Harkness Henry Lecture
Approaches to Business Rehabilitation

By Rt Hon Peter Blanchard*

It is now 11 years since the coming into force of the Companies Act 1993. Whilst a few problem areas have been identified – notably the voidable transaction provisions for which reform is proposed in draft insolvency legislation – and, with comparatively little litigation in key areas like directors' duties, many provisions have yet to be fully tested, the Act is generally regarded as a great success for the Law Commission in modernising corporate law. So is its companion, the Receiverships Act 1993, despite drafting deficiencies, in particular something of a muddle over preferential claims.

But the companies package lacks an important component in relation to insolvent companies. It reformed and carried forward provisions concerned with the enforcement of corporate securities by means of the appointment of a receiver. It has a greatly simplified regime enabling the liquidation and dissolution of companies which are regarded as being beyond redemption. And it contains mechanisms for compromises with creditors and schemes of arrangement. But one looks in vain for a really flexible and efficient way of rehabilitating or reconstructing companies which have suffered financial problems and may be insolvent, yet have businesses which are capable of being stabilised and nursed back to financial health, whether in the same corporate shell or using a new vehicle.

What one is looking for, I suggest, is a regime which encourages directors who have recognised their company's financial problems to make an early decision either to attempt rehabilitation or to put the company into liquidation. The earlier action is taken, the better the chance of a successful outcome or at least, if the company cannot be saved, of a greater return from a liquidation. Such an outcome is much to be preferred than one in which a business which is not viable is permitted to struggle on with an ever-mounting deficiency for all concerned, especially perhaps for its directors if they ultimately face claims for losses caused because of insolvent trading.

At a seminar in February 1994, before the companies package came into force, I advocated the introduction of the missing element by the adoption of the Australian voluntary administration scheme. Here is what I said:

> There is a need, in my view, for a system which can either enable an independent administrator to nurse a sick company back to health or can let the creditors quickly decide that it is in their best interests that the patient be given a speedy death.

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* DCNZM, Judge of the Supreme Court of New Zealand. I wish to acknowledge the assistance of my law clerk, Katherine Sanders, in the preparation of this article. This lecture was given on 10th October 2005. Since then, an Insolvency Law Reform Bill has been put before Parliament. Readers should note that it uses slightly different section numbering and includes some substantive changes.

> Directors who know that their company is sick but not necessarily dying are placed in a very difficult position by the present law (essentially repeated in the 1993 Act) which imposes personal liability upon them if they allow the company to continue to incur debts while it is insolvent. Sometimes it is hard to tell whether the company is insolvent. Sometimes it is obviously insolvent but that may be a temporary problem, depending upon how future events work themselves out. Under a system of administration the directors can publicly acknowledge the position and hand over control of the company to an independent accountant. There is an immediate moratorium (although a chargeholder empowered to appoint a receiver is able to do so if it acts within a short period). The administrator must summon a creditor's meeting within a period of a very few weeks and put a proposal before it.[1]

What it seemed to me was needed, and what I saw in voluntary administration, was a system which:

- Maximises the value of the company's assets,
- Is conducted by an independent insolvency expert,
- Enables swift decision making by the creditors on rehabilitation or liquidation,
- Is without need for approval by a Judge (whose experience in this field might be limited and who might be reluctant to give approval to commercial decisions),
- Has sufficient flexibility to meet new developments or to accommodate compromise, and
- Keeps costs (often the final straw for the struggling company) to a minimum, in particular, by avoiding unnecessary court involvement.

Ideally, there would be built-in incentives which would encourage early use of the rehabilitation scheme.

There was nothing very radical about the suggestion I made in 1994 that we should follow the Australian example, and I recall I was not alone in making it, but it seemed to fall on deaf ears. However, last year in April, a proposal for voluntary administration finally emerged into the light of day in draft legislation circulated for comment by the Ministry of Economic Development.[2] The Ministry's proposal does closely follow the provisions first introduced in Australia in 1993 in the Corporations Law and now found in Part 5.3 of the Corporations Act 2001 (Cth).

I will shortly describe and comment on two very different corporate rehabilitation models which New Zealand could have chosen to follow in an adaptation for local conditions. Then, I will set out the proposed administration scheme in greater detail and mention something of how it has worked in practice in just over a decade of experience across the Tasman. I do not propose to mention statutory management under the Corporations (Investigation and Management) Act 1989 which has not been much used in recent years and may, with the advent of administration, prove to be surplus to requirements.

Lest they be overlooked, before examining the overseas models, I should mention that there are already in the Companies Act the under-utilised provisions of Part 14 which enable compromises to be proposed without reference to the court. A compromise can be proposed by the board of directors, a receiver or liquidator or (with the leave of the court) by a creditor or shareholder.[3] The proposer must call a meeting and provide detailed information.[4] There is no

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1 'Corporate Insolvency under the Receiverships Act 1993 and the Companies Act 1993 – What's Old, What's New and What's Likely to Follow?' The Company Law Conference 1994 materials, 119 cited in P Heath, 'Voluntary Administration – Proposals for New Zealand' in C Rickett (ed) *Essays on Corporate Restructuring and Insolvency* (1996) 103.

2 The Draft Insolvency Law Reform Bill and Discussion Document are available on the Ministry of Economic Development web site; <www.med.govt.nz> (last accessed 26 September 2005).

moratorium unless an order to that effect is obtained from the court.[5] Separate meetings are necessary of any class of creditors. The compromise becomes binding only if approved at each meeting by 75 per cent in value of the class of the voting creditors.[6]

It may be that this avenue for a failing company has been unpopular because of the lack of an automatic moratorium coupled with the special majority requirements and lack of flexibility in relation to the proposal, i.e. an inability for creditors to negotiate changes during the process, at or before the creditors' meetings. Possibly also, companies are discouraged by the tax effect of any compromise under which debt is written off. That is a problem which may afflict any of the models if adopted in New Zealand.

I. Chapter 11 – United States

The first overseas model is the Chapter 11 regime in the United States. It approaches the question of company insolvency very much from the perspective of the company itself and the shareholders. It is debtor orientated. United States insolvency legislation is set out in the Bankruptcy Code 1978,[7] which gives two options to an insolvent company: liquidation under Chapter 9 or reorganisation under Chapter 11.

The process of securing Chapter 11 protection begins with the directors filing proceedings in the Bankruptcy Court.[8] The court must be satisfied that the applicant is acting in good faith but there is no requirement to demonstrate that the company is insolvent or likely to become so.[9] A successful application results in an order of the Bankruptcy Court which immediately freezes the rights of all creditors, whether secured or unsecured.[10] A creditor may apply to the court to lift the automatic stay but will need to demonstrate that its interest is inadequately protected under the moratorium.[11]

After the freeze has been put in place, the incumbent management and directors of the company have 120 days in which to file a reorganisation plan.[12] It is a distinctive feature of the Chapter 11 scheme that the board remains in control of the company, subject to the continuing scrutiny of the Bankruptcy Court, which must give final approval to any plan.[13] A creditors' committee is also likely to play a significant role in investigating the company's affairs and negotiating with the board of directors. The committee may employ professional advisers at the company's expense, and is entitled to file a reorganisation plan if the company itself fails to do so within the prescribed time-frame.[14]

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3 Companies Act 1993, s 228.

4 Ibid, s 229.

5 Ibid, s 232.

6 Ibid, sch 5, cl 5.

7 11 U.S.C.

8 Bankruptcy Code 1978, s 301.

9 See M Trebilcock, and J Katz, 'The Law and Economics of Corporate Insolvency: A North American Perspective' in C Rickett, (ed) *Essays on Corporate Restructuring and Insolvency* (1996) 12.

10 Bankruptcy Code 1978, s 362(a).

11 Ibid, s 362(d)(1).

12 Ibid, s 1121(b).

13 Ibid, s 1129.

14 Ibid, s 1121(c).

Before filing a reorganisation plan, the directors must seek the approval of each 'impaired class of creditors' whose rights would be affected if the proposed plan were implemented.[15] Two-thirds in amount and more than one half by number of each class of creditor is required to consent to the plan.[16] If a class of impaired creditors objects, the company may apply to the court to 'cram-down' their opposition, which the court may do if it is satisfied that the proposal is generally 'fair and equitable' to the objecting class, and at least one impaired class has consented.[17] Once approved, the plan binds all parties.

The involvement of the Bankruptcy Court does not end when the reorganisation plan is filed. The power of the court to replace the board with a trustee in cases of fraud or gross mismanagement remains. Court approval is necessary before a debtor company may act outside the ordinary course of its business and, whilst debt incurred after the company goes into Chapter 11 always takes priority over unsecured pre-commencement debts, the court may also authorise new financing secured over unencumbered assets,[18] or give a lender priority over existing secured creditors in some cases. Where the priority of secured creditors is to be disturbed, the court must be satisfied that the interests of those creditors are 'adequately protected'.[19] The court may also grant the company the right to use any difference between the value of the security and the amount secured as a 'cushion of collateral' for other borrowing. This power may significantly increase the funds obtainable for the rescue of the company.

A debtor company or a creditors' committee may recover payments under voidable antecedent transactions[20] and may, provided the contract is generally capable of assignment, assign or terminate executory contracts regardless of their terms.[21]

Developments in American insolvency practice outside the formal Chapter 11 procedure should also be noted. As the Chapter 11 procedure has become more widely understood, debtors and creditors have increasingly negotiated reorganisation plans outside the formal court process. This informal negotiation, known as a 'pre-pack', allows debtor companies to avoid some of the costs associated with seeking Chapter 11 protection, and is usually implemented by the filing of a reorganisation plan.[22] Arguably, the automatic stay on creditors' rights after a Chapter 11 order, together with the possibility of cram-down, encourage creditors to pre-empt the court process, taking the opportunity to attach favourable conditions to any future financing.

The Chapter 11 regime has both supporters and detractors. Those in favour of allowing management to stay in control of the debtor company argue that the approach in the United States

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15 Section 1124(1) of the Bankruptcy Code states that a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest.

16 Bankruptcy Code 1978, s 1126(c).

17 Ibid, s 1129(b). For discussion of the rights of creditors affected by 'cram-down' see R Broude, 'How Rescue Culture Came to the United States' in (April/June 2003) Australian Insolvency Journal 4, 10. Also, M Trebilcock, and J Katz, above n 9, 19, where it is argued that high levels of acquiescence by creditors to plans which do not respect their priority of claims reflect a desire to avoid cram-downs.

18 Bankruptcy Code 1978, s 364(c).

19 Ibid, s 364(d).

20 Ibid, s 547(b).

21 Ibid, s 365.

22 See discussion of 'pre-pack' arrangements in CAMAC, *Rehabilitating Large and Complex Enterprises in Financial Difficulties,* Report of the Australian Corporations and Markets Advisory Committee (2004) 130.

encourages struggling boards to take early remedial action. The company also has the opportunity to retain the expertise of existing management. In practice, it does not seem to 'leave the lunatics in charge of the asylum', for empirical evidence suggests that incompetent managers get fired. One commentator has put it this way 'The debtor in possession is the company, not the individual. Companies survive; managers most often do not, and at least not in their jobs'.[23]

The independent supervisory role of the Bankruptcy Court is not without its drawbacks: it seems to increase administration costs significantly and the process could never be described as speedy.[24] It is an element which might not be welcomed in New Zealand because of judicial reluctance to become involved in decision making which requires specialised commercial skills and knowledge. Criticism is also levelled at Chapter 11 that it can create unfairness for solvent competitors who, unlike the bankrupt corporation, have to continue to meet their interest bills and pay their other obligations.

II. The English Rehabilitation Process

In contrast to Chapter 11, the rehabilitation process under reforms introduced by the Enterprise Act 2002, and in force in the United Kingdom from 15 September 2003,[25] is orientated more to the interests of the ordinary creditors. The procedures are complex and I can attempt only a sketch of some of the main provisions. The rights of charge holders are curtailed. In other than cases of mortgages or charges over land and some exceptional circumstances, the appointment of a receiver by a secured creditor is not permitted where the security was created after the coming into force of the reforms. (However, grandfathering allows them under existing debentures, so that what the English call administrative receiverships will occur for some years ahead.[26])

I digress slightly to show the extent of the bias of the Enterprise Act against general charge holders and in favour of ordinary creditors. The distinction between fixed and floating charges, sensibly abolished in this country under the Personal Property Securities Act 1999, continues in the United Kingdom and currently is said to bedevil their banking law now that the House of Lords in *Spectrum Plus*[27] has followed New Zealand[28] and Privy Council[29] decisions in determining that ordinarily a general charge over future book debts must be regarded as floating. By requiring such a floating charge holder to concede priority to preferential claims that decision

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23 R Broude, above n 17, 8. See also L M LoPucki, 'Correspondence. Strange Visions in a Strange World: A Reply to Professors Bradley and Rosenzweig' (1992) 91 Mich L Rev 79, where he defends Chapter 11 arguing that the assertion that Chapter 11 shields managers from creditors while they expropriate wealth for themselves is neither supported by the empirical evidence, nor true.

24 For discussion of empirical evidence about the cost of the Chapter 11 bargaining procedure see M Trebilcock, and J Katz, above n 9, 19.

25 Section 250 of the Enterprise Act 2002 inserts a new Chapter IV in Part III of the Insolvency Act 1986 (UK). The Act applies to England, Wales, Northern Ireland and Scotland except as otherwise stated in s 280. For a general introduction to the Enterprise Act 2002 see 'Administration and Company Voluntary Arrangements' in R Goode, *Principles of Corporate Insolvency Law* (3rd ed, 2005), Chapter 10. Also, <www.insolvency.gov.uk> (last accessed 6 October 2005).

26 Insolvency Act 1986, s 72A(4)(a).

27 *In re Spectrum Plus Ltd (in liquidation)*[2005] 3 WLR 58 (HL).

28 *Supercool Refrigeration and Air Conditioning (in Receivership and Liquidation) v Hoverd Industries Ltd* [1994] 3 NZLR 300.

29 *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710 (PC); [2002] 1 NZLR 30 (PC).

may have considerable influence under the Enterprise Act because, although the Act removes the preferential priority of Crown claims[30] – employee preferential status is unaffected[31] — it more than offsets this gain to the floating charge holder by providing for ring-fencing of a prescribed percentage of the company's net property – those assets which would otherwise have been available to the floating charge holder. Except where the net property is less than a prescribed sum (currently £10,000) and subject to a dispensation from the High Court if the cost of making the distribution would be disproportionate to the benefits, 50 per cent of the first £10,000 of net property and 20 per cent of any further amount (up to a ceiling of £600,000) may be applied in payment of the administrator's remuneration, obligations and expenses and subject thereto must be applied in payment of the ordinary creditors (including the Crown) in priority to the holder of the floating charge.[32]

To return to my theme, the English insolvency legislation prior to the Enterprise Act provided for a form of company administration under an appointment made by the High Court.[33] Because of its complexity, delay and expense, as compared with administrative receivership, it was much less used. It was, for example, a necessary preliminary that a person petitioning for an administration order should submit to the court in support of the petition a detailed report on the affairs of the company by an independent person, who was often the intended administrator. That meant that a really quick rescue of the company might be impracticable.

The Enterprise Act continues to allow for an appointment by the court. But, importantly, it authorises two additional means of installing an administrator without first going to the court. The holder of a floating charge over the whole or substantially the whole of the company's property can do so,[34] in much the same way as a receiver could be appointed, giving notice to the court only after the event.[35] The company or its directors can also appoint an administrator[36] unless a winding up petition or an application for the appointment of an administrator by the court is extant or there is already a (grandfathered) administrative receivership.[37] However, the company and the directors are obliged to give 5 days' written notice to any general charge holder before they can make such an appointment.[38] Thus the general charge holder may be able to pre-empt the situation by making its own appointment of an administrator. However, no matter who does the appointing,

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30 Enterprise Act 2002, s 251.

31 Ibid, s 251(3).

32 Enterprise Act 2002, s 252 inserts a new s 176A into the Insolvency Act 1986. A similar model was recommended by the Cork Committee in its report Department of Trade, *Insolvency Law and Practice: Report of the Review Committee* (1982), Chapter 36. For discussion of the ring-fenced fund see S Frisby, 'In Search of a Rescue Regime: The Enterprise Act 2002' (2004) 67 Mod L Rev 247, 269-271; and M Simmons, 'Some Reflections on Administrations, Crown Preference and Ring-Fenced Sums in the Enterprise Act' (July 2004) J of Bus L 423, 431-435.

33 For discussion of the old administration régime, including the transitional provisions applying to existing administrations see W Kerr, and M Hunter, (eds) *Kerr and Hunter on Receivers and Administrators* (8th ed, 2005) 272-274.

34 Insolvency Act 1986 (UK), sch B1, para 14 inserted in the Insolvency Act 1986 (UK) by s 248 of the Enterprise Act 2002.

35 Insolvency Act 1986 (UK), sch B1, para 18.

36 Ibid, para 22.

37 Restrictions on appointment by the company or its directors are set out in the Insolvency Act 1986 (UK), sch B1, paras 23-25.

38 Insolvency Act 1986 (UK), sch B1, para 26(1)(a).

the administrator must act in the interests of the company's creditors as a whole.[39] He or she cannot look primarily to the interests of the chargeholder even if appointed by that person.

It is apparent that those who drafted the Enterprise Act believed that, if at all possible, a struggling company should be rescued from its insolvency. Here is the statutory statement of the purpose of administration:

> The administrator of a company must perform his functions with the objective of –
> (a) rescuing the company as a going concern, or
> (b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or
> (c) Realising property in order to make a distribution to one or more secured or preferential creditors.[40]

Later in the same provision it is stated that the administrator must perform his or her function with the objective of rescuing the company as a going concern unless he or she thinks object (b) would achieve a better result for the company's creditors as a whole;[41] and it is further laid down that the administrator may perform his or her functions with object (c) – realising property to make a distribution to secured or preferential creditors – only if he or she thinks that it is not reasonably practicable to achieve either of the other objects *and* if he or she does not unnecessarily harm the interests of the creditors as a whole.[42]

The administrator is therefore placed in something of a strait-jacket, as compared with a receiver or, as we shall see, as compared with an Australian-style administrator. It seems to be assumed that the typical case will be one in which the company can be restored to financial health and can continue to operate its business. But is not a more common outcome likely to be the sale of any rescued business as a going concern, that is, separation of a viable business from its former corporate shell, or the sale of individual assets, followed by a liquidation? In other words, it may be suggested that more often an administration will be a means of achieving object (b) or, failing that, object (c), to the advantage of the creditors as compared with a straight liquidation, or perhaps a receivership, rather than a means of achieving object (a), namely continuance of the company itself after restoration of its solvency.

As Sandra Frisby of the University of Nottingham has pointed out, the stipulations of statutory purpose may be asking rather a lot of an administrator. In order to formulate proposals for creditors which comply with these requirements of the Enterprise Act, a prospective administrator may need a great deal more information about the affairs of the company than is likely to be available at the outset.[43] Frisby suggests that an administrator may be unlikely to consent to act under an appointment by the company or its directors without a prior investigation with all the attendant delay and cost. It is at this point, she says, that legislative aspiration and commercial reality may well part company. Arguably, the new regime simply directs administrators towards a certain end without providing them with any new apparatus to achieve it.[44]

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39 Ibid, para 3(2).

40 Ibid, para 3.

41 Ibid, para 3(3).

42 Ibid, para 3(4). S Frisby, above n 32, 261 observes that para 3 'appears to place corporate rescue squarely at the top of the hierarchy of aims of the new "streamlined" administration procedure'.

43 S Frisby, above n 32, 261.

44 Ibid, 262.

The Enterprise Act directs the administrator to prepare, as soon as practicable, a statement of affairs[45] as well as proposals for achieving the purpose of the administration.[46] The proposals have to be laid before creditors for their consideration within 8 weeks of the appointment.[47] An initial creditors' meeting must be held within 10 weeks.[48] The proposals may include a compromise or arrangement with creditors or recommend conversion of the administration into a voluntary administration ordered by the court.[49] The rules made under the Act contain very detailed requirements in relation to proposals.[50] There is also a stipulation that the proposals may not include any action which affects the rights of a preferential creditor.[51] If the proposals are approved by the requisite majority the administration may continue for the purpose of implementing them. If not, or if the scheme subsequently fails, a winding up will follow.[52]

The appointment of an administrator is limited to a period of one year from the initial appointment with provision for brief extension by the creditors and by the court.[53] The administrator is given full power of management of the company,[54] acting as its agent,[55] and the directors of the company are correspondingly reduced in their powers, although they continue in office. The company's assets are protected during the administration by a general moratorium.[56] There is no ability for a general charge holder to override the wishes of the majority of the creditors.

III. VOLUNTARY ADMINISTRATION – THE AUSTRALIAN SCHEME AND NEW ZEALAND PROPOSALS

I preface my description of the voluntary administration regime by drawing attention to an important safeguard which does not yet exist in New Zealand and may be desirable once administrations begin in this country. It is that in Australia insolvency practitioners have to be registered.[57] There are qualification and good behaviour requirements designed to ensure that liquidators, receivers and administrators are proper persons to manage insolvent companies and are fully independent.[58] The need for independence is reinforced by a statement of general principle in the Code of the Insolvency Practitioners' Association of Australia that in every professional assignment a member undertakes he or she must be, and be seen to be, free of any interest which is incompatible with objectivity and independence.[59] The Australian Corporations

45 Insolvency Act 1986 (UK), sch B1, para 47(1).

46 Ibid, para 49.

47 Ibid, para 49(5)(b).

48 Ibid, para 51(2)(b).

49 Ibid, para 49(3).

50 See Insolvency (Amendment) Rules 2003, sch 1, r.2.33(2).

51 Insolvency Act 1986 (UK), sch B1, para 73.

52 Ibid, para 55.

53 Ibid, para 76.

54 Ibid, para 59(1).

55 Ibid, para 69.

56 Ibid, paras 42 and 43.

57 An application for registration may be made under s 1279 of the Corporations Act 2001.

58 Corporations Act 2001, s 1282.

Act, like the British Enterprise Act, contains a statement of purpose for administrators. But it is much less prescriptive. The purpose is:

> [T]o 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 in 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.[60]

The draft New Zealand Bill contains an almost identical provision.[61]

The Explanatory Memorandum which accompanied Part 5.3A during the Australian legislative process stated:

> The new Part is … intended to provide for
> speed, and ease of commencement, of administrations;
> minimisation of expensive and time-consuming court involvement and formal meeting procedures;
> flexibility of action at key stages in the administration process; and
> ease of transition to other insolvency solutions where an administration does not by itself offer all of the answers.[62]

A. *Appointment of Administrator*

A voluntary administration begins when an administrator is appointed either by the court or, more usually, out of court. It can be begun by the company only after the directors have passed a resolution recording that the company is insolvent or is likely to become insolvent.[63] In practice, that should encompass most cases in which the directors are in some doubt about the company's true position. An administrator can be appointed even if a liquidation is inevitable[64] but cannot be appointed except by the court (or as a replacement) if the company is already under administration.[65] However, as administration comes to an end once a deed of company arrangement (DOCA) is executed, the company, through its directors, is not prevented from appointing an administrator where it is operating under a DOCA.[66] If the company is already in liquidation, only the liquidator or the court can appoint an administrator.[67] Notice of appointment

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59 IPAA *Code of Professional Conduct*, para 2, available <www.ipaa.com.au> (last accessed 26 September 2005). See also the statement of the Federal Court in *Lam Soon Australia Pty Ltd v Molit (No 55) Pty Ltd* (1996) 22 ACSR 169, 184.

60 Corporations Act 2001, s 435A.

61 Companies Act 1993, s 239A to be inserted by s 424 of the Draft Insolvency Law Reform Bill, above n 2, hereafter referred to as the draft NZ Bill.

62 Explanatory Memorandum to the Corporate Law Reform Bill 1992, para 449, available<www.takeovers.gov.au> (last accessed 26 September 2005).

63 Corporations Act 2001, s 436A; draft NZ Bill, s 239I. See also *Wagner v International Health Promotions Ltd* (1994) 15 ACSR 419.

64 *Dallinger v Halcha Holdings Pty Ltd* (1996) 14 ACLC 263.

65 Corporations Act 2001, s 436D; draft NZ Bill, s 239H(2). A court will not adjourn or stay an application for liquidation simply because the company has appointed an administrator before the application has been heard. A company bears the onus of showing that the interests of its creditors will be better served by an administration: *Deputy Commissioner of Taxation v First Netcom Pty Ltd* (2000) 35 ACSR 615.

66 *Beatty v Brashs Pty Ltd* [1998] 2 VR 201.

67 Corporations Act 2001, ss 436A(2), 436B(1) and 436C(2); draft NZ Bill, s 239H(1)(b)(e).

will under the New Zealand proposal have to be given to the Registrar of Companies, not to the court.[68]

A person who is entitled to enforce a charge on the whole, or substantially the whole, of a company's property may appoint an administrator if the charge has become enforceable and the company is not already in liquidation.[69] I will refer to such a person as a general charge holder. There may be difficulties in determining what is a charge over substantially the whole of the company's property. One commentator has suggested that a creditor will be a substantial chargee if it has the capacity to take control of so much of the business, property and affairs of an insolvent company as is necessary to conduct an effective operation. The fact that some valuable assets of a company are excluded from the scope of the charge should be immaterial, on this view, unless they are an integral component of the company's business.[70]

I pause to ask why a charge holder who wants to intervene would ever wish to appoint an administrator if it has the power to appoint a receiver. Why would a charge holder want to subject itself to a deed of arrangement if receivership is an option?

B. Moratorium

There is an immediate moratorium as soon as an administrator is appointed.[71] This does not stop actions already begun to enforce a charge over the company's property.[72] But legal proceedings against the company and enforcement of securities and other self-help actions by creditors may not be begun or continued without the consent of the administrator or the court,[73] which is not likely to be given if that will cause significant expense and/or distraction.[74] Proceedings to enforce guarantees of the company's liabilities cannot be enforced against a director or a director's relative or spouse.[75] There is an exception to the moratorium. During a 10 working day 'decision period' running from the date of notice to it, a general charge holder may take enforcement action by appointing a receiver or taking possession of property.[76] With this exception, persons whose property is occupied by or in the possession of the company cannot take steps to recover it (unless it is perishable property)[77] without the leave of the administrator or the court.[78] Leave may be granted if the moratorium will cause the owner of the property financial or other loss or detriment greater than any benefit or advantage that the creditors might derive from the statutory restraint.[79]

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68 Draft NZ Bill, s 239ADR. Under s 450A of the Corporations Act 2001, notice of appointment must be given to the Australian Securities and Investment Commission.

69 Corporations Act 2001, s 436C(1); draft NZ Bill, s 239K.

70 J O'Donovan, *Company Receivers and Administrators* (2001) 190.

71 Corporations Act 2001, ss 440B and 440C; draft NZ Bill, ss 239AY and 239AZ.

72 Corporations Act 2001, s 441B; draft NZ Bill, s 239ABI.

73 Corporations Act 2001, s 440D; draft NZ Bill, s 239ABA.

74 *Re Capital General Corp Ltd* (2000) 19 ACLC 848, 850-851.

75 Corporations Act 2001, s 440J; draft NZ Bill, s 239ABF.

76 Corporations Act 2001, s 441A; draft NZ Bill, s 239ABH. In Australia where there has been a practice of purporting to extend the decision period by agreement between the general charge holder and the administrator – a practice seemingly in conflict with the Act – it has been recommended by a government committee that this period be increased to 15 working days: CAMAC Report, Recommendation 24, above n 22, 64.

77 Corporations Act 2001, s 441C; draft NZ Bill, s 239ABJ.

78 Corporations Act 2001, s 440C; draft NZ Bill 1993, s 239AZ.

79 *Canberra International Airport Pty v Ansett Australia Ltd* (2002) 41 ACSR 309.

However, Australian courts have generally given creditors of the company the opportunity to consider proposals put forward by the administrator to enable the company to continue trading even for a short period and have therefore been prepared to refuse leave on an interim basis to enable that to occur.[80]

C. *Powers of Administrator*

An administrator is given control of the company's business, property and affairs and has full power to carry on the business and manage the property. He or she may terminate or dispose of the business or property in whole or in part even without the consent of creditors[81] and before any meeting has been held and can exercise the functions and powers normally exercisable by the directors.[82] The administrator acts as the company's agent[83] and can appoint an agent to do anything the administrator is unable to do personally.[84] All these things can be done even when the company is in liquidation. Like a receiver under our 1993 Act, the administrator's agency for the company can exist notwithstanding that the appointment is made during a liquidation.

Any transaction or dealing by a company in administration is void unless done by or with the prior consent of the administrator or sanctioned by the court.[85] The directors continue in office but cannot act without the administrator's approval.[86] But a receiver and manager whose appointment by a charge holder is not blocked by the administration is unaffected.[87] Contracts of employment continue but, except where the administrator adopts such a contract, the draft New Zealand Bill does not provide for any personal obligation similar to that of receivers where they do not terminate employment within 14 days of their appointment.[88]

D. *Court's Power of Assistance*

A particularly useful feature of the voluntary administration scheme is the broad power given to the court – without any guidelines or qualifications – to determine how it may operate in relation to a particular company.[89] It enables the court, for example, to overcome problems arising from departures from particular requirements of the legislation. This has proved very useful in larger or more complex insolvencies, such as the Ansett collapse.[90] The court's order is made prospectively but can deal with the consequences of something which has already occurred, including a failure

80 *Re Java 452 Pty Ltd* (1999) 32 ACSR 507.

81 *Re Eisa Ltd; Application of Love* (2000) 35 ACSR 394.

82 Corporations Act 2001, s 437A; draft NZ Bill, s 239U.

83 Corporations Act 2001, s 437B; draft NZ Bill, s 239W.

84 Corporations Act 2001, s 437C(1A); draft NZ Bill, s 239V(2)(c).

85 Corporations Act 2001, s 437D(2); draft NZ Bill, s 239Z(1).

86 Corporations Act 2001, s 437C; draft NZ Bill, s 239X.

87 Corporations Act 2001, s 442D; draft NZ Bill, s 239ABH(3).

88 Draft NZ Bill, s 239Y. There is no equivalent provision in the Corporations Act 2001. For discussion of the legal issues raised in Australia for employees where their employer is in voluntary administration see P Darvas, 'From the Outside Looking In: Employees and Voluntary Administration' (2001) 29 ABLR 409.

89 Corporations Act 2001, s 447A; draft NZ Bill, s 239ADK. For a general discussion of the court's power under s 447A see K R Moore, 'Is the Voluntary Administration Process in Australia Flexible Enough?' (2003) 19 Ins L & Prac 5, 171. Moore argues that the court's approach to the discretion has encouraged commercially viable outcomes.

90 *Re Ansett Australia Ltd and Mentha* (2001) 188 ALR 165.

to comply with the company's constitution. But the Australian courts have made it clear that the power should not be exercised in a way that will affect rights which have already accrued; orders therefore can have effect only from the time they are made, though made in respect of past events.[91]

E. Procedure

The administrator is required to proceed as follows. As soon as practicable there must be an investigation of the company's business, property, affairs and financial circumstances and the administrator must form an opinion on the best outcome for the administration. The directors must provide a statement about the company's business and the like within 5 working days.[92] (For convenience, I am using the time periods in the New Zealand draft. The Australians are in the process of altering theirs and we are anticipating their changes.) Within 8 business days an initial creditors' meeting must be held.[93] At this meeting decisions must be taken on the appointment of a creditors' committee to have a consultative role and on whether to change the administrator. The administrator must table an interests statement disclosing any relationships (professional, business or personal) with the company or with any of its officers, shareholders or creditors.[94] This of course provides a check on any 'friendly' selection which may have been made by the directors.

F. The Watershed Meeting

A major meeting, known as a watershed meeting, must be convened within 20 working days[95] and held within 25 working days of the commencement of the administration.[96] That period can be extended by the court.[97] The watershed meeting decides upon the future of the company and, in particular, whether the company and the creditors (through the administrator) should execute a deed of company arrangement (DOCA). The directors are required to attend unless excused or having a valid reason. But they cannot be required to answer questions.[98]

The administrator is required when giving notice of the watershed meeting to provide a report on the company's business, property, affairs, financial circumstances, and any other material matter. The administrator must also give the creditors his or her opinion, with reasons, on whether the company should execute a DOCA, or the administration should simply end ('as you were'), or the company should go straight into liquidation. If a DOCA is recommended, there must be a statement setting out details of the proposal.[99] The fact that the creditors can resolve that the company go into liquidation[100] provides a disincentive against directors putting the company into

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91 *Australasian Memory Pty Ltd v Brien* (2002) 200 CLR 270. A useful summary by Austin J of the emerging jurisprudence on the court's power under s 447A is found in *Deputy Commissioner of Taxation v Portinex Pty Ltd* (2000) 34 ACSR 391, para 30.

92 Corporations Act 2001, s 438B(2); draft NZ Bill, s 239AD.

93 Corporations Act 2001, s 436E(2); draft NZ Bill, s 239AJ.

94 Draft NZ Bill, s 239AL. Cf. Corporations Act 2001, s 448C.

95 Draft NZ Bill, s 239AP(2). Cf. Corporations Act 2001, s 439A(5).

96 Corporations Act 2001, s 439A(2); draft NZ Bill, s 239AQ(2).

97 Corporations Act 2001, s 439A(6); draft NZ Bill, s 239AP(3).

98 Draft NZ Bill, s 239AS.

99 Corporations Act 2001, s 439A(4); draft NZ Bill, s 239AQ(3).

100 Corporations Act 2001, s 439(c); draft NZ Bill, s 239AW(c).

administration merely to gain the advantage of a moratorium or for some other reason which may be an abuse.

The watershed meeting can be adjourned by resolution of the creditors for up to 30 working days only but the court can, on application by the administrator, order a longer adjournment.[101] However, the thrust of the scheme is for decisions to be made swiftly and the court is not likely to accommodate any lengthy adjournment. If, at the watershed meeting, the creditors do not vote for a DOCA, the administration ends. There is either a reversion to the position before the administration or, if the creditors vote for it, an immediate liquidation.[102]

G. The Deed of Company Arrangement (DOCA)

At the watershed meeting a simple majority in number and value of the creditors can resolve on execution of a deed of company arrangement (DOCA),[103] which does not have to be the same as was proposed in the notice of meeting.[104] This flexibility is important as it enables changes to be negotiated with the creditors at or before the meeting. The administrator has the power to make decisions on who can vote and with what voting power.[105] If the creditors vote in favour of a DOCA but the deed is not fully approved at the meeting, the administrator must complete the drafting and circulate the proposed deed to creditors within 10 working days after the meeting.[106] The creditors then have a period of 3 working days to consider the final form of the deed.[107]

The deed must appoint a deed administrator who will typically but not necessarily be the person already acting as company administrator. The deed must specify:

- The property available to pay creditors.
- The nature and duration of any moratorium.
- The extent to which the company will be released from its debts.
- The order in which proceeds of realisation of property will be distributed.
- The cut-off day (not later than the day when the administration began) on or before which creditors' claims must have arisen if they are to participate.[108]

One matter which has been the subject of uncertainty in Australia and is not addressed in the New Zealand Bill is whether preferential creditors can be crammed down to the

level of other creditors without their consent. It is clear however that in Australia ordinary creditors need not be treated equally in a DOCA. Creditors do not vote in classes. But the Federal Court has commented in *Lam Soon Australia Pty Ltd v Molit (No 55) Pty Ltd* that where a deed which is proposed will discriminate between creditors and there is no community of interest between the groups,

101 Corporations Act 2001, s 439B(2); draft NZ Bill, s 239AV.

102 Corporations Act 2001, s 439C; draft NZ Bill, s 239AW.

103 Corporations Regulations 2001 (Cth), reg 5.6.21.

104 Corporations Act 2001, s 439C; draft NZ Bill, s 239AW(a).

105 Corporations Regulations 2001 (Cth), reg 5.6.23. See *Expile Pty Ltd v Jabb's Excavations Pty Ltd* (2003) 46 ACSR 446, 454.

106 Draft NZ Bill, ss 239AX, 239ACL(1)(a).

107 Draft NZ Bill, s 239ACL(1)(b).

108 Corporations Act 2001, s 444A(3)-(5); draft NZ Bill, s 239ACJ.

> … it is important that an administrator examine the proposal carefully and critically in order to ensure that the less advantaged group is not unfairly prejudiced. That must involve at least that the administrator takes steps to ensure, so far as it is possible, that the deed is no less beneficial to all creditors than liquidation is likely to be.[109]

This may suggest that an administrator should not put forward a scheme which reduces preferential creditors to the level of unsecured creditors without their consent.[110]

The deed is executed on behalf of the company by the administrator. The company may not execute the deed unless a board resolution has authorised that action. The deed has to be executed by the company and the deed administrator within 15 working days after the watershed meeting has approved it or within any further time allowed by the court on the application of the deed administrator made within that period.[111] If not, the administrator must apply to the court for the appointment of a liquidator.[112] A court will be hesitant about granting any extension of time for any purpose other than settling the final form of the deed.[113]

The administration comes to an end when the deed is signed. The administrator is replaced by the deed administrator who may be the same person but now playing a different role. Depending upon the terms of the deed, the directors may have their powers of management restored to them, with supervision by the deed administrator. The automatic moratorium also comes to an end. There is an ongoing moratorium only as may be provided for in the DOCA and affecting only those who are bound by the deed. It binds all creditors in respect of claims that arise on or before the cut-off day.[114] It does not however prevent a secured creditor or an owner or lessor of property used by the company from enforcing its rights (for example, under a retention of title clause) unless the deed provides otherwise *and that creditor voted in favour or the court so orders on the application of the deed administrator.*[115]

H. Termination of the Deed of Company Arrangement

The company is then administered in accordance with the DOCA. If things do not go to plan the DOCA can be terminated by the court on the application of the company, a creditor, the deed administrator or any other interested person.[116] A liquidator can then be appointed. This can occur if there is a material contravention of the deed by the company or other person who is bound by it; or effect cannot be given to the deed without injustice or undue delay; or it transpires that the administrator or the creditors were given false or misleading information; or the deed will operate in a manner which is oppressive or unfairly prejudicial to or unfairly discriminatory against one or more creditors or contrary to the interest of the company as a whole; or the court considers that the deed should be terminated for some other reason.[117] The creditors can also at a meeting resolve that the deed be terminated if there has been a material breach. They can appoint a liquidator.[118]

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109 (1996) 22 ACSR 169, 185.

110 Cf. UK position at above n 50.

111 Corporations Act 2001, s 444B; draft NZ Bill, s 239ACK.

112 Draft NZ Bill, s 239ACN. Cf. Corporations Act 2001, ss 446A and 444B(2).

113 *Re Mentha* (2002) 41 ACSR 352; [2002] FCA 530, para 60.

114 Corporations Act 2001, s 444D(1); draft NZ Bill, s 239ACP(1).

115 Corporations Act 2001, s 444D(2)(3); draft NZ Bill, s 239ACP(2)(3).

116 Corporations Act 2001, s 445D(2); draft NZ Bill, s 239ACZ(1).

117 Corporations Act 2001, s 445D(1); draft NZ Bill, s 239ACZ(2).

Alternatively, whether or not there has been a breach, they can resolve upon a variation of the DOCA.[119] Where a company is in liquidation when a DOCA is adopted the liquidation continues unless it is terminated by the court, but the company is administered in terms of the DOCA and when it ceases the liquidator takes over.[120]

I. Liability of Administrator and Deed Administrator

During the period of administration, that is, before execution of a DOCA or the passing of a resolution at a watershed meeting that a liquidator be appointed or a resolution that the administration should end, the administrator is given full power of management but is liable for debts incurred for services rendered, goods bought or property hired, leased, or occupied.[121] The liability is not as all embracing as a New Zealand's receiver's liability[122] but there is the now familiar provision for personal liability for rent for property used or occupied by the company during the administration (other than the first 7 days).[123] The administrator is entitled to an indemnity out of, and lien on, the company's property ahead of general creditors and charges over accounts receivable and inventory.[124] It is proposed that in a liquidation, the fees, expenses and remuneration of an administrator (but, unlike Australia, not those of a deed administrator)[125] will be preferential, ranking immediately after the liquidator's fees, expenses and remuneration.[126]

A deed administrator, in contrast, generally will have no personal liability to persons who give credit to the company while the deed is operating. In any subsequent liquidation those persons would rank equally with the earlier unsecured creditors under the deed. Therefore anyone funding or giving credit to the company during that time must bargain for priority.

J. Voidable Transactions

The voidable transactions sections of the Companies Act will not apply to transactions carried out by or with the authority of the administrator or deed administrator or specifically authorised by the DOCA.[127] An administrator cannot recover voidable transactions carried out by the directors. If such transactions were substantial, the creditors may favour a liquidation.

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118 Corporations Act 2001, s 445E; draft NZ Bill, s 239ADA.

119 Corporations Act 2001, s 445F; draft NZ Bill, s 239ADB.

120 *Mercy & Sons Pty Ltd v Wanari Pty Ltd* (2000) 35 ACSR 70; *Re Nardell Coal Corp Pty Ltd* (2004) 49 ACSR 110.

121 Corporations Act 2001, s 443A; draft NZ Bill, s 239ADD. Employees' claims for wages owing for the period of administration will rank equally with other unsecured creditors but in the event of liquidation they will have a preferential claim under Schedule 7 to the Companies Act 1993 in the draft NZ Bill.

122 Receiverships Act 1993, s 32.

123 Corporations Act 2001, s 443B(1)(2); draft NZ Bill, s 239ADE.

124 Corporations Act 2001, ss 443D, 443E and 443F; draft NZ Bill, ss 239ADH, 239ADI and 239ADJ.

125 Corporations Act 2001, s 556.

126 Schedule 7(1)(b) to the Companies Act 1993 in the draft NZ Bill.

127 Draft NZ Bill, s 239ABX. There is no equivalent provision in the Corporations Act 2001.

IV. The Preferred Option – Voluntary Administration

Chapter 11 seems to be off the radar in Australia and New Zealand, having been rejected by government committees in Australia and by the Law Commission in New Zealand.[128] The Ministry seems to agree. Nor have I detected any enthusiasm for copying the English reforms in the Enterprise Act. In truth, the voluntary administration regime has worked fairly well in Australia – all that is now being suggested in that country is minor adjustment – and, with reservations about the position of the Commissioner of Inland Revenue which I will mention, it appears to be the best of the models for New Zealand's circumstances.

The Australian courts have caught the spirit of the legislation and have sometimes been able to render assistance to administrators with generous and creative rulings. They have also been prepared to intervene in order to prevent abuse of the procedure by directors.

In Australia substantially more companies now undergo administration than are wound up by the court, although there is still common use of receiverships ordered by the court or resulting from an appointment by a secured creditor. The popularity of administration is illustrated by a table showing that in the year before the administration regime commenced there were 1416 windings up ordered by the court. By 1997-1998 there were only 433, but in that year there were already 664 voluntary administrations.[129]

However, the uptake and perhaps the success rate in New Zealand may not be so great. I say this because I have concerns about the position and possible attitude of the Commissioner of Inland Revenue. There are two points. First, the Commissioner retains a preferential status for claims for unpaid PAYE, withholding deductions and GST.[130] If the amount owing to the Revenue is at all substantial and the Commissioner cannot be crammed down, and is uncooperative, he may effectively block adoption of a proposal by the creditors as a whole.

Secondly, an incentive to directors to put their company into administration, which is present in Australia, is missing here in the draft legislation. In Australia under a provision of the Income Tax Assessment Act 1936 directors are made personally liable for the company's failure to pay over the equivalent of PAYE deductions or similar retentions, but the personal liability does not attach if within a specified time the company has appointed an administrator or gone into winding-up.[131] Where a company is not in a position to discharge its tax obligations there is therefore a very considerable incentive for the directors to initiate an administration. This provision was introduced in Australia in conjunction with the abolition of the Revenue's preferential status. The trade-off was that the directors of a company which had not paid over tax deductions would have to ensure that matters were brought to a head and the company's position evaluated by an independent administrator and the general body of creditors. It is apparently not proposed to have a comparable provision in New Zealand. There will be a legislative direction that, in a liquidation, in making an order against a director under section 301 of the Companies Act for neglect of duty in relation to the company, the court must, where relevant, take into

128 CAMAC Report, above n 22, 5; New Zealand Law Commission, 'Insolvency Law Reform. Promoting Trust and Confidence: An Advisory Report to the Ministry of Economic Development', Study Paper 11 (2001), 130-131.

129 G Hall, 'Voluntary Administration. The Australian Experience' Seminar Presentation at a Roundtable Discussion on the Insolvency Law Reform Bill, PriceWaterhouse Coopers, 20 May 2004.

130 Companies Act 1993, sch 7 in draft NZ Bill.

131 Income Tax Assessment Act 1936 (Cth), s 222AOB.

account any action the director took for the appointment of an administrator.[132] But whether neglectful directors will take much account of that is doubtful. Without a real incentive for directors, and bearing in mind the quite heavy professional and other costs involved in administration, some companies may not think it worthwhile to go through the administration process, particularly if the Commissioner is unaccommodating.

Much will depend on the attitude of the Commissioner of Inland Revenue. Perhaps the Commissioner will not want to be too unyielding lest there be further calls for abolition of the Revenue's priority. If the Commissioner does feel able to take a flexible approach, the advent of the voluntary administration regime could well still work, especially in rehabilitating medium and large size companies which have run into financial difficulties. The very real advantage where such a company could be fully rehabilitated, or at least more saved from the wreckage than would be the case in a liquidation, is that an appointment of an administrator can be made quickly and that there will be an immediate moratorium unless a general charge holder decides to intervene and enforce its security. The process of putting a proposal before the creditors is both speedy and flexible and it is entirely appropriate that the creditors as a body should make the decision whether there should be a workout in accordance with a DOCA or whether the company should immediately be put out of its misery and go into liquidation. Particularly if provision for registration of insolvency practitioners is included in the legislation, the creditors will have the comfort of an administration by an independent qualified person who, unlike a receiver, is obliged to act in the interests of all concerned rather than primarily in the interest of a particular secured creditor. The gap in New Zealand's company law would then at last be filled.

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132 Draft NZ Bill, s 432(2) adding subs 301(4) to the Companies Act 1993.