvent trading claim. This will give directors the opportunity to pursue a successful turnaround of the business thereby increasing the probability of creditors and employees achieving a better return and maintaining their employment.