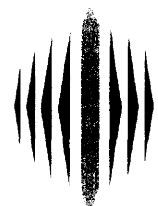
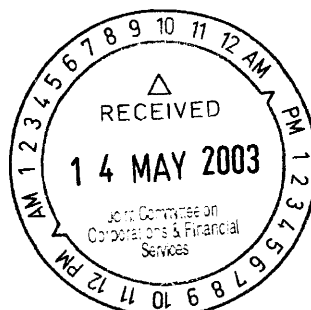
D'ALOIA HANDBERG





12th May 2003

The Secretary
Parliamentary Joint Committee on
Corporations & Financial Services
Room SG 64
Parliament House
CANBERRA ACT 2600

Dear Sir

INOUIRY INTO AUSTRALIA'S INSOLVENCY LAWS

I wish to present this further submission on Australia's insolvency laws in addition to my submission dated 3 1st January 2003.

I make this further submission to bring to the attentionof the Committee two instances of which I am aware of behaviour by secured creditors in relation to the appointment of Voluntary Administrators pursuant to Part 5.3A of the Corporations Act ("The Act"). The behaviour to which I refer would have the affect, in one instance, of frustrating one of the primary purposes of Part 5.3A and, in the other instance, of subverting the operation of Part 5.3A.

The First Instance

One of the primary purposes of Part 5.3A is to provide the directors of companies that are or may become insolvent with a quick and inexpensive means to address their financial difficulties. It was intended by the architects of Part 5.3A that the Voluntary Administration process would be invoked by the directors of companies in financial difficulty and certainly the vast majority of voluntary administrations have been invoked by directors of the companies concerned.

In the first instance, the directors of a public company sought the appointment of an Administrator because a recent development rendered the company insolvent or possibly insolvent.

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A secured creditor held a fixed and floating debenture charge over the assets of the company. The overwhelming majority in value of assets in this instance were fixed charge assets. It would have been a large and complex administration and the administrator's fees were expected to exceed the realisable value of the floating charge assets, so the insolvency practitioners that the directors sought to appoint prudently asked the secured creditor to confirm that they may take their fees and expenses out of the proceeds of sale of the fixed charge assets as well as the floating charge assets. The secured creditor refused to permit the proceeds of sale of fixed charge assets to be applied to administrator's fees. The practitioners declined to accept the appointment.

The directors approached insolvency practitioners from another firm, but the above scenario was replayed. The directors threatened to petition the Court for the appointment of a Provisional Liquidator unless the secured creditor did something. Ultimately, the secured creditor appointed Receivers & Managers to the company,

The point that emerges from this example is that the directors of the company sought to use Part 5.3A of the Corporations Act in precisely the manner envisaged by its architects, but they were frustrated by the secured creditor in doing so. Yet the secured creditor was not prepared to take matters into its own hands and appoint Receivers & Managers. (As I have said, the secured creditor only did so because it was effectively forced to by the directors of the company).

The Second Instance

The key duties and obligations of an administrator are to:

1. **Investigate the business and financial affairs of the company with a view to exploring the alternatives available and to form an opinion as to which of the alternatives is in the best interest of creditors.**

2. **He then has to report his findings and recommendations to the company's creditors.**

The whole purpose of the above obligations is to enable creditors to make informed decisions about the company's future at the second meeting of creditors at which the future of the company is determined.

In this second instance, an insolvency practitioner was appointed as Administrator of a company. A secured creditor held a fixed and floating debenture charge over the assets of the company. Again, the majority in value of the assets were fixed charge assets and the costs of the administration were expected to exceed the proceeds of realisation of the floating charge assets.

Shortly after the administrator's appointment, and still within the decision period, the secured creditor sent a letter to the administrator stating that none of the proceeds of sale of the fixed assets were to be applied to anything other than the costs of realisation of the fixed charge assets.

The particular practitioner disregarded the letter from the secured creditor and continued to do what he was obliged to do. But compliance with the secured creditor's letter would have meant that the administrator would not have been able to complete his investigation and form a **considered** recommendation as to which alternative was in the creditors best interests. This would have served to truncate and distort one of the fundamental principles upon which Part 5.3A was built.

Suggested Solution

I submit that Section 443E(1) of the Act should be amended to extend the priority of the Administrator's right of indemnity to cover unsecured debts and debts of the company secured by fixed as well as floating charges on property of the company.

Secured creditors are given a powerful concession in Part 5.3A. They may take matters into their own hands and appoint a Receiver & Manager within the decision period. If they do so they then become responsible (via the indemnity they provide to the Receiver & Manager) for the Receiver's costs and actions.

If secured creditors choose not to exercise their security by appointing a Receiver & Manager, they are implicitly consenting to the continuation of the Administration process and agreeing to allow the Administrator to retain control of the company and its assets and to continue with what the Administrator has to do (investigate the affairs of the company, consider the alternatives available and make a recommendation to creditors).

Secured creditors should not be allowed to truncate or distort the Administration process by telling the Administrator which if his functions he can and which of his functions he cannot pay himself for out of the fixed charge assets.

Section 443E(1) of the Act provides that the right of indemnity given to the Administrator by Section 443D has priority over all unsecured debts and debts of the company secured by a **floating** charge on property of the company. This is the section which enables secured creditors to subvert the Administration process.

Secured lenders would not be prejudiced by such an amendment because Part 5.3A of the Act already has an in-built protection for them; if they do not want to bear the costs of the Administration they can exercise their security and appoint a Receiver & Manager to the company.

The intrinsic equity in my submission is that if the secured creditor chooses not to appoint a Receiver & Manager and instead chooses to sit back and allow the Administrator to retain control of the company and the Administration process continues, then that process should continue in the manner envisaged by the architects of Part 5.3A, not in the manner which suits just the secured creditor.

This amendment would ensure that:

1. When directors determine that an administrator should be appointed to their companies, an indecisive secured creditor could not frustrate them in making the appointment as was the case in the first instance.

2. The administration process continues as envisaged by its architects when a secured creditor of the company chooses not to exercise its rights to appoint Receivers & Managers over the company, as was demonstrated in the second instance.

I would be pleased to elaborate on the contents of this submission should you require it.

Yours faithfully,

Tony D'Aloia
Partner