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Restructuring & Insolvency
Australia

Voluntary Administration in Australia

Overview

The voluntary administration procedure in the Corporations Act was introduced in 1993. Prior to this, the only formal mechanism for a company to compromise with its creditors was by a creditors' scheme of arrangement, a process often regarded as costly, time consuming and cumbersome.

The primary objective of voluntary administration is to provide for the business, property and affairs of an insolvent company to be administered in a way that:

- maximises the chances of the company, or as much as possible of its business, continuing in existence; or
- 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.

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The voluntary administration process gives a company a short breathing space, during which there is a general moratorium on the enforcement of creditors' claims. It enables the administrator to continue to trade the company's business during the administration period, and for any proposal to rehabilitate the company or otherwise maximise returns to creditors (other than via an immediate winding up) to be put before creditors and, if approved, implemented via a deed of company arrangement (DOCA). A DOCA will be binding on key stakeholders including the company, its shareholders and its creditors (save for secured creditors who do not vote in favour of the DOCA).

The voluntary administration process is intended to be quick, although in more complex administrations (such as corporate groups) it is usual for the Court to extend relevant time limits and the administration period may extend for more than 6 months. Extensions are allowed by the Court on a case by case basis and are entirely dependent on the circumstances of the particular administration.

In addition to providing a mechanism to maximise returns to creditors by allowing a distressed company to trade on, the voluntary administration procedure has other benefits including that:

- it is fast to implement by a simple resolution of the company's board of directors;
- it requires no Court involvement;
- the appointment of an administrator effectively avoids insolvent trading liability for the directors of the company in respect of the period post-appointment; and
- the voluntary administration procedure imposes a moratorium in respect of various claims against the company and property in its possession during the period of the voluntary administration.

Comparison to US Chapter 11

Australia's voluntary administration procedure has the same aim of corporate rehabilitation as the US Chapter 11 process, but has some important differences including that:

- the company's directors are deprived of any power during the administration period and the administration is conducted by an independent insolvency practitioner who must be a registered liquidator (and so, voluntary administration is not a debtor in possession process);
- a voluntary administration can take place entirely without Court involvement (and any Court involvement will usually be limited); and
- a secured creditor with a security interest over the whole or substantially the whole of the property of the company is entitled to enforce that security within 13 business days after the appointment of the administrator (or such longer time as the Court may order or the administrator may agree).

Commencement of voluntary administration

A voluntary administration is usually commenced by the directors of a company resolving that, in their opinion, the company is insolvent or is likely to become insolvent in the future and that an administrator should be appointed.

Although less common, a secured creditor who is entitled to enforce a security interest over the whole or substantially the whole of the property of the company or a liquidator of the company may also appoint an administrator in certain circumstances.

The consent of the proposed administrator must be obtained before the appointment is effective. The administrator must be a registered liquidator with the Australian Securities and Investments Commission (ASIC) and must not be disqualified from accepting the appointment under the Corporations Act.

It is normal to have two or more administrators appointed jointly and severally, to ensure appropriate continuity in the event of absence or ill health.

Role and powers of the voluntary administrator

The administrator takes control of the affairs and business of the company, and acts as agent of the company. An administrator is a fiduciary and, as an officer of the company, is subject to the duties applicable to company officers.

The administrator has very broad powers including to trade on the company and sell its assets. The administrator is not subject to an equivalent of the strict section 420A of the Corporations Act obligation that applies to a receiver in realising company assets.

Importantly, the administrator is personally liable for debts of the company incurred during the administration period for services rendered, goods bought, property leased or occupied and funds borrowed. This personal liability is intended to encourage suppliers, employees and customers to continue to trade with the company during the voluntary administration period. It does not extend to pre-appointment liabilities of the company. The personal liability means that an administrator will be reluctant to trade on (including to retain employees or cause the company to perform contracts) where there are not available funds to do so or where this would prejudice the position of creditors.

The administrator has a right of indemnity out of the property of the company for debts or liabilities incurred by the administrator and for the administrator's remuneration. This right of indemnity takes priority over unsecured debts of the company, and also over any debts secured by any circulating security interest - broadly equivalent to assets which were previously the subject of floating charges, and including cash, receivables, inventory and similar assets - at least until the secured creditor enforces their security (to the extent that they are able to do so consistently with the statutory moratorium discussed below), such as by the appointment of a receiver.

Impact of a voluntary administration

The powers of the company's officers are suspended during the administration period. However, they are required to assist the administrator in his or her investigation into the company's affairs. Some company management may be retained by the administrator for continuity but they are required to discharge their duties and perform their functions subject to the direction of the administrator.

Generally, only the administrator can deal with the property of the company during the administration period.

A transfer of shares in a company, or an alteration of the status of its shareholders, after the commencement of an administration is void unless done with the consent of the administrator or pursuant to an order of the Court.

The appointment of an administrator does not, of itself, constitute a repudiation of contracts to which the company is a party. Akin to the US position, and as a result of the ipso facto reforms to the Corporations Act which became effective from 1 July 2018, there is now a general prohibition in administration on counterparties relying on ipso facto clauses to terminate for an insolvency event of default (subject to a range of exclusions). Please see our separate Ipso Facto brochure for further information.

Although the administrator does not have formal power to disclaim contracts as a liquidator does, the administrator may repudiate contracts requiring performance by the company, as is likely where the administrator is not trading on some or all of the business (such as where he or she does not have funds to do so). This leaves counterparties to pursue their entitlement to damages for breach of contract by way of proof of debt in any subsequent creditors' voluntary winding up or deed of company arrangement.

The company also has the benefit of a statutory moratorium during the administration period, discussed under the following heading.

The moratorium

During the administration period:

- creditors, including some secured creditors, are prohibited from taking any action against the company to recover debts, enforce security interests or have the company wound up; and
- owners or lessors of property that is being used by or is in the possession of the company - including leased premises and goods subject to retention of title or Purchase Money Security Interest (PMSI)[1] terms - are prohibited from seizing or reclaiming property (notwithstanding that they may have contractual rights to do so);

[1] as defined in the *Personal Property Securities Act 2009* (Cth).

> "Owners or lessors of property that is being used by or is in the possession of the company...are prohibited from seizing or reclaiming property (notwithstanding that they may have contractual rights to do so)"

in each case without the consent of the administrator or order of the Court. As discussed above, the administrator has personal liability in respect of services rendered, goods bought, property leased or occupied and funds borrowed during the administration.

The main exceptions to the moratorium are:

- in relation to perishable goods;
- where enforcement has commenced prior to the appointment of the administrator; or
- where a secured creditor who has a security interest over the whole or substantially the whole of the company's property (which, where relevant, has been perfected under the *Personal Property Securities Act 2009* (Cth)) enforces their security interest within the "decision period", being 13 business days from the giving of notice by the administrator of their appointment or from the commencement of the administration, or such further time as may be permitted by order of the Court or consent of the administrator.

The administrator is not able to deal with property subject to a security interest (including property the subject of retention of title or PMSI terms) unless in the ordinary course of business, or with the consent of the secured creditor/owner or the leave of the Court.

Where retention of title or PMSI property is used by the administrator in the ordinary course of business, the Corporations Act requires the administrator to act reasonably in exercising any rights to dispose of that property and to apply the proceeds of sale in a particular manner according to the statutory priority of interests in that property.

In addition, guarantees granted by directors of the company cannot be enforced during the administration period.

Meetings of creditors in a voluntary administration

There are two meetings of creditors required to be held in a voluntary administration.

First Meeting of Creditors

The first meeting of creditors must be convened immediately after the appointment of the administrator and be held within eight (8) business days of the appointment.

The only official business at the first meeting of creditors is to consider the possible replacement of the administrator (which rarely happens) and to determine whether creditors wish to appoint a committee of inspection and if so to appoint the committee. The real value of the first meeting is in meeting the administrator, asking questions, and obtaining information about the administration.

Second Meeting of Creditors

The second meeting of creditors is more substantive in terms of outcomes and must be convened either 5 business days before, or 5 business days after the end, of the convening period. The convening period for the administration operates for 20 business days from the date of the administrator's appointment[2] unless the convening period has been extended by the Court, which is common in larger and more complex administrations.

[2] If an administrator is appointed close to Christmas or Easter, the convening period may run for 25 business days.

In convening the second meeting, the administrator must provide creditors with a report (Report) which:

- discusses the company's business, property, affairs and financial circumstances;
- sets out the details of any proposed DOCA to be put to creditors; and
- provides the administrator's opinion as to whether it is in the interests of the creditors for the company to execute any DOCA which has been proposed, for the administration to end (and the company be returned to the control of its directors) or for the company to be wound up, and the reasons for that opinion.

The Report will, where a DOCA is proposed, consider the likely returns to creditors in a winding up compared to the likely returns under the proposed DOCA, both as to quantum and likely timing. This will involve a consideration of what liquidator's recoveries may be available if the company is wound up, as these recoveries are not available in an administration or DOCA.

The second meeting of creditors may be adjourned by resolution of creditors for up to 45 business days, and potentially for longer by order of the Court.

Attending Meetings of Creditors

For each meeting of creditors, the administrator will ask creditors to submit proofs of debt for voting purposes, and proxies (if the creditor is a corporation or an individual not attending the meeting in person). Creditors will be given a further opportunity to lodge a formal proof of debt at a later stage, if any dividend is to be paid.

Voting in voluntary administration

There is no voting by separate class of creditors in voluntary administration, and voting is done on the basis that all creditors are effectively the one class.

Voting at meetings of creditors in administration is "on the voices" unless a poll is demanded (as is common).

If a poll is demanded, a resolution will only be passed if a simple majority of creditors present and voting is obtained by both value and number. If only one of these majorities is met, the administrator will exercise a casting vote. There is no requirement that the administrator's casting vote be exercised with the value vote or the number vote, and an administrator will generally exercise their vote in accordance with the recommendation they made to creditors as to what outcome was in their best interests in the Report.

Any exercise of a casting vote by the administrator, and the passing of (or the failure to pass) a resolution on the votes of related creditors can be challenged in Court.

A DOCA binds the company, its creditors, officers, shareholders and administrators, however, secured creditors can only be bound by a DOCA if they voted in favour of it.

Committee of inspection

A committee of creditors, called a committee of inspection, may be appointed at the first meeting of creditors in an administration. Essentially, the committee of inspection is available to consult with the administrator, such as on any proposal to seek an order to extend the convening period for the second meeting of creditors. Generally, the administrator will seek approval of his or her remuneration from the committee of inspection.

Outcome of voluntary administration

As noted above, prior to the second meeting of creditors, the administrator must investigate the financial situation and affairs of the company and recommend to the company's creditors in the Report whether it is in their interests to:

- end the administration and hand the company back into the control of its directors (which is uncommon and would only be appropriate if the company is solvent);
- have the company enter into a DOCA; or
- have the company wound up by transition to a creditors' voluntary winding up.

The administration usually ends when creditors resolve at the second meeting of creditors in favour of one of these options or, if the creditors resolve that the company enter into a DOCA, on its execution.

A deed of company arrangement or DOCA

A DOCA is a statutory contract between the company and its creditors that governs the relations between the company and its creditors after the end of the voluntary administration. The Corporations Act specifies certain minimum requirements of a DOCA including the nature and duration of any moratorium period, property available to pay creditors, the order of payments to creditors (usually in accordance with the statutory priorities applicable in a winding up) and the release of the debts of the company.

A DOCA is administered by a deed administrator who is usually (but is not necessarily) the same person who was appointed as the voluntary administrator of the company.

A DOCA may allow the company to trade on, including under the control of its directors, and will provide for a fund for distribution to creditors. Such a fund which will often be contributed by a third party (such as a director or shareholder), and be funds that would not be available for the benefit of creditors in a winding up of the company.

A DOCA must give employee entitlements the statutory priority to which they would be entitled in winding up out of assets of the company coming under the control of the deed administrator. Employee creditors may vote to modify this priority at a separate meeting of the employees convened under section 444DA of the Corporations Act. Priority employee entitlements include wages and superannuation, leave and redundancy entitlements.

The Australian Courts have held that a DOCA cannot effect a compromise of the claims of creditors of a company against third parties, such as the party or parties contributing to a deed fund available under the DOCA for distribution to creditors. This limitation has in part been responsible for the growing popularity in recent years of creditors' schemes of arrangement (discussed further below).

The DOCA does not affect the rights of future creditors of the company if it continues to trade and incur debts.

If the DOCA is terminated because it has been fully effectuated, the company is returned to the control of its directors and the claims of creditors against the company are released as provided for in the DOCA. However, if the DOCA is terminated prematurely, it is likely that the company will proceed into liquidation.

Additionally, the Corporations Act provides for a DOCA to be set aside on an application to the Court (in particular circumstances), and for a DOCA to be varied including by resolution of creditors.

The role of the Court in voluntary administration

The Court has no role in the appointment of a voluntary administrator and it is entirely possible that the Court will have no involvement in a voluntary administration.

Nevertheless, the Court has very broad powers to make orders in connection with administrations.

An administrator can seek directions from the Court and the Corporations Act gives the Court broad powers to make orders as to how the voluntary administration provisions operate in respect of individual companies. These orders are generally made on the application of the administrator.

It is common for the Court to be asked to extend the period in which the second meeting of creditors must be convened on the application of the administrator. This extension is sometimes sought and granted on more than one occasion during a voluntary administration.

Since the COVID 19 pandemic began it is becoming common for administrators to seek Court orders limiting their statutory personal liability, particularly in respect of rent.

Creditors and other persons aggrieved by an act, omission or decision of an administrator or a deed administrator (including the adjudication of their proof of debt) can also appeal to the Court.

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