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Voluntary Administration: Use and Abuse

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Abstract
[extract] Unfortunately, it is the precise features that make the voluntary administration procedure so attractive to insolvent companies that also make the procedure susceptible to abuse of the kind that is the subject of this article. The procedure is quick, efficient, relatively inexpensive and, most importantly, largely free from judicial interference. However, there are some recent cases which demonstrate the potential for the procedure to be employed in circumstances where insolvency is dubious, merely as a means of short-circuiting the ordinary safeguards applicable in cases of corporate reorganisation. In other words, some companies are taking advantage of the relative informality of the procedure to achieve corporate governance reform, rather than salvage companies teetering on the edge of liquidation.. Indeed, the prospect of this development was signalled with some prescience by Justice Austin in a thoughtful paper published last year. His Honour was writing on the subject of administrators as fiduciaries, but his observations, particularly in the introduction of his essay, point clearly toward this a problem confronting judges facing questions arising out of the administration of companies. Fortunately, as Justice Austin goes on to describe, the procedure is subject to judicial oversight, though the case law is still relatively undeveloped.

Keywords
voluntary administration, abuse, role of judiciary, corporate law

Cover Page Footnote
I am deeply indebted to Justice Robert Austin first for bringing this problem to my attention both in the form of his published work and in the form of a superb lecture he delivered to my students in Advanced Corporate Law. I am also grateful to those students, and in particular, Alessandra Steele, for their insights, intelligence and observations. Indeed, for those doubting the crucial connection between teaching law and writing about it usefully and intelligently, I hope that this paper offers ample evidence of the importance of that link. As always, thank you to Katya Rozenblit for her support.

VOLUNTARY ADMINISTRATION: USE AND ABUSE

Saul Fridman[1]

Voluntary Administration in Australia was introduced by the *Corporate Law Reform Act, 1992* (Cth). The aim of the legislation was to provide a workable and efficient means for companies in financial difficulty to effect arrangements with creditors so as to maximise the chance of recussitating businesses undergoing temporary cash flow difficulties. The legislation followed recommendations of the Law Reform Commission's General Insolvency Inquiry several years earlier.[2] The Harmer Report had recommended that the existing scheme of Official Management be replaced with a voluntary procedure for companies in or near insolvency. The obvious aim of such a procedure was to preserve viable companies from winding-up, where pending insolvency might otherwise compel creditors to take steps to place the company in liquidation. A successful rearrangement of company debts would, it was argued, provide tangible benefits to all corporate stakeholders. Continuation of the enterprise would allow employees to remain in employment, preserve synergies represented by the existing business and benefit creditors (particularly unsecured creditors) by saving them from the inevitable poor returns consequent on a creditors' winding up. Although the existing legislation, in the guise of the Official Management process, did contain provisions designed to effect compromises, moratoria and other "workouts", it was felt that what was needed was a procedure that was: capable of swift implementation; as uncomplicated and inexpensive as possible and also flexible in providing a means to seek unlimited alternative solutions for the affairs of the insolvent (or near insolvent) company.[3]

As a result of this reform, the *Corporations Act, 2001* (Cth) (the "Act") now contains Part 5.3A, entitled "Administration of a company's affairs with a view to executing a deed of company arrangement". This Part of the Act is found within

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1 Senior Lecturer, Faculty of Law, University of Sydney. I am deeply indebted to Justice Robert Austin first for bringing this problem to my attention both in the form of his published work and in the form of a superb lecture he delivered to my students in Advanced Corporate Law. I am also grateful to those students, and in particular, Alessandra Steele, for their insights, intelligence and observations. Indeed, for those doubting the crucial connection between teaching law and writing about it usefully and intelligently, I hope that this paper offers ample evidence of the importance of that link. As always, thank you to Katya Rozenblit for her support.

2 Australian Law Reform Commission, *General Insolvency Inquiry* (Canberra, Australian Government Printing Service, 1988) ("Harmer Report").

3 Harmer Report, para 54.

Chapter 5, which deals generally with external administration of companies.[4] It is useful to consider the circumstances within which the various forms of external administration might be used. In one consolidation of the Act, the following "outline" of Chapter 5 is provided:

> *"Chapter 5 "External Administration", deals with the different means of reorganising the manner in which a company is controlled or arranging for a company to be wound up. Usually these changes will occur because the company is insolvent. However the company's directors and shareholders may simply wish to cease operations. These measures generally involve administration of a company by persons other than the company's officers.*
>
> A company may be reorganised by an alteration of its capital structure or the appointment of administrators, liquidators or receivers and other controllers of the property of corporations. When it is considered most appropriate for the company to cease functioning altogether it may be wound up, either on the order of the court or through a decision by members or creditors of the company."[5]

While this summary is not authoritative, it does provide a clear view of the essence of these forms of external administration. The Act provides various means for companies in trouble either to reorganise themselves (presumably with a view to their ultimate preservation) or liquidate in an orderly fashion. In any event, any action taken (or inaction) in these circumstances will impact on the position of the company's stakeholders: principally members, creditors (secured and unsecured) and employees.[6]

Clearly the legislative scheme is premised on the notion that the prescribed procedure will be used only by those companies genuinely experiencing difficulties

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4 Also contained in Chapter 5 of the Act are provisions dealing with arrangements and reconstructions as well as provisions dealing with receivership.

5 *Australian Corporations Legislation, (*2003), p 577.

6 This is not an exhaustive list of such stakeholders. One might include for example the interests of the revenue and indeed the wider community. In any event, those interests are protected both directly and indirectly. An example of a provision which considers the interests of the revenue is s 443BA which imposes liability on a company administrator for certain income tax remittances. One ought read the entire Chapter as an effort to consider "wider interests" in the sense that providing means for the preservation of companies by means of compromise, properly approved and sanctioned, is ultimately in the interests of the wider community. Furthermore, provisions which mandate court approval of reorganisations or rearrangements outside of the insolvency context can similarly be read as protecting "wider interests" in view of the ability of the court to render its decision on whether or not to approve of such a scheme on a discretionary basis: see for example s 411(6), in the context of a scheme of arrangement.

in meeting payments.[7] The precise details of how voluntary administration operated are discussed below. For the present it bears noting that companies in difficulty may choose to renegotiate terms with individual creditors. Of course, the success of these renegotiations depends much on the skills of the negotiator and his or her ability to get individual creditors to "see reason".[8] Furthermore great care must be taken to ensure that subordination deals do not subsequently run afoul of undue preference legislation in the event the company later fails.[9] The benefit of administration in this context is that it provides a quick and relatively inexpensive means of assembling all of the company's creditors and obtaining approval for a means of preserving the company that is binding on all creditors, without the need for individual negotiation or unanimous consent.

Unfortunately, it is the precise features that make the voluntary administration procedure so attractive to insolvent companies that also make the procedure susceptible to abuse of the kind that is the subject of this article. The procedure is quick, efficient, relatively inexpensive and, most importantly, largely free from judicial interference. However, there are some recent cases which demonstrate the potential for the procedure to be employed in circumstances where insolvency is dubious, merely as a means of short-circuiting the ordinary safeguards applicable in cases of corporate reorganisation. In other words, some companies are taking advantage of the relative informality of the procedure to achieve corporate governance reform, rather than salvage companies teetering on the edge of liquidation.. Indeed, the prospect of this development was signalled with some

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7 Note that the Act contains separate provisions designed to assist companies seeking to reorganise for other reasons: s 411, which, importantly contains a different meeting and timing requirements as well as an enhanced role for judicial scrutiny.

8 There is a well known story of Rupert Murdoch's attempt to renegotiate secured debt of his flagship company, News Limited, in the early 1990s. News had fallen into insolvency, largely due to Murdoch's decision to spend a large sum of company funds in order to secure broadcasting rights for NFL football in the US (as key programming for his then fledgling Fox Television Network). Pundits, incidentally decried the move as excessive and opined that Murdoch had overpaid for the rights in question. As an aside, these pundits proved to be horribly wrong, as the subsequent success of Fox demonstrates. As far as News Limited was concerned, however, the decision to commit large amounts of company funds to the broadcasting rights led to the insolvency of the company. Murdoch needed to prevail upon company creditors to accept moratoria or rescheduling of debt in order to buy the necessary time for his gamble to pay off. Larger creditors proved not to be the problem, presumably on the basis that they had large enough amounts at stake that they stood to lose substantially in the event of the company's failure. It proved to be a small creditor in the US midwest which nearly scuttled the whole deal. Ultimately, of course, Murdoch (as legend has it by telephoning the local bank in question personally) was successful in putting his deal together and the rest, as they say, is history.

9 See ss 588FF *et seq.*

prescience by Justice Austin in a thoughtful paper published last year.[10] His Honour was writing on the subject of administrators as fiduciaries, but his observations, particularly in the introduction of his essay, point clearly toward this a problem confronting judges facing questions arising out of the administration of companies. Fortunately, as Justice Austin goes on to describe, the procedure is subject to judicial oversight, though the case law is still relatively undeveloped.

Finally, while preparing this paper, the Corporations and Markets Advisory Committee (CAMAC) released its discussion paper entitled "Rehabilitating Large and Complex Enterprises in Financial Difficulties"[11] in which, amongst other matters, CAMAC invites submissions on the question of whether some of the features of Chapter 11 of the United States Bankruptcy Code should be adopted in Australia. The Discussion Paper specifically refers to the contrast between the limited supervisory role performed by the courts under Australian voluntary administration and the close involvement of the US Bankruptcy Court in proceedings under Chapter 11, where the process is commenced by a petition in the Court.[12]

A Summary of the Operation of Voluntary Administration

Appointment of the Administrator

Remembering that one of the aims of the legislation is to provide a simple, effective and timely means for companies to involve their creditors in producing a means of preserving the company, it should come as no surprise that the commencement of a voluntary administration is informal and does not involve the court at all. All that is required is a resolution of the company's board of directors. Section 436A provides that the board of a company may, by writing, appoint an administrator if the board has resolved that;

> "(a) in the opinion of the directors voting for the resolution, the company is insolvent, *or is likely to become insolvent at some future time*; and
> (b) an administrator of the company should be appointed." (emphasis mine)

What is critical about this provision, aside from the lack of formality (other than writing) required, is that the necessary precondition for a valid appointment is

10 R.P. Austin and B. Brown, "Administrators as Fiduciaries", in I Ramsay (ed.) *Key Developments in Corporate Law and Trusts Law: Essays in Honour of Professor Harold Ford,* 2002, pp 179-201

11 CAMAC, "*Rehabilitating Large and Complex Enterprises in Financial Difficulties: Discussion Paper*", September 2003 ("CAMAC Discussion Paper").

12 CAMAC Discussion Paper at para 1.29 – 1.31.

merely the opinion of the majority of directors that the company is either insolvent or likely to become insolvent. Indeed, as to the likelihood of insolvency, the Act merely requires that the directors have the opinion that the company is "likely to become insolvent at some future time".

Taken at face value, this provision affords significant flexibility and virtually unlimited discretion to the board as to whether to appoint an administrator.[13] However, it seems reasonable to suggest that this discretion is not unlimited. Indeed, as the Corporations Act is now a Commonwealth statute, this provision must be read in a "purposive" fashion.[14] The Act also contains a general provision at the commencement of Part 5.3A which specifies the object of this Part of the legislation. Section 435A provides:

> *"The object of this Part is to provide for the business, property and affairs of an insolvent company to be administered in a way that:*
>
> (a) maximises the chances of the company, or as much as possible of its business, continuing its existence; or
> (b) if it is not possible for the company or its business to continue in existence – results in a better return for the company's creditors and members than would result from an immediate winding up of the company."

Accordingly, it would be inappropriate to permit the valid appointment of an administrator by resolution in circumstances where there is little evidence of either insolvency or its substantial or reasonable likelihood.

However, the definition of insolvency is capable of wide interpretation, and a judicial tradition of not questioning determinations of a board acting in good faith might well deter courts from interfering in the initial appointment of an administrator. Accordingly, while a company need not be insolvent in order for the board to appoint an administrator, what is required is that the board turn its mind to the question and form a bona fide and genuine opinion as to the solvency (or likely solvency) of the company.[15]

The Act is structured so as to provide, so far as is possible, reasonably incentives for a board to take advantage of this procedure in cases of genuine insolvency or risk thereof. Foremost among these incentives is ss 588H(5) and (6) which provide

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13 Note decisions regarding questioning board discretionary decisions. Must be made in good faith and for a proper purpose.

14 Acts Interpretation Act 1901 (Cth), s. 15AA. Even prior to the complete federalising of the Act in 2001, the Corporations Law contained a specific provision mandating "purposive" interpretation of the legislation in s 109J.

15 See *Wagner v International Health Promotions (Admin Apptd)* (1994) 15 ACSR 419.

that in the event of a breach of s 588G (insolvent trading), it is a defence if the director in question has taken "reasonable steps" to prevent the company from incurring debts and that steps taken with a view to installing an administrator will be considered as evidence of these steps.[16]

In addition to this (and other) statutory incentives for the board to act expeditiously in appointing an administrator, there is a significant practical advantage to such a board. That is that the board will be select the administrator. Given the importance of the administrator's role in organising meetings of creditors, investigating the affairs of the company and formulating an action plan for the potential recussitation of the company, one can surmise that the advantage of selecting a favourable administrator is one very much appreciated by directors. In addition, as those holding charges over substantially the whole of the company's property are themselves entitled to appoint an administrator,[17] one can surmise that in some cases the directors' decision to appoint an administrator can be viewed as a sort of "pre-emptive strike".[18]

Thus a plain reading of the legislation reveals the wide potential for abuse of the power to appoint an administrator. But what is it about voluntary administration that makes the appointment of an administrator (other than the potential for relief of directors in circumstances of insolvent trading) an attractive proposition?

The Statutory Moratorium

The main advantage of entering into a voluntary administration (apart from the relevance of the appointment in possible proceedings under s 588G as described above) is that, upon the appointment of an administrator, the company is protected from various claims or actions that creditors make make or take against it. The purpose of this statutory moratorium is obvious, and that is to give the administrator time to take stock of the company's affairs and organise the required meetings with creditors, while simultaneously determining whether or not the company can be saved. Therefore, absent the consent of the administrator or court order, charges on the property are unenforceable;[19] owners or lessors of

16 See G. Hodgson and D. McEvoy, "Voluntary Administrations: Are they really working?", *Business Imperatives Series No 1*, Coopers & Lybrand Publication, 1995, p 21 and also G. Hodgson and D. McEvoy, "Is the Voluntary Administration Process Open to Abuse?", (1996) 7 *Butterworths Company Law Bulletin* 4. Contemporary evidence suggests that the majority of voluntary administrations are commenced for this precise reason.

17 Section 436C

18 See J. O'Donovan, "Corporate Insolvency", (1994) 12 *Company and Securities Law Journal* 517.

19 Section 440B. This can apply even where the chargee has commenced to enforce the charge prior to the commencement of the administration, so long as the court is satisfied that the chargee's interests are adequately protected by the administrator's

property used by the company cannot take possession of that property;[20] proceedings against a company cannot be commenced or proceeded with;[21] and no enforcement process in relation to property of the company can be begun or proceeded with.[22] In addition to this, directors are also given protection from enforcement of personal guarantees they may have given in relation to company debt. Section 440J provides that, during the administration of a company, no guarantee of a liability of the company can be enforced against a director of the company or such persons spouse. Presumably the purpose of this provision is to ensure that there is no disincentive for directors to place a company in administration. Nonetheless, this provision may well provide directors with a strong motivation to resolve to appoint an administrator for no reason other than to protect their personal assets. There are exceptions to the statutory moratorium as regards creditors with charges over perishable property[23] and those creditors whose charge extends to the whole, or substantially the whole, of the property of the company.[24]

Directors Relinquish Control of the Company

Once the administrator is appointed, the powers of all officers of the company are suspended.[25] Thereafter, officers of the company can only exercise their powers with the consent of the administrator.[26] Again, it should be clear that this provides further incentive for directors to act expeditiously in order to ensure the administrator is someone they feel comfortable dealing with. In extreme cases, where unscrupulous directors are concerned, what may result is the administrator acting as a puppet of the directors, while those same directors are seeking to take advantage of the statutory defences to insolvent trading referred to above (as well as taking advantage of the statutory moratorium against enforcement of personal guarantees they may have given).

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proposed course of action: s 441D. Similar provisions apply for owners and lessors (s 441F) as well as receivers (s 441H).

20 Section 440C

21 Section 440D

22 Section 440F

23 Section 441C

24 These creditors are known as “substantial chargees” and the provision exempting them from the statutory moratorium in s 440B is contained in s 441A.

25 Section 437C. This must be contrasted with the situation under Chapter 11 in the US where directors retain control of the company subject to close court supervision. Likewise, in Canada, the *Companies Creditors Arrangement Act* also provides that the incumbent board remains in place subject to court supervision, usually exercised through the appointment of a court-appointed monitor over the company’s affairs. As the CAMAC Discussion Paper notes, it has been proposed in Canada that courts be given the power to appoint an external administrator or replace all or some of the incumbent board: see CAMAC Discussion Paper at para 1.29.

26 Section 437C(1A).

In particular, once appointed, only the administrator has the power to deal with the company's property.[27] In dealing with company property, or in respect of the exercise of any function or power as administrator, the administrator is taken to be acting as an agent of the company.[28]

At the same time, the administrator is liable for any debts incurred in the performance or exercise of his or her powers as administrator for services rendered, goods bought or property hired, leased, used or occupied.[29]
While in control of the company, the administrator is also required to investigate the company's affairs and form an opinion as to whether it would be in the interests of the company's creditors for:

> *(a) the company to execute a deed of company arrangement;*
> (b) the administration to end and control of the company to be returned to the directors; or
> (c) the company to be wound up.[30]

In the event that this investigation reveals evidence of malfeasance or misfeasance by any past or present member or officer of the company or by a person participating in the formation, promotion, administration or management

27 Section 437D. Others may deal with the company's property with either the administrator's consent or by court order: s 437D(2).

28 Section 437B.

29 Section 443A. While this seems harsh, there is some solace. The administrator is not liable for the first seven days of rent in respect of premises continuously occupied or used by the company, thus has a period of a week to determine whether to vacate: s 443B. Furthermore, the administrator is entitled to be indemnified out of the company's property for debts for which he or she is liable under s 443A by virtue of a statutory indemnity contained in s 443D. Of course, there are cases where the administrator will be under pressure to decide to continue to operate the company's business, often at the behest of employees. In these cases, where the business can only be carried on at a loss, the administrator will be concerned to ensure that the assets of the company will ultimately be sufficient to make good the statutory indemnity. Furthermore, the administrator will likely be pressured by secured creditors to ensure that the assets of the company are not significantly eroded during this time, thus reducing their recovery in the event the company subsequently is liquidated. The lengthy administration of Ansett Airlines is illustrative. On numerous occasions, the administrators applied to Court for directions, particularly concerned about questions of breach of duty should they elect to continue to operate the company in the face of mounting business losses. The Court refused to provide any comfort beyond indicating that administrators were accountable as fiduciaries for any breach of statutory duties of care and diligence (s 181): See *Re Ansett Australia Ltd and Others (all admin appointed) and Korda and Others (as admin)* (2001) 40 ACSR 433.

30 Section 438A. This must be done "as soon as practicable after the administration of a company begins."

of the company, the administrator must report the matter to ASIC as soon as practicable.[31]

Calling Meetings of Creditors

Within five business days of the commencement of the administration, the administrator must call a first meeting of creditors.[32] The purpose of this meeting is to determine whether a "committee of creditors" ought be appointed[33] and whether or not the creditors wish to remove the administrator selected by the board and appoint someone else.[34] Indeed, this is the only opportunity to replace the administrator available to the creditors.

A second, more substantive, meeting of creditors must, in general, be held within the next month.[35] It is at this meeting that the creditors will resolve as to which of the three course referred to above will be taken.[36] The creditors must receive proper notice, which notice must be accompanied by a copy of the report of the administrator referred to above.[37]

The Deed of Company Arrangement

If the company is to be saved as a result of the administration, it is likely that the creditors will have resolved, at the second creditors' meeting, that the company execute a Deed of Company Arrangement (DOCA). Other than certain basic matters required to be included, there is virtually unlimited scope for the contents of a DOCA.[38] The typical DOCA will involve a "white knight", often a third party or corporate insider who, in return for a willingness to inject the necessary funds or offer a compromise or moratorium, seeks some value in exchange, whether that be a commercial arrangement having to do with the company's assets or some reorganisation of the company's internal affairs. In many cases,

31 Section 438D.
32 Section 436E.
33 The function of such a committee is to deal with the administrator in respect of matters arising out of the administration: s. 436F.
34 Section 436E(4).
35 The precise requirement is for the second meeting to be held within five business days of the end of the "convening period", which itself is either 21 days or 28 days (if the administration begins either in December or within 28 days of Good Friday) from the day on which the administration began: s. 439A(5).
36 Section 439C.
37 Section 439A(3), (4).
38 Certain matters are required to be dealt with such as the identity of the administrator, the duration of the period for which the deed operates, duration of any moratorium, property of the company to be available to creditors, the extent to which there are any debt releases, conditions of termination and several other matters: s. 444A

the appointment of the administrator in the first place may have been in contemplation of eventual approval of a DOCA that has been already conceived.

The appeal of the DOCA is that it is, if properly approved, binding on all creditors of the company.[39] In order to be carried, resolutions of creditors must be supported by a majority of creditors voting in both number as well as in terms of the value of the debts such creditors are owed.[40] There is no requirement for court approval[41], though, as we will see below, there are various means by which the Court has power over a DOCA and the manner of its approval.

Abuse of Voluntary Administration and Judicial Control Thereof

Even from the previous discussion, the prospect of abuse of the voluntary administration emerges To be sure, the legislation deliberately creates an incentive for directors to be cautious in times of insolvency. However, this, coupled with the ease with which companies can appoint administrators clearly sets the stage for the unscrupulous to take advantage. This much was recognised by Justice Austin in his essay focusing on the means by which judicial control over the process can be asserted.[42] In this section of this article, I will review some of the principal examples of what might loosely be termed, abuse of the procedure.[43]

39 Section 444D.

40 Corporations Regulations, 5.6.21(1). The Regulations contain very specific rules regarding which creditors are entitled to vote (5.6.23), the manner of voting (5.6.19), the means of calculating the voting power of secured creditors (5.6.24) as well the usual provisions one would expect to find concerning meetings: notice, proof of notice, permission to use teleconferencing, participation by proxies, time and place, advertisement, quorum requirements and rules relating to selection of a chairperson (Reg 5.6.12 – 5.6.17).

41 Which is undoubtedly tempting to those seeking to reorganise a company and would rather not go through the cumbersome procedure prescribed in s 411 (Schemes of Arrangement).

42 R. Austin and R. Brown, "Voluntary Administrators as Fiduciaries", in I. Ramsay (ed.), *Key Developments in Corporate Law and Trusts Law: Essays in Honour of Professor Harold Ford*, (2002), pp 179 – 201. This paper contains a superb analysis of the judicial tools provided by the Corporations Act which may be invoked to restrain abuse of voluntary administration.

43 There has already been some empirical work which suggests that this procedure has been abused. See G. Hodgson and D. McEvoy, "Voluntary Administrations: Are they really working?", Business Imperatives Series No 1, Coopers & Lybrand Publication, 1995, p 21. The authors note both anecdotal and statistical evidence to suggest that voluntary administrations are being used inappropriately. In particular, they quote the Queensland Cell of the Centre for Excellence on Reconstruction and Insolvency, which reported that: "Directors have an unreasonable opportunity to manipulate a deal to suit their advantages and to push a deal through offering some prospects of hope to creditors. This could disguise potential relation back transactions, preferences, etc." at page 25.

Directors Seeking to Retain Control of the Company or Prevent Investigation

As is clear from the above, the legislation does provide substantial motivation for directors to appoint an administrator, if only that of self-preservation. A case which demonstrates this extremely well is *Kazar v Duus and Others.*[44] The "company" in question here was the Goolburri Aboriginal Corporation Land Council ("Goolburri"), an aboriginal council registered as an association under the *Aboriginal Councils and Associations Act 1976* (Cth) (the "ACAA"). The ACAA contains a provision (s. 71) which permits the Registrar to appoint an administrator. At the same time, the ACAA incorporates Part 5.3A, thus permitting boards of aboriginal corporations established under the ACAA to appoint an administrator in cases of real or apprehended insolvency. Goolburri was served a notice under s. 71 of the ACAA to "show cause" as to why the Registrar should not appoint an administrator. Quite apart from a situation of insolvency, accounting records showed that Goolburri enjoyed a healthy surplus. What was troubling the Registrar was evidence of accounting and financial irregularities that, in his opinion, required investigation. After having received the notice under s. 71 of the ACAA, Goolburri's board resolved to appoint an administrator (K). Subsequently the Registrar also acted to appoint an administrator (D) pursuant to his statutory power to do so. Given the timing of the board's action, one might surmise that the board acted to forestall the pending investigation of the company by an administrator appointed by the Registrar, as well as, through choice of a "friendly" administrator, continue in effective control of the company.

The matter came before Merkel J as a result of an application by K for directions as to the validity of D's appointment. Later in the same proceedings, D challenged the validity of K's appointment as administrator.

To a great extent, the problem of inconsistent appointments of administrators was resolved through process of statutory interpretation. Merkel J held that the ability of a council incorporated under the ACAA to make use of voluntary administration was subject to the power of the Registrar to appoint an administrator under s. 71 of the ACAA. Thus, once the Registrar's appointment took place, the previous appointment could not continue. Interestingly enough, His Honour noted that the purposes of the two separate schemes of administration differed. Whereas the Corporations Act scheme exists for reasons well described above in this article, the ACAA scheme exists primarily to remedy irregularities revealed by prior investigation. The Registrar's power to appoint an administrator is broadly to remedy breaches of the ACAA and other irregularities where to do so would be in the interests of members, creditors and the public generally. The ACAA mentions specific grounds which include trading at a loss, failure to comply with provisions of the ACAA or the rules of the corporation and

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44 (1998) 29 ACSR 321.

members of the governing committee acting in their own interest. To this end, once an administrator is appointed by the Registrar the offices of the members of the governing committee (the equivalent to a board of directors) are vacated. Should the administration end and control of the company is returned to the governing committee, new elections for committee members must be held. This is substantially different to the result of voluntary administration under Part 5.3A of the Corporations Act, where the directors of a company under administration continue in office during the administration. The administration merely suspends their power to manage the company until such time as control is returned to them. One can thus see why it might be in the interest of an incumbent governing committee to preclude the Registrar's appointment of an administrator in favour of an appointment of their own, particularly in circumstances where there are allegations of financial and other improprieties involving committee members.

In the final analysis, Merkel J held the appointment of the administrator under Part 5.3A (as incorporated into the ACAA) to be invalid, principally for two reasons:

1. The council had not formed the requisite opinion as to the company's solvency as required by s. 436A; and
2. The council's appointment of an administrator was activated by an improper purpose.

It is worth quoting from the judgment at some length in order to get a sense of the evidentiary basis for Merkel J's conclusions. In addition, the evidence leads to a clear inference of abuse of the voluntary administration procedure.

As to the first reason, His Honour recounted at some length the background to the decision to enter voluntary administration, referring specifically to concerns expressed by Goolburri's chairman that the Registrar had a "personal vendetta" against him as well as the desire of the governing committee to continue to influence the affairs of the company. His Honour referred to the minutes of the crucial directors' meeting, which was attended by Kazar (the person ultimately appointed as adminstrator) and Hanrahan (a chartered accountant invited to attend the meeting):

> It was in that context that Kazar offered the alternative of appointing him as an administrator under the CL. Kazar and Hanrahan were aware of the desire of the governing committee to be able to take matters into their own hands so that they could have input into the running of the association. Kazar assured the members that he would cooperate with the committee which could continue to have an input if he was appointed administrator. After Kazar informed the meeting of the proposal for him to be appointed as an administrator under the CL, he said that that proposal required the committee to form the view that Goolburri was or was likely to become

insolvent. Thomas informed the meeting that although Goolburri's financial records were a disaster it was simply not possible to ascertain what its financial position was at that point of time. Thomas did not suggest, nor was it his view, that Goolburri was in financial difficulty. It is quite clear that no one attending the meeting was aware of, or was in a position to ascertain, the current asset and liability situation of Goolburri. Someone asked whether appointing Mr Kazar under the CL will "stymie" the Registrar. Nicol, who attended the meeting to advise as to legal issues in relation to Kazar's appointment, said "yes" and explained that there could not be a dual appointment. There was discussion about a number of potential financial problems that might arise including liabilities arising from certain claims for unfair dismissal. The central problem was that no one was able to form a view as to whether Goolburri was, or was likely to become, unable to pay its debts. In his evidence, Kazar conceded that he understood that the governing committee did not have the information available to make an informed decision as to solvency or otherwise. Kazar's evidence was that, in substance, he advised the meeting that:

Unless they're able to form an opinion that the organisation can pay its debts as and when they fall due, the implication must follow that at some point in the future there's a possibility that it might not.

and that:

... if there was some concern about the organisation [being] able to pay its debts as and when they fall due, then that is a ground upon which they could pass [the] resolution.

I am satisfied that the impression created by Kazar, and intended by Kazar to be created, with members of the committee at the meeting was that if they could not form a view as to solvency of Goolburri it followed that it was or was going to become insolvent. Ms Lawton said that she understood the resolution proposed by Kazar to mean:

… that we didn't know if we were solvent or insolvent at the time.

Kazar then left the meeting to enable the committee to discuss his proposal but Nicol remained in the event that any legal advice was sought. There was some discussion about various aspects of Goolburri's financial problems including the outstanding unfair dismissal claims and their potential cost. After Kazar's return to the meeting, five matters relating to Goolburri's finances were formulated and put to the meeting which agreed upon each of them. It is unnecessary to outline the detail of the matters save that they relate to the committee's concerns about the need to get its financial accounts in order, the unfair dismissal claims, the uncertainty of

Goolburri's financial position and the possibility that the notice under s 71 might have an adverse affect on the viability of Goolburri. The resolution proposed by Kazar was then passed and his letter of appointment approved.

The handwritten minutes prepared by Ms Menhinnitt record that Kazar and Hanrahan had undertaken to "work with" the committee. Finally they record Thomas' thanks to the committee for entrusting him to work with Goolburri.

Somewhat ironically, the final observation made by Thomas, and recorded in the minutes, is that working with the current staff of Goolburri he "would have things working well in a month or more".

Did Kazar's appointment comply with s 436A? …

It is a precondition to the valid exercise of the power to appoint an administrator that the board (or in the present case, the governing committee) form an opinion as to the insolvency, or likely insolvency, of the corporate entity.

It is implicit in the statutory requirement that the opinion be bona fide and genuinely formed. Further, statutory decisions that are conditional upon the formation of an opinion, satisfaction as to certain matters or other subjective criteria can be reviewed and vitiated where they involve, for example, an error of law…

An inability to determine whether a corporation is or is not solvent, without more, cannot found an opinion that it is or is not insolvent or likely to become insolvent. As was emphasised by Santow J in *Wagner v International Health Promotions* (1994) 15 ACSR 419 at 421, s 436A requires a "concluded" rather than a tentative opinion. For example his Honour found that having reason to believe a company may be insolvent was not a concluded opinion that it is insolvent.

Judicial views have differed as to whether an opinion must be separately formed as to insolvency or as to likely insolvency (see *Lanson Investments Pty Ltd v Murray River FM Pty Ltd* (1 December 1993, Fed C of A, Gray J, unreported, at 5–6)) or whether a single opinion as to "actual or likely insolvency" will satisfy the requirements of the section (see Re *Roy Davis Contracting Pty Ltd* (22 April 1996, SC (Qld), Moynihan J, unreported at 3)). There is a fine line between the concepts of actual or likely insolvency which need to be viewed "as it would be by someone operating in a practical business environment": Re *New World Alliance Pty Ltd v Baseler* (No 2) (1994) 51 FCR 425 at 434 per Gummow J. Viewing the concepts in

that way, if an opinion is genuinely formed as to "actual", "likely" or "actual or likely" insolvency, that opinion will satisfy the requirements of the s 436A. Thus, I
would not treat the resolution of "actual or likely" insolvency in the present case as one which does not satisfy s 436A merely because it failed to form a separate opinion as to actual or as to likely insolvency.

Thus, the validity of the decision to appoint Kazar as an administrator of Goolburri pursuant to s 436A of the CL requires that:

- Goolburri's governing committee form a genuine, bona fide and concluded opinion as to insolvency, that is, Goolburri is or is likely to be unable to pay its debts as and when they become due and payable;

- in forming the requisite opinion, the governing committee address the question formulated in the section and not err in law in doing so….

In the present case it is not possible to penetrate the minds of each of the members of the committee as, putting all else aside, only one of the members gave evidence. However, that fact cannot immunise the decision from challenge. The task of the court is to determine, having regard to the actual facts and circumstances, whether on the balance of probabilities the opinion required to be formed by the repository of the power (that is, the governing committee) as a condition of its exercise, has been formed. Although statements as to subjective intention must be relevant the court must approach its task of classification of the conduct in question objectively: see *Advance Bank Australia Ltd v FAI Insurances Ltd* (1987) 9 NSWLR 464; at 485; 12 ACLR 118 per Kirby P.

Was the opinion purportedly formed by the committee bona fide and genuinely formed by it? My findings, which I have set out above, satisfy me that:

- the committee members were not able to form any view as to the solvency or likely insolvency of Goolburri on the basis of the information available to them at the meeting on 20 June;

- the committee members did not form an opinion at that meeting that Goolburri was insolvent or likely to become insolvent at some future time on the ground that it was likely to be unable to pay its debts as and when they fall due;

- the opinion in fact formed by the committee was that it was unable to determine Goolburri's actual or likely ability or inability to pay its debts as and when they fall due;

> - at the time the resolution required by s 436A was passed, the governing committee was of the opinion that if it was unable to form any view as to the solvency of Goolburri it was appropriate to pass the resolution.
>
> On the basis of those findings, it must follow that the opinion required by s 436A was not, as a matter of fact, formed by the governing committee. I would add that even if the committee had, as a matter of fact, formed the requisite opinion I would have concluded that the opinion was vitiated by a mistake or error of law. It is quite clear that the committee, in passing the resolution, was of the view that the legal requirement for the resolution to be passed was that its members form an opinion that they were unable to determine whether Goolburri was or was likely to become unable to pay its debts. Plainly, that view is an error of law. Consequently, the governing committee failed to address the question required to be addressed by s 436A and therefore did not validly exercise the power conferred by the section."[45]

I trust that the reader will excuse me for quoting from this judgment at length. In my view, Merkel J's reasons provide a detailed account of the law relating to the necessary conditions supporting a valid appointment of an administrator under Part 5.3A. In addition, His Honour's reasons provide an extremely useful analysis of the sort of factual judgments that directors are required to make in order to make a valid appointment. Finally, the foregoing extract from the judgment clearly shows already the evidentiary basis for the second reason given by Merkel J for determining that the committee's appointment of an administrator was invald, that being that the appointment was for an "improper purpose". Once again, His Honour's reasons are worth reproducing:

> "A statutory power must be exercised for the purpose for which it was conferred. If the power is exercised for more than one purpose, where one of those purposes is improper, the exercise of the power will be vitiated if the improper purpose was a substantial purpose in the sense that the decision would not have been made but for the ulterior purpose…
>
> It is clear… that the exercise of the power to appoint an administrator under s 436A must be in furtherance of the object of Pt 5.3A as set out in s 435A. Thus, if the power to appoint an administrator is exercised for a purpose unrelated to that object but for an ulterior or extraneous purpose then it will be invalidly exercised. A purpose of preventing the Registrar from appointing an administrator under s 71 of the ACA Act would in my view clearly be an appointment for an ulterior, and therefore improper

45 (1998) 29 ACSR 321 at pp 332-335.

purpose, as such a purpose is unrelated to the object or purposes to which I have referred.

It would also be an improper purpose to exercise the power conferred under Pt 5.3A to perpetuate control or positions of the directors or the governing committee: see *Howard Smith v Ampol Petroleum Ltd* [1974] AC 821; at 837; *Ngurli Ltd v McCann* (1953) 90 CLR 425; at 439–40, 447–48 and *Aloridge Pty Ltd v Christianos* (1994) 13 ACSR 99; at 102. In Aloridge, Burchett J terminated the appointment of an administrator under Pt 5.3A which was made, not for a statutory purpose, but in order to "wrest control" of the affairs of the company from a previously appointed provisional liquidator, with whom the directors were having a dispute. Similarly in the present case, it would be an improper purpose of the governing committee to exercise its power to appoint an administrator under Pt 5.3A if in doing so the purpose, or a substantial purpose, was enabling it to retain influence or control over the affairs of Goolburri.

In summary, a purpose of impeding the Registrar or a purpose of the committee members retaining influence or control is unrelated to the object set out in s 435C and to the purpose of administering a company's affairs with a view to achieving any of the "normal" outcomes provided for by s 435C (2).

As pointed out above, determination of the purpose of a deliberative body constituted by a number of individuals requires consideration of the actual facts and circumstances rather than the penetration of the mind of each member of the body. In the present case the actual facts and circumstances leave little doubt as to the purpose of the governing committee in purporting to exercise its power to appoint Kazar as administrator. The purpose, or more accurately, the purposes which actuated the governing committee to appoint Kazar as administrator were to prevent the Registrar from exercising his power to appoint an administrator under s 71 of the ACA Act and to enable the governing committee to continue to have input and influence over the conduct of the affairs of Goolburri through their appointee, Kazar. Those purposes are not purposes for which the power under s 436A might properly be exercised and are ulterior and improper purposes.

On 20 June 1998 the problems that were required to be addressed by Goolburri were the deficiencies and irregularities which were the subject of the s 71 notice, rather than any difficulties with creditors. At that time, Thomas had been addressing the accounting and financial problems of Goolburri. If the governing committee was of the view that Thomas was not sufficiently addressing those problems, it was quite open to it to engage Kazar or his firm to do so. There was no need for Kazar to be

> appointed as an administrator to achieve that object. Further, there were no outstanding claims being pressed by creditors and no evidence available at the time of actual or potential insolvency. In these circumstances, any argument that the power might have been exercised for the purposes of Pt 5.3A, as set out above, is untenable.
>
> Accordingly, the appointment of Kazar is also invalid on the ground that the governing committee's appointment of Kazar was actuated by an impermissible purpose."[46]

The case is instructive for several reasons. First of all, it demonstrates that it is possible to challenge the appointment of an administrator if the appointment is not consistent with the statutory purpose of Part 5.3A. Clearly, the evidence in this case was consistent with an obvious motivation of thwarting a legitimate investigation by the appropriate statutory officer. One could imagine similar motivations arising in other cases where, rather than the Registrar under the ACAA acting, an investigation by ASIC might be pending.[47] Second, the case clearly demonstrates the necessity for a board to form a genuine view as to the insolvency or likely insolvency of the company as a prerequisite to appointment of an administrator. Third, the passages quoted above show very clearly how a board, with the participation of a friendly administrator, can act to extend its control indirectly.

More recently, in *Blacktown City Council v Macarthur Telecommunications Pty Ltd*[48] Barrett J ordered the termination of an administration and the appointment of a liquidator in a similar case involving abuse of the process. In this case, the

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46 *Ibid.* at pp 335-337.

47 Or a proper investigation by a liquidator. One such case was *Cresvale Far East (in liq) v Cresvale Securities Ltd and others (No. 1)* (2001) 37 ACSR 394 where Austin J exercised his judicial discretion to terminate a deed of company arrangement under s 445D. The case was complex and there were a number of justifications advanced for terminating the deed, but principal amongst those reasons was a concern that the deed would circumvent proper investigation of dubious transactions. This of course is a slightly different matter than terminating the appointment of an administrator in the first place. However, the principles involved are similar. Indeed, as the *Cresvale* litigation demonstrates, there is even greater potential for abuse in the event that the administrator proposes a deed of company arrangement. Austin J's judgment was partially reversed on appeal: *Kirwan and others v Cresvale Far East (in liq)* (2002) 44 ACSR 21. This case is discussed at greater length below.
In fact, it should be pointed out that there is a discretionary power in s 447A for a Court to make "such order as it thinks appropriate" about the operation of Part 5.3A in relation to a particular company. Such orders include the termination of an administration (s. 447A(2)), and s. 447A(4) includes ASIC among the list of those entitled to apply for such an order.

48 [2003] NSWSC 883, Supreme Court of NSW, 26 September 2003.

sole director of the company attempted to place the company into administration on the eve of the trial of an action the company was defending. The director also proposed a deed of company arrangement which would result in creditors compromised the substantial value of their claims. The only creditors at the time were the director and the company's solicitors and accountants, the latter two who were in the view of the courts likely to have come to some other arrangement with the company's sole director. In view of these facts, Barrett J concluded:

> …that the administration in general and the deed proposal in particular were engineered by [the director] in a clear and deliberate, but not subtle, attempt to stave off the District Court hearing by bringing the statutory stay of proceedings under s 440D into play and to provide a legal framework in which he, his accountant and his solicitor would become the sole effective decision makers in a process which, while ostensibly holding out some theoretical benefit of modest proportions to creditors, is really designed to forestall the obvious and inevitable fate of insolvent winding up, in which the conduct of [the director] will come under scrutiny by reference to the insolvent trading provisions. There is, at best, mere lip service to the purposes of Pt 5.3A, the overriding purpose and motivation being the avoidance technique to which I have referred. In particular, there is not and could not be any real purpose of rehabilitating the company as a commercial concern. Nor can improved returns to creditors through the proposed deed of company arrangement be regarded as anything but purely speculative."[49]

These cases demonstrate that, despite the lack of judicial control of entry into administration *ab initio* as in both of the North American jurisdictions, there is sufficient opportunity for the court, on application, to control abuse of this part of the legislation.

Restructuring or Effecting Significant Changes to Corporate Governance

There are a number of cases which demonstrate the potential for the voluntary administration procedure to be used to effect changes in control of the company or substantial restructuring in a manner that avoids normal procedural safeguards, such as approval by a general meeting or the Court.

One such case was *Cadwallader v Bajco*[50]. This case involved two family companies, each of which was owned and operated by different members of the same family. The core business of the group was carried on by Cadwallader, while Bajco owned the property where the core business was being conducted. This property was leased to Cadwallader. The shareholders of each company were

49 Id. at 889.
50 Unreported, 24 December 2001, [2001] NSWSC 1193.

family members, such shareholdings distributed in such a way that two distinct groups, representing feuding factions of the family, emerged. Feuding family members disputed payments made to directors, purported share transfers as well as matters relating to the division of the original business among family members by its founder. Subsequently Bajco commenced litigation against two of the siblings and Cadwallader. During negotiations to settle disputes, it became clear that two of the siblings, using their majority shareholding in Bajco would, by means of requisitioning the required meeting, attempt to remove and replace the directors of Bajco with whom they were feuding. Prior to any such meeting taking place, the incumbent directors of Bajco resolved to place the company into administration. A subsequent Deed of Company Arrangement was executed, pursuant to which the principal asset of Bajco (the property on which the engineering business conducted by Cadwallader was carried out) would be sold and proceeds distributed among the members. It was further provided that deductions representing disputed amounts would be deducted from the proceeds due to certain shareholders.

The evidence revealed that Bajco was in all likelihood not insolvent at the time the directors resolved to appoint an administrator. Furthermore, Austin J held that when the directors of Bajco resolved to place the company into administration they were acting improperly. Austin J found as a fact that the incumbent directors were motivated by a desire to prevent themselves from being removed from office and replaced by family members with whom they were feuding. As His Honour put it:

> "Since the directors, when exercising their powers as a board, are acting in a fiduciary capacity, the power to pass the resolution envisaged by section 436A(a) is a fiduciary power…In order to validly exercise that fiduciary power, the directors who vote in favour of the resolution must form their opinion about the solvency of the company and the desirability of appointment of an administrator genuinely and in good faith…Additionally the law requires that the purpose of the resolution, as an act of the board, be ascertained, and then characterised as proper or improper…
>
> [The] actual purpose in resolving in favour of the appointment of administrators – probably [the] sole real purpose, at least the dominant one, and the one but for which [the directors] would not have acted…was to preserve themselves in office and thereby ensure the continuation of [proceedings previously commenced against other family members and their company]. A decision made for that purpose is a misuse of the fiduciary power of directors under s. 436A. Directors cannot use a fiduciary power to take steps which are designed to prevent the body of shareholders from considering a resolution to remove them, even if they believe that by retaining office they will be able to advance the interests of

> shareholders…it follows that the resolutions for the appointment of administrators and consequential matters were voidable and liable to be set aside in properly constituted proceedings."[51]

Austin J then went on to hold that, pursuant to s. 447A, all steps taken pursuant to the appointment of administrators (which was voidable on account of its having been motivated by an improper purpose) could be overridden.

Leaving aside any discussion of whether this represents a proper interpretation of the "proper purpose" rule[52] Austin J's disposition of this matter demonstrates how resort to general fiduciary principles combined with specific statutory power over Deeds of Company Arrangements is necessary to prevent "improper" use of voluntary administration, in this case as a means of circumventing the general meeting as an important protective device to counter self-serving directors.[53]

Another such case is *Cresvale Far East Ltd (in liq) v Cresvale Securities Ltd and Others (No. 1)*[54] Once again, the facts of this case are complicated and involve a complex corporate group structure. The salient part of the litigation, from our perspective, concerns the appointment of an administrator by one of the companies in the group (Securities) and the subsequent decision to execute a DOCA. The group's holding company (Far East) was itself a wholly-owned subsidiary of a foreign entity, itself in liquidation. Further issues concerned transactions between Securities and another subsidiary in the group, Capital, whereby Capital transferred assets to Securities as repayment of intercompany debt. Disputes over the voidability of this transaction affected determination of voting strength in subsequent creditors' meetings. Furthermore, Kirwan, one of the directors of Capital subsequently acquired some shares from Securities at an attractive price (ostensibly in order to assist Securities in meeting Stock Exchange liquidity requirements). One of the subsequent issues in the litigation concerned the propriety of this transaction. Suffice to say that, ultimately, a DOCA was proposed for Securities, pursuant to which one of the directors of Capital, Kirwan, proposed to inject funds into Securities in exchange for massive allocations of shares. The effect of these new share issues would be to reduce Capital's interest in Securities drastically. Kirwan had previously negotiated to purchase Capital's stake in Securities unsuccessfully. Lurking in the background were also claims by Newland relating to a share issue in respect of which Securities were alleged to

51 *Cadwallader v Bajco* [2001] NSWSC 1193 (24 December 2001) at 37-39.

52 Austin J's analysis raises the difficult question of whether directors are ultimately justified in their actions if honestly believing the actions to be in the best interests of the company. This matter is dealt with in more detail in my earlier paper "An Analysis of the Proper Purpose Rule", (1998) 10 *Bond Law Review* 210.

53 In addition, Austin J was concerned that the DOCA was being used as a device to effect the winding up of Bajco without compliance with relevant provisions of the Corporations Act: at page 45.

54 (2001) 37 ACSR 394.

have underwriting liability as well as a claim relating to alleged amounts unpaid in respect of management service contracts.

Austin J later described the effects of the DOCA on the various parties:

"The DCA was clearly disadvantageous to Far East, Capital and Newland. Capital was deprived of its control of Securities for no direct consideration, and in [the administrator's] view, it was not a creditor entitled to participate at all in distributions. Far East was disadvantaged indirectly by the unfavourable treatement of Capital, since it was the holding company of Capital and also a substantial creditor of Capital. Newland, if its claim succeeded, would be deferred to employees and trade creditors. Far East and Newland would receive only a proportion of their claims in distributions. The business would be launched again in the hands of the directors, free of their claims and with its assets in tact."[55]

The DOCA was challenged by Far East. Unlike the situation in *Cadwallader,* there was no question of the insolvency of Securities. In the trial judgment, Austin J was critical of various aspects of the administration, including the exercise by the administrator of a casting vote at the second meeting of creditors. The need for a casting vote arose on account of the indeterminacy of the votes exercised by creditors: a majority in number voted one way, while a majority in value voted the other. Austin J held that the administrator exercised his casting vote improperly. Following a review of the reasons given by the administrator for exercising the casting vote, he observed:

> *"It is entirely appropriate to bear [the objectives of Pt 5.3A] in mind, but it is quite another matter to exercise a casting vote in favour of a DOCA which has the effect of preferring the interests of a director over the interests of one or more substantial creditors, who are seriously prejudiced by it. It is important, where one can, to maximise the chances of the company and its business continuing in existence, and to secure a better return for the company's creditors and members than would flow from the immediate winding up of the company. But if the proposal which would achieve these objectives is partial to a director, unfair to major creditors, and will thwart proper investigation as to whether a potentially serious wrongdoing has occurred, the objectives of efficiency and business continuity must yield to the justice of the alternative."*[56]

Austin J also took issue with the exclusion from voting at the creditors' meetings of two creditors. This further influenced the Judge's application of discretion to terminate the DOCA under s. 445D.

55 *Ibid.,* at 20.
56 *Ibid.,* at 29.

Finally, having terminated the DOCA, Austin J turned to the question of the shares issued pursuant to it. Having determined that, notwithstanding the appointment of an administrator, directors still had the power to issue shares (particularly when required to do so by the DOCA), Austin J then considered the validity of the directors' issue of fresh shares. He held that the shares had been issued to take control of Securities from Capital without providing any demonstrable benefit to Securites. As he put it:

> "When their attempts at a negotiated acquisition failed…[the directors] developed the proposed DOCA as an alternative strategy. Their purpose was to wrest control of Securities from Capital by using Part 5.3A when negotiation failed. That purpose, clearly an improper one, infected their operative decision to allot and issue the shares…[the administrator] was willing to be persuaded [as to the fairness of the DOCA notwithstanding its effect on the control of the company] without making adequate investigations."[57]

The NSW Court of Appeal disagreed with Austin J's findings of impropriety on the part of the administrator, and also considered the share issue to have been valid. The Court saw no reason to find that the administrator had been biased, and after a careful review of the evidence, concluded that the administrator was correct in his refusals to admit claims as well as his exercise of his casting vote. As to the share issue, the Court concluded that, even if a purpose of the issue had been to assist Kirwan's efforts to control the company, the lack of available capital from other sources gave credence to the view that the share issue had been motivated by a desire to raise capital and preserve the company. Critical to this finding appears to be the conclusion that there were no other sources of capital available. The Court did not disturb Austin J's orders regarding the DOCA, as:

> "By the time the appeal came on for hearing, it was clear that there was no purpose in disturbing the actual orders that had been made by Austin J because any hope of saving Securities under administration or under the DCA had gone, Securities had been in liquidation for 18 months, and the shares for which Mr Kirwan paid $100,000 were valueless."[58]

These cases nicely illustrate the potential for the flexibility with which voluntary administration is associated to be utilised to achieve some corporate governance aim. Most interesting is Austin J's observation (quoted above) that in a contest between sustaining the enterprise and adjudicating questions of partiality or unfairness as relate to members, directors and even creditors "the objectives of efficiency and business continuity must yield to the justice of the alternative."

57 *Ibid.*, at 40.
58 Kirwan and others v Cresvale Far East (in liq) (2002) 44 ACSR 21 at 88.

Conclusions

It is clear that the potential for abuse of voluntary administration exists. It is also clear that Courts are live to this and have at their disposal a number of tools to combat such abuse. These tools range from broad consideration of the objects of Part 5.3A (set out in s 435A) to application of fiduciary principles to both directors and administrators to application of discretionary statutory powers to intervene in respect of the administration and any resulting deed of company arrangement. Given the potential for abuse, one must consider whether there is any justification for judicial control of entry into the process. It is clear that allowing an administrator to be appointed by simple board resolution provides maximum chance of preserving the insolvent company, this same informality and flexibility may prove attractive for many other reasons. One problem with the current regime is that, as the facts of *Cresvale Securities* illustrate, *ex post* judicial review of the process will often be moot, given the usual state of the company in administration. Given the high percentage of companies that proceed from voluntary administration directly to liquidation, it might be worth reconsidering the merits of greater judicial control of the process *ex ante*.

A further interesting question concerns the relative strength of the various stated objectives of the scheme. The legislation (in s. 435A) lists two principal objectives of Part 5.3A:

1. The preservation of the company (corporate continuity); and
2. Maximising returns to creditors and members (return maximisation).

It is clear that, when considering questions of maximising returns to stakeholders, some consideration must be given to fairness and equity. Thus, one might expect that deeds of company arrangement which offer disproportionate benefits to some stakeholders at the expense of others (as was alleged in the *Cresvale* litigation) would meet with judicial disapproval when challenged. Section 445D, giving the Court power to terminate a deed, makes this clear.

What is not clear is whether the goal of corporate continuity is more important than the goal of return maximisation. What if the only likely means of corporate rescue is the execution of a deed of company arrangement pursuant to which an unsecured creditor injects funds and receives control of the company as well as elimination of the claims of secured creditors? In *Cresvale* it would appear as though Austin J and the Court of Appeal applied different orders of priority to the statutory objectives. Austin J expressly indicated that in his view preservation of the corporate enterprise as a goal must yield to other concerns, namely ensuring that appropriate investigations take place and ensuring fairness to members and creditors. By contrast, members of the Court of Appeal appeared more concerned with corporate continuity. This might explain why the appellate court differed with Austin J's conclusions as to the propriety of the share issue. To the Court of

Appeal the most compelling question was whether there was any other likely means of preserving the company, not whether Mr Kirwan was seeking to use the deed of company arrangement to acquire that which he could not otherwise purchase.

This question of the importance of corporate continuity also involves looking at the degree to which major creditors control the process of a voluntary administration. It is trite to observe that, on one view, when a company lapses into insolvency, the members' capital has been lost and the company is effectively using loan capital to finance operations. It has been this observation, in the past, which has accompanied judicial statements to the effect that directors owe a duty to consider the interests of company creditors at such times.[59] In the context of administration it is thus fair that major decisions regarding the future of the company, particularly whether to approve a deed of company arrangement, should be left to the creditors. This is particularly so given the fact that creditors (other than those with security over all or substantially all of the assets of the company) have been denied their contractual rights during the administration.

On the other hand, if corporate continuity is the most important of the statutory objectives, perhaps there is room to question the seemingly appropriate delegation of decision making power to creditors, particularly secured creditors.

The argument runs thus: a creditor, as opposed to a member, has provided capital in exchange for a fixed and preferential return from the company, often reinforced by the right to take possession of and sell assets of the company to satisfy the company's obligations. Given this, the creditor has little incentive to further corporate success beyond the level necessary to meet its claim. If the company is insolvent, then the motivation for the creditor, particularly the secured creditor, is to maximise short term returns to satisfy the fixed claim. For those creditors with sufficient security in liquid assets, there is virtually no incentive to take the risk of dissipating the value of the security by continuing in business. It is these creditors, who are also usually the largest and most powerful, who, in the course of voluntary administration, are given the power to control the fate of the company. Given this, it is hardly surprising that most administrations move seamlessly to liquidations.

So, if corporate continuity is to be the paramount objective (and I am by no means suggesting that it ought be), might one expect to see some adjustment to the voluntary administration process? Is there a case to be made for shifting the control of the process more in the direction of members and unsecured creditors (particularly employees), both of whom have a greater stake in the continued viability of the corporation? Of course the risk of doing this is that the members

59 See the statements of Street CJ to this effect in *Kinsella v Russell Kinsella Pty Limited (in liq)* (1986) 4 NSWLR 722 at 736.

and unsecured creditors would gamble the security of senior creditors in an effort to extend life to what may be their own worthless claims. One could argue that there are already a number of safeguards in place to control this risk. Administrators who continue to operate the business of the company are personally liable for debts and other obligations incurred and deeds which are oppressive can be terminated by the Court.

The major policy issues underpinning the law in this area have, in the American context, been outlined masterfully by David A Skeel, Jr in a history of American bankruptcy law.[60] Skeel recounts the conflict between what he refers to as "progressives" championing the cause of promoting corporate recussitation at the expense of sacrificing the absolute priority rights of creditors and "law and economics theorists" who see bankruptcy and reorganisation law as "the solution to a collective action, or common pool, problem".[61] Skeel outlines how the shape of US bankruptcy law has been influenced dramatically by developments in corporate law, particularly trends to excessive debt arising from leveraged buyouts and substantial liabilities imposed as a result of mass tort litigation. He also points out the instrumental role of bankruptcy professionals. In these cases, it is argued, Chapter 11 is attractive on account of the fact that the US regime offers a means for corporate reorganisation offering the benefit of a moratorium on claims while permitting incumbent managers to retain control. This, of course, is not a feature of Australian law, as Pt 5.3A provides for the replacement of the incumbent board (in effect) by the administrator.

While there can be no doubt that collective insolvency administration (as opposed to the appointment of a receiver by a secured creditor) offers a real advantage in terms of promoting corporate recussitation, one must be careful to ensure that this goal is not pursued either fruitlessly or inefficiently. Recent reforms in the UK provide an example of an attempt to privilege the goal of corporate revival at the expense of the usual rights of secured creditors. The Enterprise Act 2002 limits the use of receivership by prohibiting its use by holders of floating charges.[62] The premise of the legislation is that secured creditors have acted precipitately in the appointment of receivers, thus diminishing the chances of corporate rescue. The legislation is best viewed as an attempt to "further the rescue culture".[63] A full consideration of the utility of this exercise is beyond the scope of this paper. However, in the Australian context, one must observe that efforts to limit the contractual rights of secured creditors are likely to lead to those parties making

60 David A. Skeel, Jr, *Debt's Dominion: A History of Bankruptcy Law in America*, (2001).

61 *Id.* at 225. See also C. Anderson, "Commencement of the Part 5.3A Procedure: Some Considerations from an Economics and Law Perspective", (2001) 9 *Insolvency Law Journal* 4.

62 Insolvency Act 1986, s. 72A. The Act provides exceptions in cases where the floating charge is granted as part of a capital market transaction. See V. Finch, "Re-Invigorating Corporate Rescue", (2003) *Journal of Business Law* 527.

63 *Id.* at 527.

use of other mechanisms to secure their positions in situations of insolvency. In particular, one would expect increased use of retention of title agreements and set-offs or charge backs, both of which offer the creditor means of recovery which are unaffected by the imposition of an administrator.[64] Furthermore, one must take into account the possible impact of such a move on the availability of credit, particularly as affects smaller enterprises.

In the final analysis, we return to the question of abuse of Pt 5.3A and whether judicial control of the procedure is best exercised ex post or ex ante. The current regime of ex post control is justified by legislators on account of the need for speed and flexibility in cases of insolvency if any hope of recussitating the business is to be provided. For those of the opinion that such form of control affords too much opportunity for abuse of the process, it is hoped that the case law reviewed in this paper provides reasonable assurance that Australian Courts have both the means and the will to exercise the requisite control, particularly in cases of small and medium sized enterprises. Insofar as larger and more complex enterprises are concerned, there is certainly significant anecdotal evidence that Courts will be involved in the process in any event.[65] It is hard therefore to say whether ex post or ex ante control is more cost efficient. What one can say with some certainty however is that, in either event, Australian Courts are well-placed to exercise the requisite degree of control. As to whether reform in this area should go beyond technical and timing matters and introduce real restrictions on the contractual rights of secured creditors, one's view is likely to depend on the importance one places on the concept of corporate rescue. This, ultimately, is a political question.

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64 See *Commonwealth Bank of Australia v Butterell* (1994) 14 ACSR 343 and *Cinema Plus Ltd v ANZ Banking Group Ltd* (2000) 157 FLR 204.

65 One need only look to the lengthy Ansett administration to see this: see *Re Ansett Australia Ltd* (2001) 39 ACSR 355, *Re Ansett Australia Ltd (No. 1)* (2001) 115 FCR 376, *Re Ansett Australia Ltd v Mentha (No. 2)* (2002) 115 FCR 395.