VICTORIA UNIVERSITY OF TECHNOLOGY

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THE APPOINTMENT OF A VOLUNTARY ADMINISTRATOR BY UNSECURED CREDITORS: A CASE FOR THE INTRODUCTION OF SUCH A RIGHT

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ABSTRACT

Insolvency practice, has in recent years undergone many changes with the introduction of the Voluntary Administration scheme under Part 5.3A of the Corporations Law. So significant are these changes that current statistics show that as much as 48% of all external appointments over "insolvent" companies are by the appointment of a Voluntary Administrator. The scheme fails to allow the largest class of creditor, the unsecured creditor, the right to initiate the appointment of an Administrator over an insolvent company in order to protect their interests.

This study aims to identify the rationale behind the exclusion of such a right, the cost/benefit of introducing the right to unsecured creditors and the possible social and economic consequences of including such a right into Part 5.3A of the Corporations Law. It is concluded that whilst the Voluntary Administration scheme continues to operate in the manner that it does, overall returns to creditors will not increase unless unsecured creditors are given the right to initiate the appointment of an Administrator. Extensions to the existing appointment process are suggested and reviewed.

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Ivan M Glavas

DECLARATION

I hereby declare that this thesis contains no material which has been accepted for the award of any other degree or diploma in any institute, college or university, and that to the best of my knowledge and belief, it contains no material previously published or written by any other person, except where due reference is made in the text of the thesis.

Ivan M Glavas

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LIST OF ACRONYMS USED IN THIS THESIS

VA	Voluntary Administration scheme under Part 5.3A of the Corporations Law.
Law	Australian Corporations Law.
Right	refers to the right of unsecured creditors to seek the appointment of an Administrator.
At Risk	refers to the potential for unsecured creditors to incur monetary loss.
Terms of Trade	refers to the trading terms agreed upon between a creditor and the debtor.

CHAPTER 1

ADVENT OF THE VOLUNTARY ADMINISTRATION SCHEME. A COMPARISON BETWEEN THE RECOMMENDATIONS AS OUTLINED IN THE HARMER REPORT WITH THE OPERATION OF THE VOLUNTARY ADMINISTRATION SCHEME UNDER PART 5.3A OF THE AUSTRALIAN CORPORATIONS LAW

INTRODUCTION

Despite the volume of literature which has in recent times appeared on the subject of Voluntary Administration (VA), very little has addressed the rights of the unsecured creditor[1] to appoint an Administrator over a debtor company. Yet statistically at least[2], unsecured creditors tend to represent a significant proportion of the debts of companies. Accordingly, the following questions are asked:

Are the current debt recovery methods available to unsecured creditors a cost effective way of realizing debts? Are the current methods socially and economically acceptable? In light of the popularity and flexibility of the VA scheme, why can an unsecured creditor seek to appoint a Liquidator by the court yet cannot seek the appointment of an Administrator? How do overseas systems compare? What are the reasons as outlined in the original proposal for a VA scheme for not including unsecured creditors in the appointment process? Could it be that the voluntary nature of the scheme may be compromised? Perhaps it was anticipated that implementing such a right may provide power to those who should be without it.

The following chapters address these questions. However, it is first necessary to look at the history behind the creation of the VA process and review the current legislation under Part 5.3A of the Australian Corporations Law (the 'Law').

[1]Unsecured Creditors - defined as all creditors not holding a registered fixed and /or floating charge over the whole or substantially the whole of the company's assets, includes partly secured creditors who forgo their rights under a secured charge and contingent creditors where it can be clearly identified that a portion of their claim will become unsecured at some future point in time.

[2]Source: refer Chapter 3 of this report.

1.1 THE HISTORY BEHIND THE VOLUNTARY ADMINISTRATION PROCESS - LOOKING AT THE HARMER REPORT

On 20 November 1983, the Federal Attorney-General requested the Australian Law Reform Commission conduct inquiries into the laws relating to insolvency. Taking into consideration recent overseas developments in the area of bankruptcy and company law, the commission undertook to highlight and recognize ways of improving antiquated insolvency laws and procedures. The commission reviewed various recommendations taking special interest in the US Bankruptcy Code (1978), the UK Insolvency Law Review Committees "Cork Report" of 1982 (which eventually led to the introduction of the UK Insolvency Act 1986) and the Colter Report of Canada (1986).

In 1987, the results from the inquiry led the Australian Law Reform Commission to issue report number 45, entitled "General Insolvency Inquiry." The "Harmer Report" as it is commonly referred to after the chairman of the committee, Mr Ron Harmer, contained proposals for a new voluntary administration procedure aimed at encouraging a more "constructive"[3] approach to insolvency, by focusing on the possibility of saving a business and preserving employment prospects[4] but not necessarily saving the company itself.

Amongst other things, the report recognized the need to provide an alternative to the then existing forms of insolvency administration, namely Schemes of Arrangement, Official Management (repealed with the introduction of Part 5.3A of the Law), Creditors Voluntary winding up and Court winding up.

Deficiencies such as those found in the systems of reconstruction, namely Schemes of Arrangement and Official Management were not only costly and

[3]The Harmer Report (ALRC No: 45), Par 53

[4]ibid, Par 52

time consuming but also failed to provide companies with a reasonable opportunity to continue trading via a reconstruction process. In particular, Schemes of Arrangement were noted as being unsuited to the average private company in financial difficulty[5] and Official Management required payment of the company's debts in full in order to succeed.[6]

Meanwhile, the Creditors Voluntary winding up procedure had problems. Not only did the process fail to provide an ordered administration in the period between the calling of the meeting of creditors and the appointment of a Liquidator, but there appeared to be a continuous lack of independent information about the financial affairs and conduct of the business of the company at the meeting of creditors.[7] Furthermore, a Creditors' Voluntary winding up and Court winding up usually resulted in the cessation of the business of the company.[8]

Integrating the procedures most commonly used in a voluntary winding up with a Scheme of Arrangement, the Harmer Report identified that a new procedure would need to be designed with the aim that it would be:

" (i) capable of swift implementation;
(ii) as uncomplicated and inexpensive as possible; and
(iii) flexible, providing alternative forms of dealing with the financial affairs of the company."[9]

The report recognized that the new voluntary procedure would be available to companies with a temporary liquidity problem and not just those that were hopelessly insolvent.[10] The company would be required to make a

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[5]ibid, Par 46
[6]ibid, Par 47
[7]ibid, Par 49
[8]ibid, Par 45
[9]ibid, Par 54
[10]Insolvency is defined as the inability to pay all debts as and when they fall due. Whilst the Administration procedure is open to a company which is not insolvent, directors of the company have

declaration of its financial difficulty and appoint a registered Liquidator as Administrator of the company. Subject to the appointment, the company would be required to give notice of the declaration to any secured creditor holding a registered charge over all of the property of the company. The secured creditor may then proceed to take possession of that property or appoint a receiver to do so.

The effect of the appointment upon the Administrator would mean that the Administrator would take full control of the company and its property for a period which would not normally exceed 28 days. This "control period" would also bring about a stay on actions against the company and its property and directors pursuant to guarantees given. The effects of the stay would apply to all unsecured creditors, secured creditors (with some exception) and all owners or lessors of property possessed, used or occupied by the debtor company.

It was decided as a consequence of adopting the report that Official Management should be abandoned as a form of administration and that Schemes of Arrangement should be preserved for use by larger private or public companies. It was also suggested that the then existing form of creditors voluntary winding up be abandoned.[11]

1.2 METHODS OF APPOINTING A VOLUNTARY ADMINISTRATOR

The Harmer report recognized that an Administrator should be appointed either by:

"(I) directors of the company;

(ii) by the Liquidator if the company is being wound up; and

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to be satisfied that there is a likelihood that the company will become insolvent at some future point in time.

[11]ibid, par 57.

(iii) by a person entitled to enforce a floating charge on the property of the company."[12]

In other instances, an Administrator may be appointed by the court, either after an Administrator has been removed from office or the office of the Administrator for any other reason remains unoccupied.

Like a Creditors Voluntary winding up, Administrators may be appointed jointly and severally and an Administrator must consent to the appointment as Administrator of the company.

1.2.1 Appointing an Administrator by an unsecured creditor under the recommendations outlined in the Harmer Report.

The prospect of appointing an Administrator by an unsecured creditor was noted in the Harmer Report.[13] Amongst the various submissions supporting this right were those as submitted by the Australian Institute of Credit Management.[14] However, little became of these recommendations, other than to note the inquiry's belief that the introduction of such a right was considered impractical and would also detract from the voluntary nature of the procedure.[15]

Whilst there are valid arguments for and against the appointment of an Administrator by unsecured creditors[16], one of the more significant arguments against[17] is that such a right could be utilized by aggrieved creditors to frustrate management of the debtor company. However, as unsecured creditors generally make up the greatest portion of a company's debt[18], valid

[12]ibid, Par 61.
[13]ibid, Par 65
[14]AICM submissions 135, 156 & 160 to the Harmer Report, Vol 2., See Chapter 4 of this report.
[15]The Harmer Report (ALRC No: 45), Par 65
[16]Refer Chapter 3 - Significance of the problem and statistical analysis therein.
[17] Refer Chapter 4 for a more detailed discussion.
[18]Refer Chapter 3 - Significance of the problem and statistical analysis therein.

arguments also exist for the right to allow unsecured creditors the ability to appoint an Administrator over a debtor company.

In support of this right, an analysis of 24 companies[19] under administration has revealed some interesting facts. Over 19 of the 24 companies (or 79%) reviewed had unsecured creditors holding greater than 50% of all the companies' debts. In fact, of the sample randomly selected, 11 companies (or 45%) had unsecured creditors holding over 95% of all debts of the company. Further details regarding this study is discussed in Chapter 3.

The right to be consulted in the appointment of an Administrator by directors was also noted by the report, however, this was considered impractical and would detract from the so-called "voluntary" nature of the procedure.[20]

1.2.2 Appointment of an Administrator by a secured creditor under the recommendations outlined in the Harmer Report.

As noted in the report, the holder of a charge over all or substantially all of the property of a company should be entitled to appoint an administrator if default in the payment of moneys has been made.[21]

Although the appointment of an Administrator by a chargeholder may seem to detract from the voluntary nature of the procedure, it was nevertheless recommended. However, this relates only to a charge which extends over all or substantially all of the property of the company and entitles its holder to appoint a receiver to take control of that property in any case. In outlining the commission's recommendation, the report noted the inquiry's aim which was to protect the "unsecured creditor" and which would in retrospect be better protected under the recommendations.

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[19]Refer Chapter 3 for a more detailed discussion of same.

[20]The Harmer Report, (ALRC No: 45), Par 65

[21]ibid, Par 66

The report recognized that creditors holding a registered charge over all of the property of the company must be given notice of the appointment of an Administrator [22]and have rights to enforce its charge within a specified period of time and not after the time had lapsed.

It was also noted that if the chargeholder elected to enforce the charge, the Administrator would continue in office although the powers of the Administrator would be subject to those of the chargeholder, Receiver or other agent of the chargeholder under the charge.[23]

1.3 A REVIEW OF PART 5.3A OF THE CORPORATIONS LAW

The recommendations as outlined above in the Harmer Report were generally adopted into Part 5.3A of the 'Law'. In fact, many of the procedures referred to in the Harmer Report now form part of Part 5.3A. An outline is provided below with particular attention being placed on the methods of appointing an Administrator.

1.3.1 Operation of the Voluntary Administration Scheme under Part 5.3A of the Law

An administration has been defined as a moratorium on a company's business, property and affairs which allows the Administrator and the company's directors time to determine how the company may be saved or, if this is not possible, how creditors' interests may be protected.[24]

The objectives of the VA scheme are outlined in Section 435A as follows:

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[22]ibid, Par 68

[23]ibid, Par 68.

[24]"A Practical Guide to Insolvency", Adam Townley & David Pratt, p:151

" to provide for the business, property and affairs of an insolvent company to be administered in a way that:

(a) maximizes the chance 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 company's creditors and members than would result from an immediate winding up of the company."[25]

The person appointed to oversee the administration is called the Administrator. The appointee must be a registered Liquidator,[26] who prior to appointment must consent to the appointment in writing.[27]

The main objective of the appointment is to investigate possible solutions to the company's financial problems. As such, a debt moratorium exists during the period of administration.[28] During this moratorium, the rights of secured creditors to enforce any registered charges over the property of the company are suspended subject to limited exception and unsecured creditors are prevented from taking debt recovery action against the debtor company.[29]

The appointment of an Administrator is normally a pre-cursory step in trying to reorganize the company's affairs through an arrangement with its creditors. The moratorium period allows a proposal to be coordinated and put to creditors for their acceptance. The drafting of the proposal and creditors meetings can then take place without the pressing threat of litigation from aggrieved creditors.

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[25] Section 435A of the Law.
[26] ibid, Section 448B.
[27] ibid, Section 448A.
[28] ibid, Section 440D.
[29] ibid, Section 440F.

Essentially, the VA scheme is a swift process controlled by a series of strict deadlines and meetings. During the period of administration, the Administrator must investigate and seek information about the company's affairs. A report must be provided to creditors of the company before the second meeting (which decides the company's future) and must contain an opinion about each of the following matters:

1. whether it would be in the best interest of the company's creditors for the company to enter into a Deed of Company Arrangement; or

2. whether it would be in the interests of the company's creditors for the administration to end; and

3. whether it would be in the interests of the company's creditors for the company to be wound up.[30]

Should the proposal as put to creditors be accepted, it will be documented in the form of a Deed of Company Arrangement. Upon execution, the Deed is binding on all creditors of the debtor company[31]. However, if the proposal fails, the debtor company can automatically move into voluntary liquidation or can be released from an administration and continue operating[32].

Recent case law has highlighted the need for an Administrator to ensure compliance with this section in forming an opinion on the above matters. In the case of Deputy Commissioner of Taxation v Comcorp Australia Ltd and McVeigh[33], the creditor applied to the court seeking an order to declare a series of Deeds void on the basis that information provided in the reports to

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[30]Section 439A(4) of the Law.
[31]ibid Section 444D(1).
[32]Ibid Section 439C.
[33]Federal Court of Australia, Lockhart, Sheppard and Carr JJ, 24/9/96 (1996) 14 ACLC 1616; 21 ACSR 590.

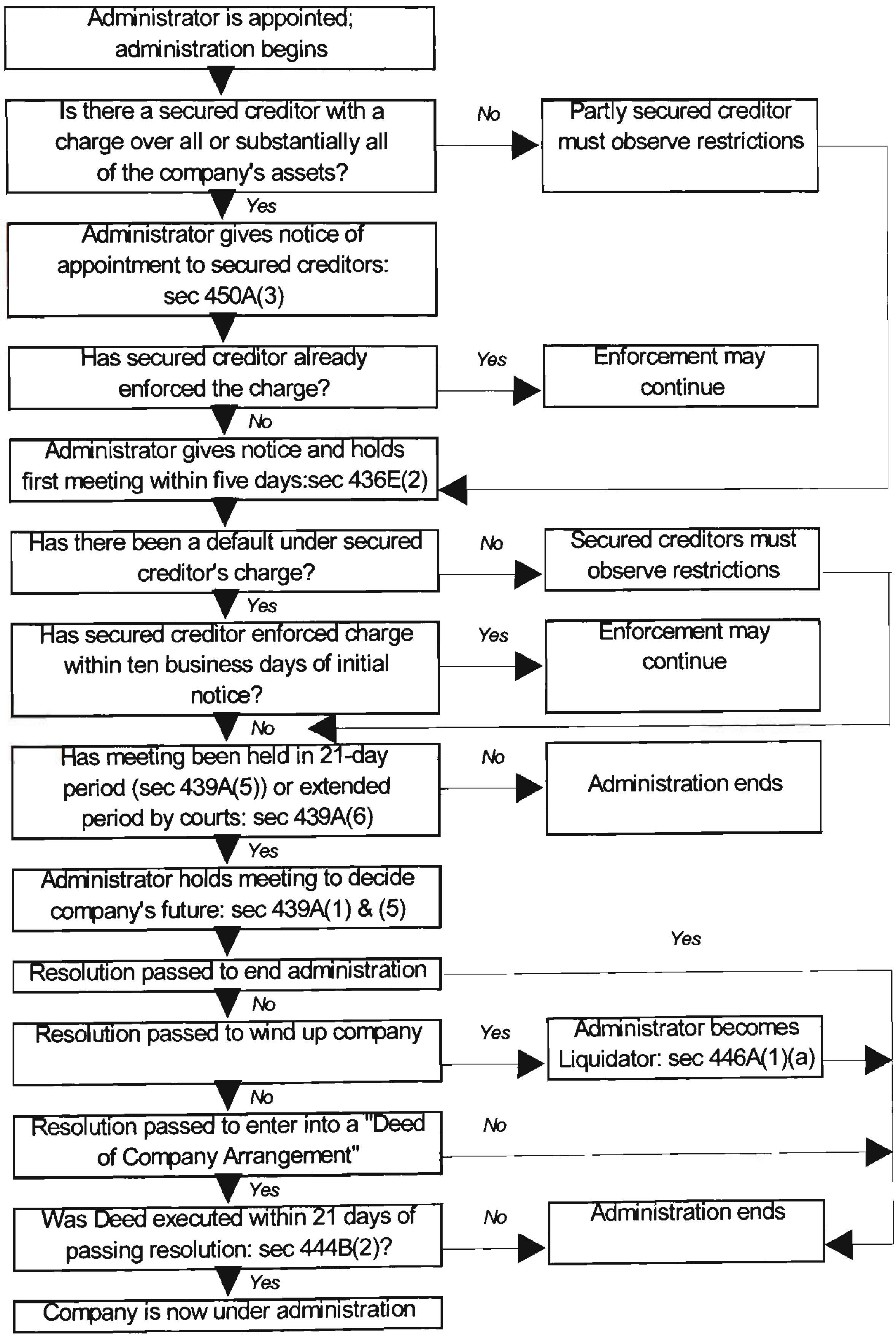
creditors failed to comply with the requirements under section 439A(4). In this instance, the court held that the three courses available to creditors were mutually exclusive however, they should have been given literal interpretation by the Administrator in order to give creditors the ability to assess whether they agreed with the Administrator's opinion.

Where a Deed of Company Arrangement has already been executed, the court may set aside the Deed upon application by a creditor.[34]

For ease of understanding, a summary of the administration process is provided in Diagram 1.1.

[34]Ibid Section 447A. Case Law: Re Bartlett Researched Securities Pty Ltd; Re Nova Corp Ltd (1994) 12 ACSR 707. In this instance "creditors" also includes all other relevant parties.

DIAGRAM 1.1
Summary of the Administration process under the VA scheme



Source: A Practical Guide to Insolvency, Townley A & Pratt D, pp: 152-153.

1.4 THE APPOINTMENT PROCESS

The Administration process may be initiated by the following mechanisms:

1.4.1 Appointment by the company under seal[35];

1.4.2 Appointment by a Liquidator or provisional Liquidator[36];

1.4.3 Appointment by the holder of a charge on the whole, or substantially the whole of a company's property[37].

A brief summary of each type of appointment is provided below.

1.4.1 Appointment by the company under seal

The administration process may be initiated by the company under its common seal if a majority of directors of the company resolve that the company is or is likely to become insolvent in the future.[38] The resolution itself must clearly state that an Administrator is to be appointed because the company is or is likely to become insolvent at some future point in time. It is not necessary for all directors to vote in favor of the resolution. Appointment by this means cannot be sought if the company is already being wound-up.[39]

1.4.2 Appointment by a Liquidator or Provisional Liquidator

A liquidator or provisional liquidator may seek to appoint an Administrator if he or she believes that the affairs of a company might best be handled by an Administrator. Circumstances in which this method of appointment may be useful include, for example, where the appointment of an Administrator may assist the Liquidator in disposing of the company's business as a going

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[35] Section 436A of the Law.
[36] ibid Section 436B.
[37] ibid Section 436C.
[38] ibid Section 436A(1).
[39] ibid Section 436A(2).

concern. Provided leave of the court is obtained, the liquidator can also appoint themselves as Administrator of the company.[40]

1.4.3 Appointment by the holder of a charge over the whole, or substantially the whole of a company's property

A secured creditor may also seek to appoint an Administrator over a company if the charge has become and still is enforceable before the appointment.[41] The secured creditor must hold security over the whole or substantially the whole of the company's assets. It should be noted, the enforcement of a charge by a secured creditor over the whole or substantially the whole of the company's assets before the commencement of the administration or during the 10 business days of being notified by the administrator[42] does not prevent the company from being placed into administration, or cause the administration to end.

A secured creditor cannot seek to appoint an Administrator where the company is being wound up.[43]

1.5 SUMMARY

Although there are no provisions within the 'Law' which allow an unsecured creditor the right to appoint an Administrator over a company, statistical evidence in this study suggests that the process has failed to recognize the largest class of creditor in its own right.[44] However, as already noted by the Harmer report, providing unsecured creditors with the right to appoint an administrator was "considered impractical and would also detract from the

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[40] ibid Section 436B(1).
[41] ibid Section 436C.
[42] Commonly referred to as the "decision period" under Section 441A of the Law.
[43] Source: Section 436C(2) of the Law.
[44] Refer Chapter 3 and 4.

voluntary nature of the procedure."[45] Further commentary regarding the "impracticality" and effect upon the "voluntary nature" by introducing the appointment rights of unsecured creditors will be discussed in the following chapters.

Chapter 2 will focus on outlining the current options available to unsecured creditors in recovering their claims against a debtor company with significance being placed upon the time and cost constraints associated with these claims. Chapter 3 will analyze the significance of the problem in more detail by identifying the social and economic consequences of failing to introduce the right to unsecured creditors. Chapter 3 will also discuss the results of a statistical analysis conducted to identify the significance of the problem.

The remaining chapters will outline the research hypothesis and conduct case studies which will aim to identify and examine the hypothesis. The results of the studies are analyzed and a range of suggestions allowing for the appointment of an Administrator by unsecured creditors is reviewed.

[45] The Harmer Report (ALRC No: 45), Par 65

CHAPTER 2

CURRENT OPTIONS AVAILABLE TO UNSECURED CREDITORS TO RECOVER DEBTS

Chapter 1 outlined the operations of the VA scheme under Part 5.3A of the 'Law' and provided a brief summary of the Harmer Report and the reasons therein for not providing unsecured creditors with the right to appoint an Administrator. The following chapter will summarize the current options available to unsecured creditors in the debt recovery process and discuss the associated time and other economic costs[46].

In the broadest sense, the legal debt recovery process offers no guarantee by which a creditor can recover an outstanding debt.[47] However the efficient use of the process will maximize the potential for a return to the creditor.

There are two general steps in the debt recovery process. The first is to obtain a court judgment. The second is to obtain payment of the outstanding debt from the debtor. Each of these issues will be dealt with in turn.

2.1 OBTAINING A COURT JUDGEMENT

The first step involves preparing a summons to initiate the action and bring the existence of the debt to the attention of the courts. The summons must be served upon the debtor and an application for judgment must be made to the relevant court.

In instances where the debtor defends the summons, caution should be taken not to incur unnecessary cost in the process leading to judgment. While some of the legal procedures are complex and particularly costly, in over 95% of debt cases the legal actions are not defended.[48] In these instances, the court will generally order costs and interest to be paid by the debtor. In many

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[46]Other economic costs refers to the anticipated costs incurred to proceed with a particular avenue of debt recovery as at February 1997. It should be noted that these costs are an average only and may vary considerably between legal practitioners. For ease and understanding, where monetary costs are provided, these costs will be as per the Magistrates Court scale of costs unless specified otherwise.

[47]"Debt Recovery in Victoria - A Guide to the Law", pp: xix, Robert White, 1993

[48]Australian Chamber of Manufacturers - Debt Management Seminar, 18/3/97, Presented by: Citibureau Collections & Sheezel Sandor & Associates, pp: 2.

cases, the debtor company does not pay because it does not have sufficient funds to pay its creditors. It is therefore crucial for creditors to act promptly and proceed with legal action to protect their interests. As will be discussed in the following chapters, an aim of this thesis is to suggest a mechanism to allow the implementation of a 'right' to unsecured creditors in appointing an Administrator promptly and without the incidental costs associated with the current debt recovery process.

It is suggested that larger companies have more significant resources and are more likely to use them efficiently in the processing of information[49], that is, a company's size can influence many variables including the efficiency of processing information. It would follow from this that larger creditors are more likely to be better informed as to the avenues of debt recovery available to them than are smaller creditors. Furthermore, it is submitted that as larger creditors are relatively more 'at risk' they would be likely to react quickly to recover their outstanding claims against a debtor company. The flow of information (or lack thereof) may prove costly to smaller unsecured creditors who may not only be financially incapable of pursuing a claim against a debtor company, but may also be unaware of the legal avenues available to them due to the costs associated with obtaining such information.

Accordingly, prompt action by larger unsecured creditors may cause 'free-riding' to occur in that it may not only protect the individual interests of the larger unsecured creditor, but could also preserve the interest of other smaller creditors. This is discussed in more detail in chapters 3 and 4 of this report.

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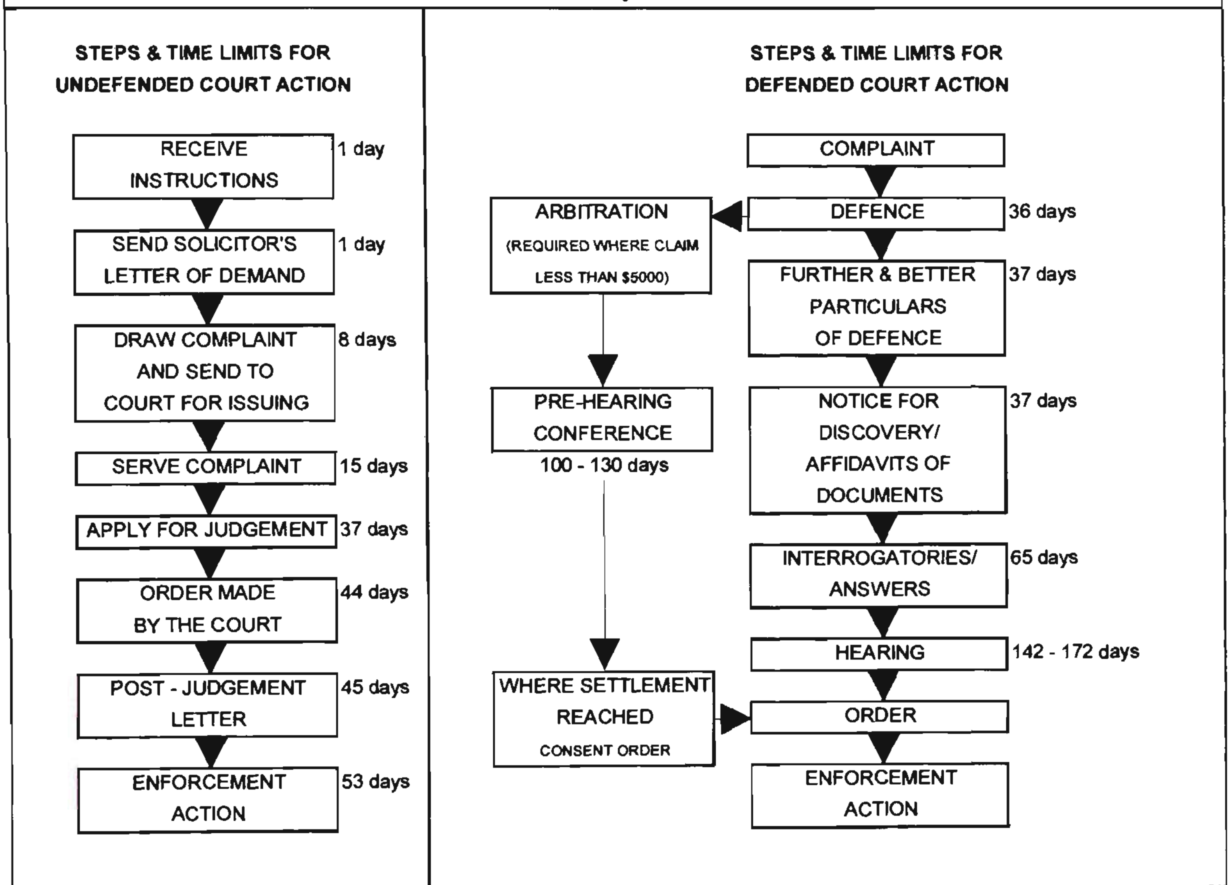
[49]Ball R & Foster C (1982) "Corporate Financial Reporting: A Methodological Review of Empirical Research, Studies on Current Research Methodologies in Accounting: A Critical Evaluation." Journal of Accounting Research, pp: 161 - 234, Vol. 20.

Diagram 2.1 sets out the major steps in the legal recovery process for undefended and defended debt recovery actions.[50] The diagram also indicates the days from date of initiation for each step in the process.

DIAGRAM 2.1
The major steps in the Legal Recovery Process for undefended and defended debt recovery actions



Note: days represents days from date of instruction for action against debtor company

Source: Australian Chamber of Manufacturers - Debt Management Seminar, 18/3/97, Presented by: Citibureau Collections & Sheezel Sandor & Associates, pp: 21-22

A brief summary of the major steps noted in diagram 2.1 are provided below:

2.1.1 Letters of Demand

A letter of demand should be sent to the debtor by the creditor or its solicitor in almost every instance prior to issuing court proceedings for the recovery of a debt. Although not required by statute, there are significant advantages in doing so, for example; the letter may lead to the payment of a debt or an offer

[50]Australian Chamber of Manufacturers - Debt Management Seminar, 18/3/97, Presented by: Citibureau Collections & Sheezel Sandor & Associates, p: 21 & 22.

to pay by installments by the debtor which the creditor may agree to accept and which will save on additional recovery costs.

Furthermore, it may also lead to a response in which the debtor indicates any subsequently issued summons will be defended. In this instance, the creditor will be more aware of the debtors anticipated actions and, should the creditor wish to continue pursuing the debt, may approach the matter in a more detailed manner than would otherwise be required.[51]

It is common for a solicitor's letter of demand to request the debtor pay costs associated with the preparing of a letter of demand. However, debtors are not obliged to pay these costs unless specifically stated in the creditors 'Terms of Trade'. Prior to the issue of proceedings, it should be noted that the obligation to pay costs rests with the pursuing creditor. The cost for a one-off letter of demand is approximately $60.[52]

Whilst this stage of the recovery process is relatively inexpensive, the costs associated with debt recovery can increase dramatically where the process leads through to enforcement.

2.1.2 The Debt Summons

Less than 5% of all summonses issued against debtors are defended in the State of Victoria.[53] Therefore, precautionary measures should be taken by the creditor not to incur additional costs prior to determining the actions of the debtor.

Whether an action is defended or not, it is still necessary to obtain the relevant information in order to prepare the summons. Once this information

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[51]Debt Recovery in Victoria - A Guide to the Law, p: 10, Robert White, 1993

[52]Costs are as at February 1997 sourced from Australian Chamber of Manufacturers - Debt Management Seminar, 18/3/97, Presented by: Citibureau Collections & Sheezel Sandor & Associates.

[53]Annual Report of Attorney General's Department for the year ended 30 June 1991.

is received the creditor's solicitor can then prepare the appropriate 'Complaint' or 'Writ'. The cost associated with this is dependent upon the value of the debt. However, as a general rule, where the debt is less than $500, the cost of issuing a complaint is approximately $300. Where the debt is between $7,500 and $20,000, the costs to proceed with a Writ will vary between $450 and $850. Where the debt is over $200,000, the cost will be approximately $1,200.[54]

In preparing a Writ or Complaint against a debtor company, a company search will usually be undertaken. The search will identify the existence of an external Administrator, registered charges over the company's assets and details of any pending winding-up applications which have been filed against the debtor.

For a creditor wishing to issue a debt summons against the debtor, the existence of an external Administrator would, in most instances, sway a pursuing creditor away from any further action against the debtor company, in so far as any action against the company will be unlikely to improve the creditor's position. Where a Liquidator is appointed, the debtor company can only be sued if permission is obtained from the Court.

Where a registered Charge exists over the debtor's assets, inquiries should be made as to when the charge was created. If registered less than six months previously, it is possible that an action can be taken which would ultimately lead to the chargee's security being declared void and the chargee merely ranking as an unsecured creditor. However, where a charge has been registered for more than six months and is a registered charge, the creditor should determine the scope of the charge in order to determine whether it would be cost effective to pursue any further claims against the company.

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[54]Costs are as at February 1997 sourced from Australian Chamber of Manufacturers - Debt Management Seminar, 18/3/97, Presented by: Citibureau Collections & Sheezel Sandor & Associates.

In instances where details of a pending winding-up action have been filed, it is generally pointless to sue a debtor company against which a winding-up application is pending. The main reasons for not doing so is that such an action will not normally improve the creditor's financial position. Furthermore recovery from any such action would be void against a Liquidator of the company. A summons can later be issued in the event that a winding-up order is not made.

It should be noted that creditors with a claim of more than $2,000.00 against the debtor have the right to support the pending application. This is particularly useful when the original winding-up applicant is paid by the debtor as the creditor who gave such a notice may be able to obtain an order to be substituted. The net effect is that the applicant may be in a stronger bargaining position to obtain payment of its own debt.[55]

In light of this practice, it is suggested that if a medium to large unsecured creditor had the 'right' to seek the appointment of an Administrator at some time prior to the company seeking the appointment of an external Administrator or a petitioning creditor proceeds to wind-up the company (which can take up to 13 to 16 weeks), the prospect of achieving a more favorable return not only to that individual creditor but for all creditors may be more readily achieved.

Chapter 7 outlines a system of appointing an Administrator which incorporates current winding-up procedures but which also take into consideration the prospect of allowing the debtor company a chance to survive or where this is ultimately not possible may offer a better return to all creditors.

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[55] Debt Recovery in Victoria - A Guide to the Law, p: 187, Robert White, 1993

2.1.3 Jurisdictional[56] Limits of the Courts in Debt Matters

The following is a summary of the monetary jurisdictional limits of the various courts in Victoria:

TABLE 2.1

COURT	MONETARY LIMIT
Magistrates Court	debts less than $25,000
County Court	debts between $25,000 and $200,000
Supreme Court	debts over $200,000 (for Winding Up procedures the debt must be over $2,000)
Federal Court	for Winding Up procedures the debt must be over $2,000

In reviewing the above table, it is important to note that the higher the courts powers to hear matters, the greater the associated costs such as court and legal costs will be in order to achieve a favorable outcome. Whilst it may be argued that these costs can be justified upon the level of debt sought to recover, the apparent costs alone may only be available to larger unsecured creditors who may be more capable of absorbing greater costs in anticipation of a return.

2.1.4 Issuing and Serving Complaints or Writs

On filing with the appropriate court, the Complaint or Writ must be served upon the debtor within 12 months of the date of the issue. As noted in diagram 2.1, it takes approximately 8 days from instruction to issue a Complaint or Writ and up to 15 days to serve it upon the debtor.

[56]Jurisdiction also refers to geographical jurisdiction and power to determine classes of cases. In this instance, the Magistrates' Court, County Court and Supreme Court are all able to hear debt actions up to the court's monetary jurisdiction. Geographical jurisdiction refers to the court's jurisdiction to hear debt claims for any debts incurred in Victoria and to any debtor within Victoria. As such, any debt incurred within Victoria can be pursued through the appropriate courts, whether or not the debtor (defendant) resides in Victoria.

Upon service, an Affidavit of Service must be sworn and filed with the appropriate court. Particulars of the method, date and time of service should be included in the Affidavit.

2.1.5 Defences and Appearances

A debtor who wishes to defend a Magistrate Court Complaint must give Notice of Defence. A debtor has 21 days from the date of service of the complaint in which to file at the Court of issue a Notice of Defence and serve a copy on the plaintiff's solicitor.[57] If the debtor does not file a defence within the 21 day period, the plaintiff may proceed to enter Judgment by Default.

Where an action is defended, a number of steps may be taken prior to the case coming for hearing. These include steps such as Discovery, Interrogatories, Notices to Admit, Offers of Compromise and a Request for Further and Better Particulars and are available to both parties. The option of a Counterclaim and Third Party Notice is only available to the defendant (debtor company).

In addition, a pre-hearing conference must be held between the parties and/or legal representatives at a date and time fixed by the court. If neither party or their representative attends the Pre-Hearing Conference, the Registrar may be requested to discuss the claim or strike out the defence. As noted in Diagram 2.1, to arrive at this stage in the debt recovery process can take between 37 and 130 days from date of instruction.

2.1.6 Orders/Judgments

A creditor (plaintiff) can enter judgment on the day after the last day available to the debtor to defend the action, that is, after 21 days from the date of service of a Complaint (or 25 days if interstate service). Described as

[57] Note: 25 days if the defendant is incorporated interstate.

"obtaining an order in default of defence" in a Magistrate Court and "Default Judgment for Debt" in the County and Supreme Courts, in each instance, the plaintiff must lodge the relevant evidence at the appropriate registry to prove service together with the completed form of Order or Judgment.

The application for an order together with an affidavit verifying service of the complaint and a copy of the original complaint will be required to be lodged with the appropriate court. Upon lodgment, the court Registrar will usually make an order in favor of the creditor and issue a 'Notice of Order Made' within 5 to 7 days after lodgment of the application.

Where a debtor files an application to set aside any judgment that has been obtained by default, the debtor must file an affidavit setting out the reasons for the application and the nature of the defence. It should be noted however, that half, if not more, of debtors who file defence notices have no real defence or intention to proceed with the action but rather intend to delay payment.[58]

2.1.7 Summary

As has been identified in this section, the time and monetary costs associated with the legal debt recovery process can be both costly and time consuming with little prospect of a return. If however, judgment is obtained and there are sufficient funds from which to provide payment to the pursuing creditor, there are various methods of enforcement available to recover funds. Section 2.2 of this chapter will discuss and outline the time and monetary costs associated with these methods of recovery.

[58]Debt Recovery in Victoria - A Guide to the Law, p: 61, Robert White, 1993

2.2 STEP 2 - METHODS OF ENFORCEMENT AVAILABLE TO UNSECURED CREDITORS

The second step in the debt recovery process involves considering the means which are available to enforce the court judgment.[59]

Upon an order being made, enforcement action is usually undertaken to recover the debt due. A summary of the more commonly used enforcement options available together with associated time frames and economic costs are outlined below:

2.2.1 Summons for Oral Examination

A debtor's representative can be directed to attend court to give evidence under oath as to the company's assets, liabilities, income and expenses in order to assist in determining the best course of action to recover moneys outstanding. Considered to be the cheapest form of enforcement[60], the only information required prior to issuing a summons for oral examination is the address of the person to be examined. Whilst it only costs approximately $125, it can take up to 4 to 6 weeks before an oral examination of the debtor company's director is undertaken at which point it is anticipated that a resolution may be made as to the best possible course of recovering the outstanding claim.

2.2.2 Installment Orders

After the court has orally examined a debtor and is satisfied that in all circumstances there are sufficient funds to pay the outstanding claim by installments, the Court may make an order under the *Judgment Debt*

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[59]"Debt Recovery in Victoria - A Guide to the Law", p: xix, Robert White, 1993

[60]ibid, p: 100.

Recovery Act for the debtor company to pay the judgment debt by way of installments.

Where a debtor defaults on an Installment Order, the Order can be struck out on the application by the Judgment Creditor. Furthermore, should the debtor company continuously fail to pay or willfully default under the arrangement, the Judgment Creditor may apply to the Court to have the Debtor's representative imprisoned.

2.2.3 Warrant of Seizure and Sale

A warrant can be issued by either the Magistrate's, County or Supreme Courts in order to sell the debtor's real estate or personal property. The proceeds are then applied to pay the debts of the judgment creditor.

Generally, the costs of issuing either a Warrant to Seize Property or Warrant of Seizure and Sale are minimal. However, the costs of contesting any third party claims which may arise by way of interpleader[61] may cost hundreds or even thousands of dollars. Additionally, it may often take many months for a recovery to be effected, whether personal property or real estate is seized[62].

In addition, where a debenture or charge exists over the property it is unlikely that the Sheriff will be able to successfully seize and sell the property or item. Whilst it costs approximately $300 for this procedure to occur, as noted above, the costs and time delay involved in contesting any third party claims may result in little or no return to the creditor. It can still take up to 6 to 10 weeks from the date of order to seize and sell property where no objections by a third party occur.

[61]Litigation undertaken in order to settle a point in which a third party is concerned.

[62]"Debt Recovery in Victoria - A Guide to the Law", p: xix, Robert White, 1993 p: 134.

2.2.4 Attachment of Debts

An application can be made to attach a debt due to a debtor from a third party (known as the garnishee) to the creditor. To obtain an order to attach a debt, the debt must specifically be due to the debtor or be a debt accruing to the debtor. A debt cannot be attached if there is some condition which has to be fulfilled before it becomes payable from the 'garnishee' to the debtor[63].

Attachment of debts are the least commonly used form of enforcement, particularly as it is necessary for a creditor to have specific information, which in most cases is not readily available.

Where a Receiver is appointed to the debtor company after the attachment Order is made but prior to the 'garnishee' paying the debt to the creditor, the Receiver will have priority over the attachment by the creditor[64]. If the garnishee has already paid the debt to the judgment creditor prior to the receiver being appointed, the receiver is unable to take action against the judgment creditor to recover the claim. The approximate cost of obtaining an attachment order is $600[65]. The approximate time duration is 6 to 8 weeks from the order being made.

2.2.5 Winding Up

Where a debtor company is unable to pay its debts, a creditor may apply to the Supreme Court or Federal Court to have the debtor company wound - up and placed into liquidation. An application can be made by a creditor with a debt of $2,000.00 or greater.

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[63]Ibid, p: 140.
[64]Ibid, p: 143.
[65]Costs are as at February 1997 sourced from Australian Chamber of Manufacturers - Debt Management Seminar, 18/3/97, Presented by: Citibureau Collections & Sheezel Sandor & Associates.

A demand under Section 459E of the Law must be made in the prescribed form, commonly referred to as a "509H Notice" or "Statutory Demand". Upon service of the Notice, the Debtor is required to either pay the debt, come to an arrangement with the creditor or apply to the Court to set aside the Notice within 21 days of receipt.

A debtor cannot lodge an application to set aside the Notice after the 21 day period has expired. However, where an application is lodged within 21 days of receiving notice, a Statutory Demand may be set aside provided there is a genuine dispute over the existence or size of the claim or if the demand Notice originally lodged is defective[66].

Where the debt remains unpaid or an arrangement has not been made within 21 days of service of the Notice, the company will be deemed to be insolvent. The creditor has the option of applying to the Court for a Winding-up order within 3 months from the date of Notice. The Application and supporting Affidavits must be issued and served on the debtor and details of the hearing advertised in the Government Gazette and local paper. In addition, a notice must also be lodged with the Australian Securities Commission.

Upon completion, the matter will be listed for hearing by way of filing of an application. This will normally take 10 to 12 weeks from the date of the application being filed. As a general rule, winding-up proceedings are encouraged where it is evident that the debtor has recently paid other creditors or if the debtor transferred assets to other entities.

It can take between 13 and 16 weeks from the end of the 21 day Statutory Demand period to achieve an order to wind-up the debtor company at a cost of approximately $3,000.00[67]. It should be noted that a major portion of these costs are borne through the costs associated with court costs and legal

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[66] Australian Chamber of Manufacturers - Debt Management Seminar, 18/3/97, Presented by: Citibureau Collections & Sheezel Sandor & Associates, p: 18

representation. As such, this method of enforcement is generally out of reach of the smaller creditor for whom the individual claim may be less than the cost of proceeding. However commonly, by the time the company proceeds into liquidation, the remaining assets of the company have been sold or diminished over the period of litigation.

2.3 SUMMARY

This chapter has briefly summarized the steps required to initiate an action under the current debt recovery process whilst focusing on the significance of time and the costs associated in this regard.

The process is open to abuse by debtor companies seeking to stall proceedings. If this occurs the debtor company's asset base will more likely diminish over the period of recovery resulting in a reduced level of funds from the debtor to pay outstanding creditors' claims. Furthermore, where an external Administrator[68] is appointed during the period of recovery, these procedures are stopped by provision of the Law.[69] Unfortunately, the end result may lead to little or no return to the pursuing creditor.

Rose[70] proposed that the debt recovery process be initiated by court appointment and only upon verification that the debtor company was insolvent. Whilst this thesis supports Rose's argument for the extension to the VA appointment process, it does not endorse the mechanism by which the procedure would become available to unsecured creditors. Rose suggested that a creditor be required to apply to a Court for the appointment of a Liquidator or Provisional Liquidator. Given that this procedure would prove to be both time consuming and costly, it is suggested that under Rose's

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[67]ibid, p: 18

[68]"External Administrator" includes: Receiver or Receiver and Manager (where a secured charge exists over the debtor company's assets), a Liquidator or a Voluntary Administrator.

[69]Refers to Voluntary Administration under Part 5.3A of the Law, Section 440D.

mechanism, the benefit from such an action by unsecured creditors would be lost. Further discussion on the proposed methods of appointment is provided in Chapter 7 of this thesis.

The purpose of suggesting such a mechanism is, amongst other things, primarily to achieve equity between the unsecured creditors and the secured creditor. Additionally, many creditors cannot afford, nor is it economically efficient for them to seek to register a charge over a debtor company.

Chapter 3 will highlight the social and economic impact borne by unsecured creditors in order to understand the significance of the problem.

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[70]Voluntary Administrations - Will They Work? Unpublished Thesis by Michael Rose, June 1994 p: 77.

CHAPTER 3

SOCIAL AND ECONOMIC CONSEQUENCES, SIGNIFICANCE OF THE PROBLEM, DESCRIPTIVE STATISTICS

Chapter 1 outlined the operations of the VA Scheme under part 5.3A of the Law and compared the operations of this part to the Harmer Report. Emphasis was placed on highlighting the reasons why unsecured creditors were denied the right to appoint a VA under these recommendations. Chapter 2 outlined the current options available to unsecured creditors to recover their claims under the debt recovery process with significance being placed on the costs and time constraints associated with these procedures. Chapter 3 focuses on highlighting the social and economic impact borne by unsecured creditors in the current VA process, discussing the significance of the issue and outlining the results of a statistical analysis conducted to assess the significance of the issue.

3.1 SOCIAL AND ECONOMIC IMPACT ON UNSECURED CREDITORS IN THE CURRENT VOLUNTARY ADMINISTRATION PROCESS.

Socially and economically, the impact borne by unsecured creditors under any form of insolvency administration may have detrimental effects. The introduction of the VA process aimed to reduce these effects by offering a greater chance for companies to survive and/or provide a better return to creditors. This is largely inequitable due to the failure to provide the 'right' to appoint a VA by the largest class of creditors (the unsecured creditors).

In the case of a small trade creditor for example, a poor return from a debtor company under Administration would usually increase bad debts and increase the cost of the unsecured creditor doing business. This cost would most likely be borne by the consumer through an increase in price or result in reduced profits to the creditor. At worst, the increased cost burden may force the unsecured creditor into insolvency.

Outlined below are some of the more significant social and economic costs which may be borne by unsecured creditors as a result of failing to introduce the 'right':

- increased cost of operating creditor's business;
- loss of capital;
- inability to speculate on market trends;
- increased risk;
- decrease in industry confidence;
- decrease in return on investment;
- increase in market volatility;
- increase in criminal activity, both individual and white collar crime;
- greater chance of "domino effect[71]" occurring;
- decreased confidence in the legal recovery process;
- decreased confidence in insolvency law and practice;
- increased unemployment.

When we consider the social and economic impact borne by unsecured creditors as a class and review their role in determining a debtor company's future under Part 5.3A of the Law, there appears to be a void in the appointment process. To demonstrate, unsecured creditors' rights under Part 5.3A are outlined below:

1. Section 436E(4) At the first meeting, creditors may remove the administrator from office or appoint someone else as administrator of the company;

2. Section 436E(1) At the first meeting, creditors may resolve to appoint a committee of creditors to consult with the administrator about matters relating to the administration and receive and consider reports by the administrator;

[71]Where the failure of one company (Company A) causes another (Company B) or a series of companies (Companies C - Z) to fail, this is commonly referred to as having a "domino effect". Direct contact between companies does not have to occur to have an impact.

3. Section 439C At the second meeting of creditors convened under section 439A, creditors may resolve:

    - that the company execute a Deed of Company Arrangement;
    - that the administration should end; and
    - that the company be wound up.

4. Section 445A Creditors may resolve to vary a Deed of Company Arrangement in accordance with a meeting convened under Section 445F;

5. Section 445B A creditor may apply to the Court for an order canceling the variation to the Deed of Company Arrangement;

6. Section 445C Creditors may pass a resolution terminating the Deed at a meeting convened under Section 445F;

7. Section 445D A creditor may apply to the Court to have a Deed terminated where:

    - the provisions of the Deed are oppressive, or unfairly prejudicial to, or unfairly discriminatory against one or more creditors;
    - contrary to the interest of the creditors of the company as a whole;

8. Section 445E Creditors may at a meeting of creditors convened under Section 445F, pass a resolution terminating the Deed and resolve that the company be wound up.

In addition to the above, unsecured creditors may also seek direction from the Court on various matters relating to the administration of the company[72].

[72]Source: Section 447A(4) of the Law.

When we take into consideration all of the above opportunities which unsecured creditors have in deciding a company's future, failing to provide the 'right' to appoint an Administrator makes little sense.

As briefly noted in Chapter 2, despite evidence to suggest that unsecured creditors tend to make up the majority of a company's creditors,[73] not all creditors can afford to register a charge over assets of a debtor company nor is it commercially viable to do so. What is suggested in this study is a system which recognizes the significance unsecured creditors have in the administration process and the social and economic impact borne by them in comparison to other creditors.

Social and economic inequity will always exist unless all creditors are treated equally. It is suggested that at least the majority class of creditor should be given powers equal to those of the secured creditor in order to protect its own as well as other creditors interests[74].

As noted by the Harmer Report:

> "Insolvency law should, so far as it is convenient and practical, support the commercial and economic processes of the community... (and)...should provide mechanisms that enable both debtor and creditor to participate with the least possible delay and expense."[75]

It is submitted that failing to recognize the appointment rights of what is often the largest class of creditor in economic terms does not support the commercial or economic processes within a community. Nor can it be said

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[73]See Section 3.3 of this chapter.

[74]See Chapter 4, Arguments For and Against the right where it is suggested that unsecured creditors are usually the first to feel the impact of a slow paying debtor.

[75]Source: Australian Law Reform Commission, General Insolvency Inquiry - Report No: 45 (The Harmer Report) - Par 33

that the system provides the most efficient mechanism which enables both debtor and creditor to participate with the least possible delay and expense.

If unsecured creditors were given the right to seek the appointment of an Administrator, it is suggested that the opportunity to achieve a more efficient solution or greater flexibility to trade out of financial difficulty may result.

In summary, from a social and economic point of view, providing unsecured creditors with the opportunity to seek the appointment of an Administrator sooner is a more efficient approach to insolvency.

As it stands, those who have the power to appoint an Administrator control the VA process. Where a class of creditor has no power, there will be less likelihood of reducing the burden of losses. This in turn is likely to result in greater social and economic inequity. It may be argued, on this basis, that all creditors should have the 'right', whereas currently it is the majority which is disadvantaged.[76]

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[76]See section 3.3 of this chapter.

3.2 SIGNIFICANCE OF THE ISSUE

The premise behind the argument for the appointment of an Administrator by unsecured creditors is relatively simple. As it stands, Part 5.3A of the 'law' offers directors the opportunity to voluntarily appoint an Administrator where financial difficulty is evident, but as noted by Parbery:

> " Most directors of insolvent companies leave it too late to seek advice. By the time a meeting takes place, it is usually apparent that a company is insolvent and there is an urgent need for a formal appointment. Directors are always reluctant to hand over control. They live in hope that their circumstances will change dramatically, that they will be able to carry on as usual.[77]"

Where a director fails to seek assistance in this regard, for whatever reason, it is submitted that a system which improves an unsecured creditor's position should be implemented. Although such a right may be in breach of business standards which exist within a business community, these "standards" are breached if debtor companies fail to honor their agreement to pay for goods and services provided.

It is submitted that unsecured creditors, if given such a right, would react by appointing an Administrator sooner than would the directors of the company. This reaction would be initiated by a failure to provide payment to the unsecured creditor who in turn could, where appropriate to do so, proceed to recover their claim via the debt recovery process. One of the options under the process would be to seek the appointment of an Administrator.

Whilst critics may argue that the introduction of such a right would only mean that the process would be more readily used, resulting in an even larger

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[77]"Call the Company Doctor", Stephen Parbery, Prentice Parbery Barilla, Australian Accountant, July 1996, pp: 39 - 41.

portion of VA's not meeting their objectives[78], such criticism should take into account the objectives under Part 5.3A of the 'law' and recognize the possibility of higher returns being provided to all classes of creditors than that which may have been provided in the past.

In support of this suggestion, a survey conducted by the Australian Society of Certified Practicing Accountants, (ASCPA) Centre of Excellence for Insolvency and Reconstruction found that insolvency practitioners believed the average return to creditors would increase from 7.32% to 21.5% for a company in administration[79]. Although this has yet to be proven, should this be the case, introducing the 'right' to unsecured creditors who would seek to appoint a VA sooner would increase the average return to creditors significantly. Chapter 5 develops a case study in relation to this issue.

Recent literature has highlighted "abuses" of the process by directors of financially troubled companies. Suggestions that creditors have been forced to accept unreasonable settlements by way of scenarios that look suspiciously like blackmail[80] have recently made the regulatory bodies sit up and listen[81].

In fact, a study conducted by Hodson and McEvoy[82] suggested directors of financially troubled companies were using the process to avoid investigations into related parties or directors' breaches. Yet despite all the warning signs, very little has yet been done to suggest mechanisms to amend possible irregularities in the process.

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[78]Source: Coopers & Lybrand: Voluntary Administrations - Are They Really Working?, Hodson and McEvoy, October 1995, p: 35

[79]Source: Australian Society of Certified Practicing Accountants (ASCPA) - Centre of Excellence, survey conducted 1994.

[80]"Creditors Forced to Accept Unreasonable Settlements", Lloyd Nash & Roger Byrne, Australian Accountant, February 1995, p: 45

[81]"Study suggests that creditors should think twice", Lucinda Schmidt, BRW, Nov 6, 1995, pp: 90 - 91.

[82]Source: Coopers & Lybrand: "Voluntary Administrations - Are They Really Working?", Hodson and McEvoy, October 1995, p: 25

Hodson and McEvoy[83] also noted that in excess of 80% of VA's to 31 May 1995 have resulted in:

- a formal liquidation of the company;
- the execution of Deeds of Company Arrangement which essentially comprised a realization of the company's assets, that is: an informal liquidation; or
- the execution of a Deed of Company Arrangement which essentially provides for a debt write-off by creditors which is comparable to losses which may be expected to be incurred through a liquidation of the company.

It is suggested in this study that the introduction of such a 'right' would increase the chances of preserving the business of a debtor company and/or improve the return to creditors generally by offering a better return under a VA initiated by unsecured creditors than one which may be effected at a later date by directors.

Where a proposal for the business to continue trading is put forward by a company, variables such as emotion may play a significant part in a creditor's decision making process. Nevertheless, it is recognized that creditors may also be influenced by an indeterminate number of other variables, for example: opportunity cost, emotion and risk, and may react in a totally illogical manner other than that which may be anticipated by directors of the company. We can assume that where losses are smaller, less emotion would be attached to the decision making process of a creditor. Where losses are predominantly critical or unbearable, a greater degree of emotion may influence creditors in deciding irrationally about the debtor company's future.

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[83]Source: Coopers & Lybrand: Voluntary Administrations - Are They Really Working?, Hodson and McEvoy, October 1995, p: 35

Chapter 7 presents a method in which a system may operate which will involve a review of current practice and development of a proposed method of appointment.

3.3 SAMPLE SELECTION AND DESCRIPTION OF STATISTICAL ANALYSIS CONDUCTED TO ASSESS THE SIGNIFICANCE OF THE ISSUE.

In order to determine the significance of the problem, a statistical analysis was conducted over a sample group of 24 companies to identify the percentage and relative value of unsecured, secured and partly secured creditors holding debts within those companies[84]. Details of the analysis follow:

3.3.1 Aim and Assumptions of the Study

The aim as noted above was to identify the significance of the issue by conducting a simple statistical analysis over a group of companies under external administration. This was conducted by reviewing the 'Administrator's report'[85] and where necessary the company's 'Report As To Affairs'(RATA)[86] to determine the number and value of each known class of creditor listed in Table 3.1. These two documents were chosen as they should both contain the required information in order to complete the study.

Prior to the completion of the study, it was suggested that unsecured creditors as a class would generally make up the largest portion of a company's debts. In order to test whether this conjecture was a reasonable assumption, a random selection of companies was chosen and examined.

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[84] It is recognized that creditors cannot always be easily classified into the above categories, whether due to their contingent nature or future claim potential, however for the purposes of this study, creditors where possible will be classified into these categories where the requirements under each rule is satisfied.

[85] Report under Section 439A of the Law.

[86] Form 507 of the Law.

3.3.2 Sample Data Selection

As a basis for data selection, companies under external administration were chosen as the information is readily available. There were no specific criteria other than to ensure that information relating to each particular class of creditor was available in the Administrator's report and/or company's RATA.

Commencement of the Administrations ranged from December 1993 to December 1996 and were provided by four practicing insolvency practitioners in Melbourne. The information was readily available.

3.3.3 Limitations of the Study

Limitations to this study include the sample size. Although it provided sufficient evidence to suggest the validity of the argument, it would have been interesting to determine whether the sums would change considerably between different sample sizes.

The only significant delimitation to this study was ensuring that the sample group of companies were large enough to conduct the appropriate study without confounding the results.

3.3.4 Research Design

Simple descriptive statistics were employed to test whether unsecured creditors represent a major portion of the total debts of the companies in the sample.

Table 3.1 summarizes 24 companies under external administration. It shows the level of debt per company and per class of creditor. Graph 3.1 emphasizes the significance of the results.

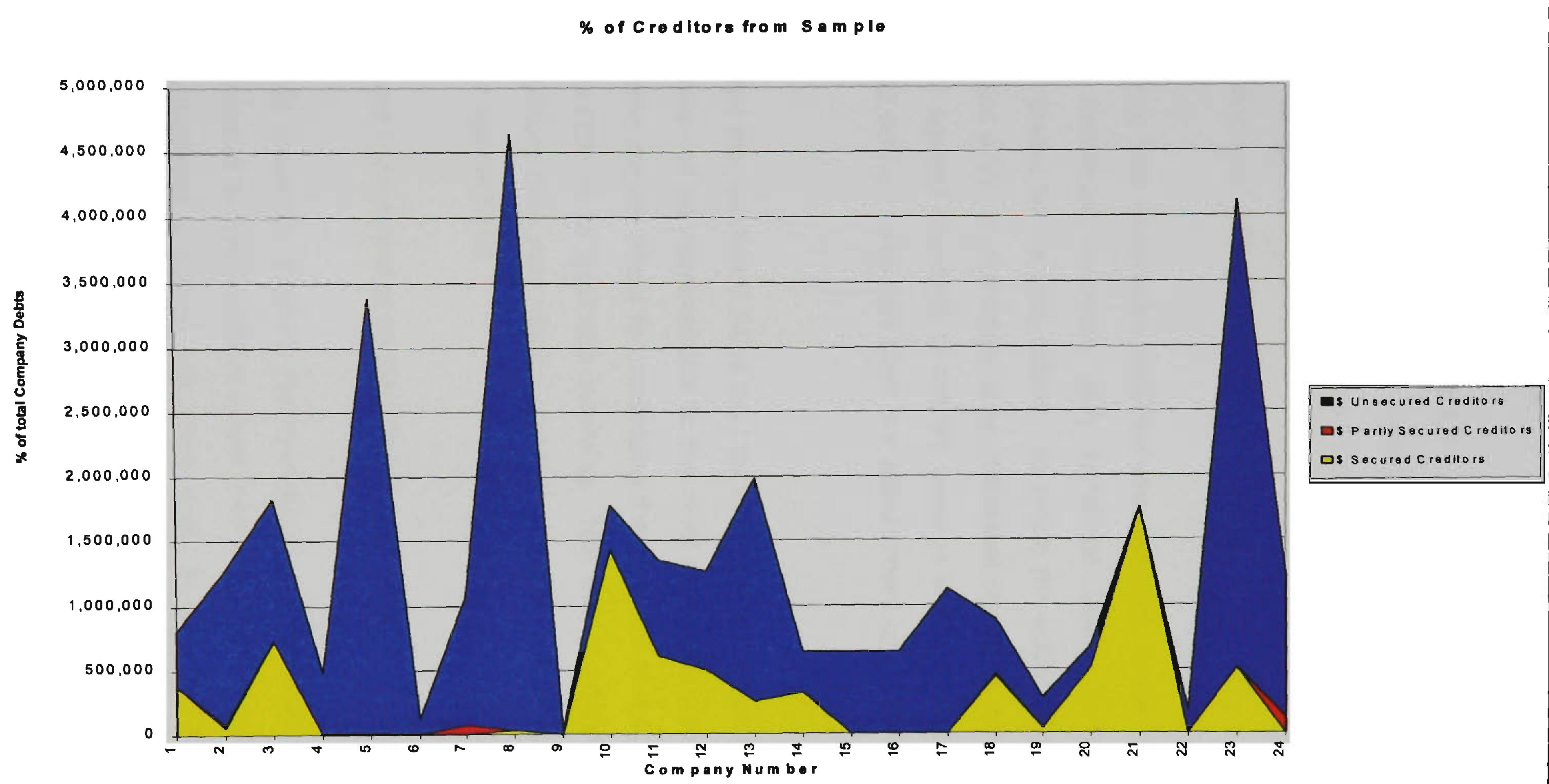
TABLE 3.1

SUMMARY OF CREDITORS FROM VARIOUS ADMINISTRATIONS SHOWING AMOUNT OF TOTAL CLAIMS PER CLASS OF CREDITOR FOR EACH COMPANY. Company Administrations Range from January 1994 to December 1997

Coy No	$ Secured Creditors	$ Partly Secured Creditors	$ Unsecured Creditors	$ Total Creditors	% of Secured Creditors	% of Partly Secured Creditors	% of Unsecured Creditors
1	376,990	0	420,420	797,410	47.28%	0.00%	52.72%
2	53,738	21,326	1,192,939	1,268,003	4.24%	1.68%	94.08%
3	730,000	0	1,100,937	1,830,937	39.87%	0.00%	60.13%
4	0	0	482,131	482,131	0.00%	0.00%	100.00%
5	0	5,001	3,374,828	3,379,829	0.00%	0.15%	99.85%
6	0	0	116,068	116,068	0.00%	0.00%	100.00%
7	0	67,173	1,009,495	1,076,668	0.00%	6.24%	93.76%
8	30,072	0	4,613,853	4,643,925	0.65%	0.00%	99.35%
9	0	3,669	27,691	31,360	0.00%	11.70%	88.30%
10	1,435,000	0	345,832	1,780,832	80.58%	0.00%	19.42%
11	603,000	0	742,000	1,345,000	44.83%	0.00%	55.17%
12	500,000	0	763,255	1,263,255	39.58%	0.00%	60.42%
13	250,000	0	1,730,991	1,980,991	12.62%	0.00%	87.38%
14	320,000	0	311,889	631,889	50.64%	0.00%	49.36%
15	0	0	637,574	637,574	0.00%	0.00%	100.00%
16	0	1,490	630,931	632,421	0.00%	0.24%	99.76%
17	0	0	1,127,927	1,127,927	0.00%	0.00%	100.00%
18	450,000	11,100	426,376	887,476	50.71%	1.25%	48.04%
19	35,000	0	236,477	271,477	12.89%	0.00%	87.11%
20	504,893	0	165,818	670,711	75.28%	0.00%	24.72%
21	1,750,000	0	8,935	1,758,935	99.49%	0.00%	0.51%
22	0	0	178,493	178,493	0.00%	0.00%	100.00%
23	512,000	0	3,612,376	4,124,376	12.41%	0.00%	87.59%
24	0	122,480	1,128,283	1,250,763	0.00%	9.79%	90.21%
$ Total	7,550,693	232,239	24,385,519	32,168,451			
% average					23.79%	1.29%	74.92%

GRAPH 3.1

Summary of Table 3.1 showing a graphical representation of total claims per class of creditor for each company.



3.4 THE DESCRIPTIVE STATISTICS

As indicated in Table 3.1 and Graph 3.1, unsecured creditors represent the majority of debtor company total liabilities. Of the sample selected, 19 companies (or 79%) have unsecured creditors with claims exceeding 50% of their total company liabilities and 11 out of 24 (or 45%) have unsecured creditors holding over 95% of total company debts.

It is recognized that unsecured creditors are generally made up of a large number of individual creditors with individual claims which may be insignificant relative to the total claims. To refute the notion of providing the right to appoint a VA on the basis of an individual creditor's net claim would however, act against the spirit of current practice in which a creditor with a claim over $2,000 or more can seek the appointment of a Liquidator via the Courts[87].

It is suggested that as Part 5.3A of the Law does not recognize or provide for the appointment of an Administrator to the most significant class of creditor, the VA scheme cannot attest to maximizing the chances of a company or as much as possible of its business surviving. Nor may it provide as great a return to creditors than may result if unsecured creditors were given the right to initiate the appointment.

This statement is premised upon the following conjectures:

1. unsecured creditors, if given the opportunity, would seek to initiate the appointment of an Administrator earlier than directors of the company;
2. larger unsecured creditors are more likely to be informed as to the avenues of debt recovery available to them than smaller creditors and are more likely to react quickly to recover debts against a company; and

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[87]See Chapter 2 Winding-up procedures and Section 3.1, unsecured creditors existing rights.

3. larger unsecured creditors are more willing and able to incur those costs associated with recovery of debts.

A study to test these conjectures is developed in Chapter 5 where case studies of two companies are provided in validation of the study hypothesis. The procedure (maximization of return given that 'the right' to appoint a VA is conferred on the unsecured creditors) cannot be directly tested as the right does not currently exist. Thus whilst a comparison cannot be made, some tentative suggestions can be drawn from the analysis undertaken in this study.

Chapter 4 will review prior research into the matter and outline the hypothesis.

CHAPTER 4

A REVIEW OF PRIOR RESEARCH INTO THE MATTER AND SPECIFICATION OF THE HYPOTHESIS

Despite the large volume of literature which has been written about the operation of the VA scheme under Part 5.3A of the Law, very little has been directed towards the 'right' to appoint an Administrator by unsecured creditors. Chapter 3 highlighted the social and economic impact borne by unsecured creditors and outlined the significance of the problem through discussion and supporting descriptive statistics. This chapter focuses on the following:

4.1 review of prior research;

4.2 summary of the arguments for and against unsecured creditors having the right to appoint a VA;

4.3 comparison of the US and UK systems of administration; and

4.4 specification of the research hypothesis.

4.1 PRIOR RESEARCH INTO THE MATTER

Whilst very few studies have been conducted in this area of insolvency, there has certainly been no lack of commentary relating to the operations of the VA scheme in general. In recent times, discussions on the success of the VA scheme seem to have gone full circle with articles such as "Administrations Soar"[88] and "VAs save 38% of Companies Under Threat" [89] to a more cryptic analysis[90] which suggest that creditors should think twice before accepting a proposal for a Deed of Company Arrangement from directors of financially troubled companies.

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[88]"Administrations Soar", Accountancy Hotline, BRW, July 3, 1995, p: 83

[89]"VAs Save 38% of Companies Under Threat", Mark Lawson, The Australian Financial Review, 25/3/94, p: 7

[90]"Study suggests that creditors should think twice", Lucinda Schmidt, BRW, Nov 6, 1995, pp: 90-91

Key words like blackmail[91] and abuse[92] of the system have become common place when talking about the VA scheme. In fact, studies such as those undertaken by Hodson and McEvoy[93] have suggested that the system has failed to meet its objectives under Part 5.3A of the 'law'. Nevertheless, the scheme is more popular now than ever before with as much as 48% of insolvency administrations commencing as VA's.[94]

A review of the scheme's operation conducted by Taylor[95] concluded that admidst all the criticism, the real value of the VA scheme is in encouraging directors to take early steps to deal with an existing or anticipated state of insolvency. The aim is simply to maximize the chances of a company or business surviving or, if this is not possible provide a better return to creditors than would otherwise result from an immediate liquidation of the company.[96] Taylor states:

> " Whilst there is an abundant use of Voluntary Administrations, my impression is that there are not many assets in these administrations and what assets there are, are swallowed up by the secured creditors. This indicates to me that the directors are not seeking help early in the insolvency...Perhaps the community's attitude and the attitude of politicians would change if they were to reflect on the suffering caused to a large number of trade and service creditors when the company becomes insolvent; if they could reflect on the anguish caused

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[91] "Creditors forced to Accept Unreasonable Settlements", Lloyd Nash and Roger Byrne, Australian Accountant, February 1995, p: 45.

[92] "Voluntary Administrations: Abuse of a Good Idea?", Greg Hodson, Australian Accountant, March 1996, pp: 34 - 36.

[93] Source: Coopers & Lybrand: "Voluntary Administrations - Are They Really Working?", Hodson and McEvoy, October 1995, p: 25

[94] ASC Corporate Relations Unit, April 1997. Summary of the Insolvency and Termination's for the month ending 28 February 1997

[95] Commentary from the National President of the IPAA, Terry Taylor, IPAA Journal, No: 1, Jan/Mar 1996, pp: 1 - 2.

[96] Commentary from the National President of the IPAA, Terry Taylor, IPAA Journal, No: 1, Jan/Mar 1996, p:1.

> to employees who lose their jobs and if they could reflect on the general social upheaval caused to wives and families of creditors who themselves may be forced into bankruptcy." [97]

It appears that the system is here to stay. Should recent commentary be correct however, it is in need of a thorough review. As part of this review, it is suggested that the 'right' to appoint a VA by unsecured creditors should be assessed in line with the aim of Part 5.3A of the 'law'.

In light of the above commentary, only two studies have been conducted in this area. Rose[98] aimed to review what was then a relatively new method of administration. In this study, Rose analyzed a variety of issues relating to Part 5.3A of the Law. In particular, he discussed issues surrounding the failure of providing unsecured creditors with the right to appoint an Administrator.

The Australian Institute of Credit Management made a series of submissions to the General Insolvency Inquiry[99]. These submissions form part of the recommendations outlined in the Harmer Report.

4.1.1 A critique of "Voluntary Administrations - Will They Work?" (Rose)

The study by Rose concerned itself with a variety of issues considered worthy of discussion in relation to Part 5.3A of the Law. In particular, Rose analyzed why the VA scheme had become so popular in recent years and suggested a variety of possible extensions to the VA scheme in order that it may improve in use and operation.

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[97] Letter to the editor, AR Taylor, Horwath & Horwath (Qld) Pty Ltd, Australian Insolvency Bulletin, 6/9/95, pp: 91 - 92.

[98] Voluntary Administrations - Will They Work? Unpublished Thesis by Michael Rose, June 1994 pp: 76 -77.

[99] Australian Law Reform Commissions - General Insolvency Inquiry Report No: 45, commonly referred to The Harmer Report (ALRC No: 45)

One of the more significant suggestions was to analyze, in part, whether it would be in the best interests of the business community to allow the scope of the VA scheme to be widened. Although no particular study to test the validity of the proposal was undertaken, the suggestion was analyzed in light of current practice and the inequities which appeared to be occurring due to the absence of such a 'right' from the system.

As part of his study, Rose analyzed whether the existing scope of the legislation enabled viable companies to obtain the benefit of using the VA scheme. He gave two reasons as to why existing companies may not have the ability to appoint a VA. Firstly, VAs can only be initiated by the company, its Liquidator or provisional Liquidator, or by a secured chargee.[100] Secondly, Rose highlighted that the VA scheme may not be an attractive alternative to directors of financially troubled companies as it may be considered too costly and would remove some of the incentives management utilized in operating the company.

Rose also highlighted the need to provide the right to appoint a VA by unsecured creditors. He noted that general creditors may apply to the Court for the appointment of a Liquidator or Provisional Liquidator, who may then, if considered appropriate, appoint a VA. However, it was noted that this indirect procedure would prove both time consuming and costly.[101] This argument, as noted by Rose, coincides with one of the conjectures outlined in this thesis, that is, the time taken to instigate such an action may itself be to the detriment of the company and its creditors.

Amongst other things, Rose also noted the Harmer Report recommendations and in part, he agreed with the idea that creditors may try to frustrate the debtor company's management should the right become available. As such,

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[100] Voluntary Administrations - Will They Work? Unpublished Thesis by Michael Rose, June 1994 pp: 76 -77.

it was proposed by Rose that the process be initiated by Court appointment only upon verification that the debtor company was insolvent. In much the same manner as has been noted in this thesis,[102] it was suggested that the Statutory Demand method be utilized to prove insolvency. Where the debtor company failed to comply with the notice, the company would be deemed to be insolvent and the petitioning creditor should be entitled to have the company wound up or if the creditor so desired, have an Administrator appointed.

Rose noted two deficiencies in the argument of the Harmer Report that providing the right to unsecured creditors would detract from the voluntary nature of the procedure. Firstly, he notes that as a registered chargee who has a charge over all, or substantially all, of the property of the company is entitled to appoint a VA, the procedure is not voluntary. Secondly, Rose notes the difficulty in comprehending why the procedure needs to be voluntary, as the objectives under Part 5.3A of the Law do not stipulate this. Therefore, he submits that whether or not the appointment is made voluntarily is irrelevant.

On the basis of Rose's findings, there should be no reason why unsecured creditors could not be given the right to appoint an Administrator. Accordingly, the research question is: would the return to all unsecured creditors increase if they had the right to appoint an Administrator?

According to Rose, the effect of such a proposal may ensure that higher returns to creditors may be more adequately achieved should creditors be given this right. He noted that directors may be reluctant to seek the appointment of a VA.[103]

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[101] ibid, p: 77.

[102] For a more detailed overview of this suggestion see Chapter 7 of this report.

[103] Source: Voluntary Administrations - Will They Work? Unpublished Thesis by Michael Rose, June 1994 pp: 78 - 80.

In fact, Rose supports the argument that management often believes the business can be saved by trading out of its difficulties. However, in many instances the assets of the business are consumed in the process, leaving little to be distributed to creditors should the directors seek to appoint a VA or the company proceed into liquidation.

4.1.2 A review of the submissions provided by the Australian Institute of Credit Management to the Australian Law Reforms Commission - General Insolvency Inquiry.

The only documented reason noted in the Harmer Report as to why unsecured creditors were denied the 'right' to appoint a VA is that it was considered to be " impractical and would detract from the voluntary nature of the process.[104]" In deciding this, the Harmer Report referred to submissions 135, 156 and 160, lodged by the Australian Institute of Credit Management (AICM) - South Australian, Queensland and New South Wales Divisions, to the Australian Law Reform Commission[105].

Some of the relevant points made include the following:

- Submission 135 accepted the reasoning behind not providing creditors with the right to appoint a VA but noted that, by not permitting creditors to invoke the procedure, it would provide directors of the company with an avenue of delay. It was suggested that the opportunity should be open to a creditor to initiate proceedings. Where a company did not do so within, for example, 7 days, the creditor would then have the right to do so.[106]

- It was proposed that a statutory demand should not be set aside without the additional filing of an affidavit providing adequate reasons

[104]Source: General Insolvency Inquiry Report No: 45 (The Harmer Report), par: 36
[105]Source: Refer to section 3.4 in this chapter for a more detailed discussion of these submissions.

for doing so. Without such a provision, it was noted that this mechanism presents a foolproof means of gaining time for the company at the expense of creditors since the company would continue trading during the period before a final determination was made as to the company's future.

- It was proposed under submission 160 that the use of an administrative rather than court procedure be adopted to facilitate early control of the affairs of the corporate debtor.

In summary, the following quote generally sums up the opinion of the AICM in general with regard to the rights of creditors:

> " We agree that it is desirable that this action be taken by directors, but we have some reservations as to whether this would in fact, take place early enough in all cases. We feel strongly that there must be a provision for creditors actually to require directors to take this action, or for a creditor to take some enforcing action if the directors are unjustifiably reluctant to do so... The pattern now is frequently that directors continue trading until forced into liquidation, often by a creditor losing patience with broken promises... There is neither justification, truth nor consideration in refusing a creditor or creditors the power for invoking procedures because they would know little of the financial affairs of the company. Major as well as smaller creditors are alerted as soon as a debtor company initiates a payment pattern change. The subsequent negotiations then reveal insolvency signals...We can suggest no reason for this tendency to continue trading for as long as possible but

[106]Source: Australian Institute of Credit Management - submission number 135, p: 1, 27/11/87.

suggest...that there should be provision for a creditor to take action rapidly if directors refuse to."[107]

- Submission 160 also noted that it did not concur with the suggestion that the VA procedure be initiated by resolution of directors only. Rather, the submission noted that as it is the directors' inefficiency that places the company in a situation of insolvency by their actions, they should surrender some of their rights in order that the procedure be instigated.

As a consequence of these submissions, the Harmer Report outlined the current operations of the Voluntary Administration scheme without providing the right to appoint an Administrator by unsecured creditors. The commerciality of this decision remains unknown. In conclusion the AICM commented:

> " We are appalled and flabbergasted to note that the thoughts of the commission in the printed words *' The possibility of a better return to unsecured creditors can not, of course, be an overriding aim of any insolvency law both for economic reasons and by reason of the pre-eminence given to special interest creditors.'* We maintain politeness by our lack of written comment".[108]

On the basis of the AICM submission and the study conducted by Rose, it is suggested that the return to unsecured creditors would increase if they had the right to appoint an Administrator.

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[107]Source: Australian Institute of Credit Management - submission number 160, see reference to Page 7, par 4 (Desirable Features), 9/12/87.
[108]ibid, p: 25, Par 5.

4.2 SUMMARY OF THE ARGUMENTS FOR AND AGAINST UNSECURED CREDITORS HAVING THE RIGHT TO APPOINT AN ADMINISTRATOR

Whilst the aim of this thesis is to highlight the need to provide unsecured creditors with the right to appoint a VA, there are some arguments against its introduction. Outlined below is a summary of the major arguments for and against the introduction of such a right:

4.2.1 Arguments for the right to appoint a Voluntary Administrator

1. anticipated greater returns to unsecured creditors (Chapter 5);
2. as unsecured creditors are usually last in line to receive any form of distribution from a debtor company in administration, appointing a VA sooner may increase the likelihood of a return to all creditors thereby minimizing the burden of losses borne by unsecured creditors (Section 6.1);
3. greater control to the majority (Chapter 3);
4. provides a greater opportunity to reduce the gap between 'bearable'[109] and 'unbearable' losses;
5. reduces the time delay of directors who do not seek assistance sooner, i.e.: the introduction of such a right may prompt directors to move more quickly in seeking advice from a practitioner giving the company a better chance of survival (Chapter 5);
6. may reduce debt recovery costs borne by creditors (Chapter 7);
7. where a debtor's trade terms are frozen or restricted due to failure to pay a creditor, it is not uncommon for a debtor company to seek a new supplier who will in turn provide credit to the failing debtor. Whilst the insolvent trading provision of the Law aims to penalize such activity, due to the costs associated with such an action, few directors are ever penalized for trading whilst insolvent;

[109]The terms, 'bearable' and 'unbearable' describe the difference between losses that can or cannot be sustained without a significant loss being borne by the creditor.

8. if an unsecured creditor can wind up a company with a debt of $2,000.00 or greater, an unsecured creditor should be able to appoint a VA on the same basis. The argument that it may frustrate directors of a debtor company is largely irrelevant when we consider the effects of a winding up application upon a company's future;
9. it may reduce the time during which directors trade whilst insolvent (Section 3.2);
10. it may prompt directors to seek professional assistance sooner, which in turn should increase the chances of a company surviving (Chapter 7);
11. it may give directors a greater chance to seek and achieve an equitable debt compromise or repayment schedule over a period of time for all creditors (Chapter 5);
12. where a compromise or repayment schedule is not initiated, and the company proceeds into liquidation it may maximize returns to creditors (Chapter 7).

4.2.2 Arguments Against the right to appoint a Voluntary Administrator

1. requires an amendment to current law (Chapter 7);
2. aim of the VA process is to encourage directors to appoint a VA, that is, it goes against the intentions within the scheme (Chapter 1);
3. it is not proven that it would increase returns to creditors (Chapter 6);
4. no guarantee that it would enable a company to continue trading;
5. creditors may still need to go through the debt recovery process, therefore may not be cost efficient (Chapter 7);
6. the VA process has already been criticized for providing a soft-option[110] to directors of a financially troubled company. The introduction of such a right may give directors an even greater opportunity to avoid their responsibilities.

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[110] Voluntary Administrations: Abuse of a Good Idea?, Greg Hodson, Australian Accountant, March 1996, pp: 34 - 36.

4.3 A COMPARISON OF THE US AND UK SYSTEMS OF ADMINISTRATION

As noted in section 1.1 of this thesis, the operation of Part 5.3A of the Law has historically been influenced by both the United States and United Kingdom's systems of insolvency reconstruction. However, a review of the means by which an Administrator can be appointed highlights some significant differences. A summary of the main differences follows.

4.3.1 United States - Voluntary Chapter 11 Bankruptcy

As a comparative, 'Chapter 11' is very much a court based procedure, unlike Part 5.3A and is, as noted above, initiated by the filing of a petition with the Bankruptcy Court. The court remains actively involved throughout the procedure.

In the United States, a "Voluntary Chapter 11 Bankruptcy" case usually commences by the debtor filing a petition with the Bankruptcy Court. A 'Chapter 11' procedure, as it is generally referred to, may also commence involuntarily, although this approach is not commonly used.[111]

Like Part 5.3A of the Law, the reason why a debtor company pursues a Chapter 11 plan is to implement a structured reorganization or plan for orderly liquidation. The debtor may file such a plan at any time.

Rarely will a Trustee be appointed in Chapter 11 cases. Rather, it is more common that management will remain in control of the company unless a "party in interest"[112] can prove the existence of fraud or dishonest activity by management of the debtor company. Where such a case exists, the Bankruptcy Court will normally appoint an examiner to review the Chapter 11

[111]Source: Philip Crutchfield: Annotated Corporate Voluntary Administration Law, page: 40, LBC.
[112]Any creditor of the company is included as a party in interest.

case. Unless considered appropriate to do so, the appointment of an examiner will not remove control from management of the company.

Unlike Part 5.3A of the Law and the UK system, creditors are encouraged to participate in the reconstruction process. Whereas in Australia the creditors' role is limited to consulting with the Administrator and voting on any proposals put by directors, the Chapter 11 system is subject to the watchful eye of the committee of creditors, their professional advisers, assistants and the courts. Unfortunately, the involvement of so many parties has led the procedure to be criticized due to the time delays and costs associated with the process.

In summary, although both Chapter 11 and Part 5.3A of the Law have a common goal of rehabilitation, the difference in the systems is considerable.

4.3.2 United Kingdom - Insolvency Act 1986

The UK Insolvency Act introduces two types of administration available to the debtor company. Part 1 deals with a more informal company voluntary arrangement (CVAs). The intent is to enable a company to enter into a binding arrangement with its creditors without the need for that arrangement to obtain the approval of the courts. Part 2 is a more formal procedure initiated by an application to the court for an "Administration Order".

Unlike Part 5.3A, any creditor may apply for an administration. The court then follows a set of "statutory purposes" in order to determine whether the administration would be in the best interest of the debtor company's creditors. As a rule, the court must be satisfied that at least one of the purposes has been satisfied.

The need to apply to a court for an appointment has been criticized due to the expense of supplying affidavit material and accounting reports to support the application.

4.4 SPECIFICATION OF THE HYPOTHESIS

Given the arguments, advantages and disadvantages cited above and the research question outlined in the chapter, the hypothesis is now expressed in the form below:

"The return to unsecured creditors would increase if they had the right to appoint an Administrator under the provisions of Part 5.3A of the Law."

4.5 SUMMARY

In summary, Part 5.3A is more aligned with the UK system of administration. The main difference, however, still remains in the appointment process. Whilst administration under Part 5.3A is considered relatively inexpensive in initiating the appointment of an Administrator, the existence of delay seems to be a major contributing factor to reaching its full potential as a flexible and viable system for all creditors within our business community.

This chapter has reviewed a range of literature in light of the proposal to provide the 'right' to appoint an Administrator by unsecured creditors. Rose and the AICM highlighted the efficiency of implementing such a right. Yet, despite these recommendations little has been done to test whether such a system could be implemented. Chapter 5 will analyze the research hypothesis as detailed in this chapter and conduct a case study on two companies to test the hypothesis.

CHAPTER 5

INTRODUCTION TO THE CASE STUDY, THE TESTING OF THE RESEARCH HYPOTHESIS, LIMITATIONS OF THE RESEARCH APPROACH

Chapter 4 reviewed prior research into the matter and outlined arguments for and against unsecured creditors having the right to appoint an Administrator. The US and UK systems of administration were reviewed and the research hypothesis was outlined. Part 5.1 of this chapter tests this hypothesis.

A case study of two companies currently under administration is developed in Parts 5.2 and 5.3 of the chapter. This examines past debt recovery proceedings undertaken by unsecured creditors against each debtor company.

5.1 INTRODUCTION TO THE CASE STUDY - AN ANALYSIS TO TEST THE RESEARCH HYPOTHESIS

Ultimately, the purpose of incorporating the rights of unsecured creditors into the appointment process is to influence directors of financially troubled companies to seek the appointment of an Administrator sooner. The intention is to maximize the chances of a company surviving, or where this is not possible, increase the chance of a greater return to unsecured creditors than is currently occurring in the VA process.

As can be seen in diagram 5.1 below, the company's financial position deteriorates over time. At period 1, assets of the company exceed that of its liabilities. For simplicity, movements in the financial position of the company have been 'smoothed' i.e.; erratic increases and/or decreases have been taken out. In a normal business operation, the assets and liabilities of the business would increase and/or decrease in accordance with trade and/or other external variables. An example of these erratic increases and/or decrease would occur where assets of the company were sold thus reducing the company's asset position and overall liabilities (should the funds be utilized in paying off creditors).

The company's break even point occurs in period 4. Any liabilities incurred after period 4 will cause the company to be deemed 'insolvent'.[113] This will be explained in more detail below:

DIAGRAM 5.1
Graph showing movement of the company's Assets and Liabilities over time

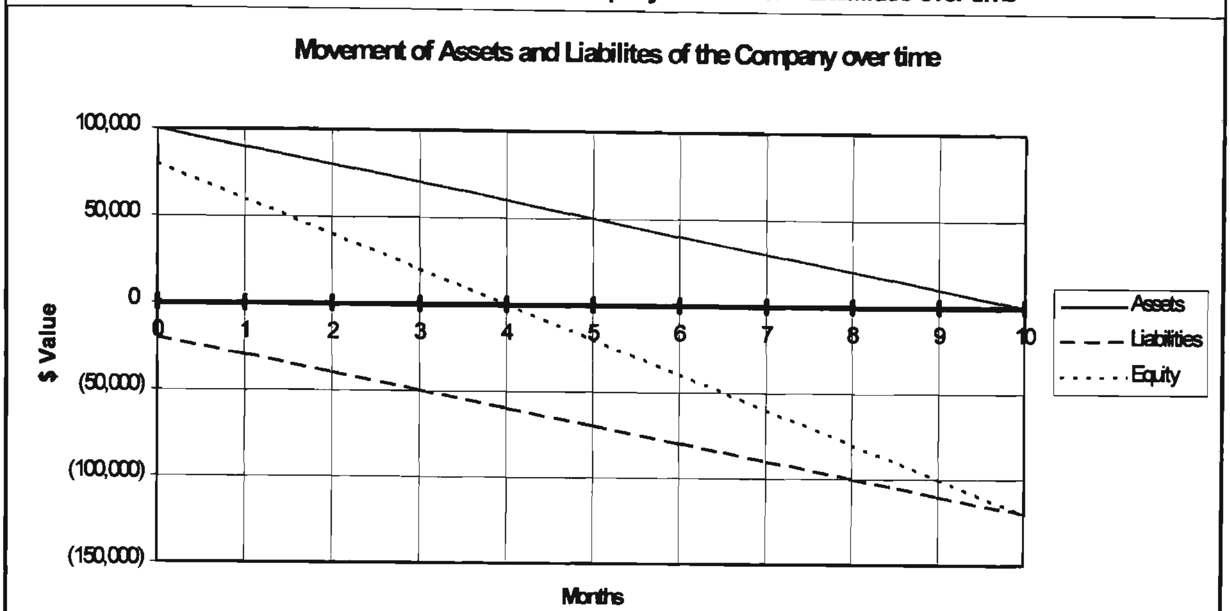


DIAGRAM 5.2
Time line showing the company's Assets and Liabilities over the period and points at which debt recovery action was undertaken by creditors

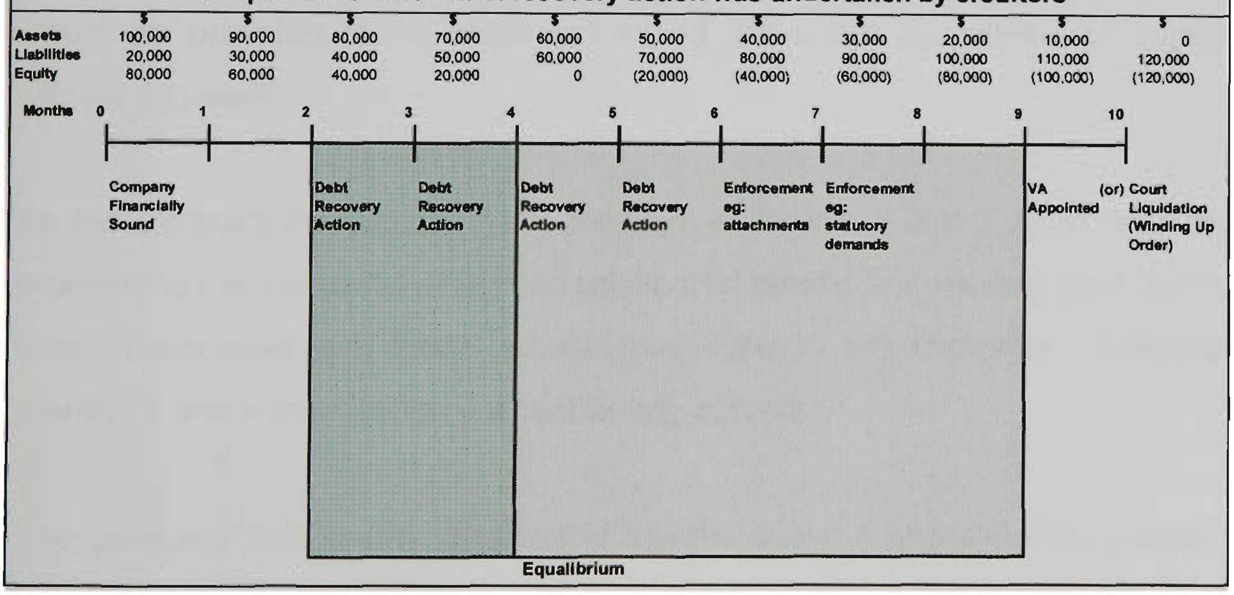


Diagram 5.2 is essentially a time line of the company's life. It outlines the points at which creditors seek to recover their claims against the company. The area to the left of month 4 represents the period in which the company is

[113]See Chapter 1 of this report for a definition of insolvency.

solvent. The area to the right of month 4 represents the period in which the company is deemed to be insolvent.

The above diagrams provide a simplified view of the outcome of seeking the appointment of an Administrator sooner. Whilst it is recognized that in real life the financial position of a company will fluctuate in accordance with a vast range of internal and external variables, for example, movements in the business cycle, competition, change of management, strong price competition or an additional injection of capital, for the purpose of explanation, a simple model is used to demonstrate the steps and timing in a logical sequence.

In comparing diagrams 5.1 and 5.2, note that at month 4 our debtor company's assets and liabilities are at break even point, that is, assets equal $60,000 and there are $60,000 in liabilities. At this point, no equity exists within the company. Equity is included in the diagrams to highlight the point at which a further capital injection would be required to keep the company from breaching technical solvency, that is, should the company's directors inject sufficient capital to meet any additional liabilities incurred, full payment would be provided to creditors but would leave the contributor of capital without payment.

As the company has failed to pay creditors in months 1 and 2, debt recovery proceedings are undertaken by the unsecured creditors to recover their claim. Costs associated with these actions are borne by the company. Between months 2 and 4 the company is technically solvent.[114]

The company fails to pay creditors in months 4 and 5 and creditors proceed to recover their claims through debt recovery proceedings. From months 4 to 10, the company is technically insolvent. Refinancing is unavailable due to the company's financial position and the directors are unable or reluctant to

[114] Note: Technical solvency refers to a company's ability to meet all of its obligations to creditors in full from assets within the company.

inject sufficient capital into the business. The outstanding claims are not paid by the company and enforcement proceedings are undertaken by creditors to recover their claims. For the purposes of demonstration, there are no secured or priority unsecured creditors with claims in the company.

At months 6 and 7, enforcement action by creditors is successful and the company is required to pay those creditors their outstanding claims including costs. Payments are not made to one of the creditors who lodges a Statutory Demand against the company. The directors apply to the Court to set aside the notice. They are unsuccessful. The creditor applies to the Court for a winding up order which is to be heard in month 10.

At month 9, the directors seek advice from their accountant who suggests seeking the assistance of a registered insolvency practitioner. The insolvency practitioner reviews the company's financial position and outlines the options available to the directors. The directors of the company choose to appoint an Administrator at month 9. At this time, the company holds $10,000 of assets and has liabilities of $110,000.

Creditors are informed of the appointment and during this period all actions against the company are stayed by provision of the Law. The Administrator prepares a report to creditors on the company's financial position and outlines the directors' proposal which includes an additional $10,000 to be provided by a third party towards creditors' claims in the administration.

The second compulsory meeting of creditors is held to consider the future of the company and the proposal is discussed. The proposal is accepted by creditors and a Deed of Company Arrangement is executed which provides for:

- $10,000 to be contributed by the directors of the company towards claims by creditors;

- the remaining $10,000 of assets in the company are to be sold with proceeds to be distributed in accordance with priority under the Law.

The calculation is as follows:

	$
Total Assets available to realize	10,000.00
Funds contributed by directors to the company	10,000.00
Total Funds Available	20,000.00
Less Administrator's Remuneration and Costs	10,000.00
Total Available to Unsecured Creditors	10,000.00
Unsecured Creditors Claims	110,000.00

Therefore the dividend available to unsecured creditors is 9.09 cents in the dollar on proved claims, that is: 10,000/110,000.

However, if unsecured creditors were given the right to initiate the appointment of an Administrator in month 7 and the directors were to still contribute $10,000 towards creditors claims, the following would result:

	$
Total Assets available to realize	30,000.00
Funds contributed by directors of the company	10,000.00
Total Funds Available	40,000.00
Less Administrator's Remuneration and Costs	10,000.00
Total Available to Unsecured Creditors	30,000.00
Unsecured Creditors' Claims at month 7 (see Diagram 5.2)	90,000.00

Therefore the dividend to unsecured creditors would be 33.33 cents in the dollar on proved claims. This action is clearly beneficial to the unsecured creditor.

This simple scenario takes into account various conjectures, some of which have already been discussed in Chapter 3 of this thesis and will be tested in Parts 5.2 and 5.3 of this chapter, namely:

1. Unsecured creditors if given the opportunity, would seek to initiate the appointment of an administrator sooner than directors of a debtor company;

2. Unsecured creditors are willing to take swift debt recovery action to recover their claims;

3. Over the period as shown, liabilities of the company would continue to increase at the same rate as assets decrease; and

4. There are no internal or external variables which will cause the company's financial position to fluctuate over the period.

If we were to assume that the company was to stop incurring liabilities at month 4, that is, maintain liabilities at $60,000 and an Administrator was appointed at month 7 through action taken by an unsecured creditor, the following would result:

	$
Total Assets available to realize	30,000.00
Funds contributed by directors to the company	10,000.00
Total Funds Available	40,000.00
Less Administrator's Remuneration and Costs	10,000.00
Total Available to Unsecured Creditors	30,000.00

Unsecured Creditor's Claims at month 7 60,000.00

Therefore the dividend to unsecured creditors would be 50.00 cents in the dollar on proved claims.

As has been demonstrated in the simple (hypothetical) case scenario above, the return to unsecured creditors would be greater where a VA commenced sooner.

Parts 5.2 and 5.3 of this chapter review the results of a case study undertaken on two companies currently under administration to determine whether the above hypothetical situation could occur in real life, that is, whether the return to unsecured creditors would increase if they had the right to appoint an Administrator.

The case studies consist of two debtor companies under administration with a history of debt recovery action brought against them by creditors. The purpose of this review is to analyze whether the hypothesis outlined in Chapter 4 may occur in real life.

5.1.1 Reviewing the accessibility of source data available to indicate a company's insolvency

A review of the more prominent indicators used to determine whether a company may be trading whilst insolvent was undertaken. The purpose was to determine which option would best provide a timely indication to unsecured creditors of the appropriate time to appoint an Administrator.

DIAGRAM 5.3

PROMINENT INDICATORS OF A COMPANY TRADING WHILST INSOLVENT

INDICATOR	DATA SOURCE	ACCESSIBILITY
Deficiency in the company's Balance Sheet and Profit and Loss statements over the period	Financial records/reports, information could be provided via discovery	Difficult, time consuming and costly.
Deficiency in Working Capital over the period	Periodical financial records. Information could be provided via discovery	Difficult, time consuming and costly.
Increasing losses over the period	Financial accounts; Statement of Assets and Liabilities as a comparative to financial data. Information could be provided via discovery. Credit Reference Association of Australia (CRAA) report may reflect increasing actions by creditors over the company to assist in determining same.	May be difficult, time consuming and costly. This will be dependant upon the type of information sought i.e: CRAA information is easliy accessable as compared to Financial Accounts.
Payments to creditors not in accordance with trading terms and an expanding list of trade creditors	CRAA reports may indicate indebtedness, judgement action if disclosed in the CRAA report will assist in determining same. Information could be via discovery.	Insufficient information may be provided to CRAA. CRAA reports may not always have details of action taken against the company. If information is sought via discovery, it may be time consuming and costly.
Payments to creditors by Instalments	Correspondence from creditors, information may be sought via discovery.	Little to none unless via discovery or debtor company has agreed to provide petitioning creditor with payments via instalments and has failed to do so. Would need financial rcords to determine eg: bank statements, cheque butts, letters etc via discovery.
Level of outstanding tax liabilties	Financial accounts. Information only pertinent to the Australian Taxation Office who would generally not disclose such information due to rules of privacy.	Difficult to access. Need source records which the Australian Taxation Office will not provide as a public document.
Quantity and value of dishonoured cheques	CRAA may show indebtedness to creditors via failure to pay. Financial reports, bank statements, etc obtainable via discovery.	Difficult, need to source appropriate data re: discovery. May be time consuming and costly.
Amount of unsatisfied judgements over the period	CRAA report may show various judgements on file. Probably best form of public information available however heavily reliant upon information of actions etc being provided to CRAA or equivalent service	CRAA or equivalent credit body must ensure all data is available. Creditor may need to be a member of such a body. If relevant information provided, easy to access and relatively inexpensive.
Banking facilities being operated outside approved limits	Debtor companies bank accounts. Information would have to be accessed via discovery.	Difficult to access unless via discovery. Time consuming and may be costly.

All the methods noted above would certainly assist in providing a more detailed review of the debtor company's current financial position however the time and cost taken in such an analysis may not maximize returns to a creditor company.

It is for this reason that the "amounts of unsatisfied judgments" over the period by creditors was chosen as it tends to be one of the more public indicators of a company's insolvency. Although it should not be the only indicator used, it can provide creditors with an historical indication as to the company's credibility and general short term viability. It was also an easily obtained indicator for the purposes of facilitating the examinations undertaken in this study.

The two case studies of A Pty Ltd and B Pty Ltd, both of which are currently under external administration[115] were chosen because they both contain relevant issues which highlight the basis of the hypothesis.

Case study 1, A Pty Ltd has an unsecured creditor with a debt large enough to be worth pursuing. Whilst it was not possible to analyze the conjecture that larger unsecured creditors would be more willing to pursue claims over small unsecured creditors (as there is essentially only one unsecured creditor), it highlights the issues raised in Chapter 2, that is, this company has a history of a debt recovery action which has dragged on for a considerable period of time. There was also sufficient data available to determine the company's assets and liabilities over the period of the study.

Case study 2, B Pty Ltd was chosen because it has a good range of large and small unsecured creditors who were willing to pursue claims through the

[115]It should be noted that for the purposes of adhering to standards of professional conduct as stipulated under Rules of Ethical Conduct (REC4) generally and APS7 Statement of Insolvency Standards, paragraph 13 and 14, the above debtor companies' names and associated parties have been disguised.

legal recovery process. In addition, sufficient data was also available to review the company's assets and liabilities over time.

5.2 CASE STUDY 1 - A PTY LTD

Chronology of Occurrences

A brief history of the company is provided below in order of occurrence.

1. A Pty Ltd first commenced trading as a wholesaler throughout Victoria and interstate in 1993. However in October 1995, the company began to experience financial difficulty (as noted in the Administrator's report to creditors).

2. In February 1996, M Pty Ltd issued a Statutory Demand against A Pty Ltd for an outstanding debt totaling $29,317.75. Accordingly, in March 1996, A Pty Ltd issued Federal Court proceedings to set aside the Statutory Demand. In an Affidavit sworn by the director of A Pty Ltd on behalf of the company, the director admitted to the debt claimed in the demand but asserted that the claim was being offset against another debt.

3. On 26 April 1996 a further creditor's Statutory Demand for the payment of the debt was issued by M Pty Ltd against A Pty Ltd claiming a further sum of $8,658.90. On 3 May 1996 A Pty Ltd issued County Court proceedings referring to offset claims it relied upon in the Federal Court proceedings to set aside M Pty Ltd's Statutory Demand. The offsetting claim consisted of an action in breach of confidence against M Pty Ltd and a former employee of A Pty Ltd who had since been employed by M Pty Ltd. An analysis of the company's accounts indicate that the company ceased trading in this month.

4. On 2 August 1996 the Federal Court set aside the Statutory Demand in favor of A Pty Ltd.

5. On 4 October 1996 the County Court proceeding was set down for trial on 13 August 1997.

6. On 11 July 1997, A Pty Ltd filed a Notice of Discontinuance in the County Court against proceedings. Further proceedings were immediately convened on behalf of M Pty Ltd seeking to recover their debt. A summons for final judgment was issued on 18 August 1997. A Pty Ltd failed to appear and the application proceeded. Judgment was ordered in favor of M Pty Ltd.

7. On 8 October 1997 a Notice of Motion to Wind Up the company was filed with A Pty Ltd. The petitioning creditor, M Pty Ltd sought recovery of its debt of $45,324.35.

8. On 21 October 1997 an Administrator was appointed pursuant to a resolution of the company.

9. As it stands, M Pty Ltd is the only known trade creditor of the Administration.

10. On 17 November 1997 the second meeting of creditors was held to decide the company's future. It was resolved by creditors, which included related party creditors, that the company execute a Deed of Company Arrangement. M Pty Ltd voted against the Deed.

11. A hearing to wind up the company was heard on 19 November 1997. The application was set aside. The company executed a Deed of Company Arrangement on 28 November 1997. As at 27 February 1998, the company has still to comply with the terms of this Deed.

DIAGRAM 5.4

Timeline of A Pty Ltd showing the company's Assets and Liabilties over the period and points which debt recovery action was undertaken by creditors

	Jun-94	Jun-95	Oct-95	Feb-96	Mar-96	Apr-96	May-96	Jun-96	Aug-96	Oct-96	Jun-97	Jul-97	Aug-97	Oct-97
Assets	21,963	62,401						19,469			7,226			1,300
Liabilities	28,291	62,377						93,472			110,485			118,044
Equity	(6,328)	24						(74,003)			(103,259)			(116,744)

Months: 0, 1, 13, 17, 21, 22, 23, 24, 25, 27, 29, 37, 38, 39, 41

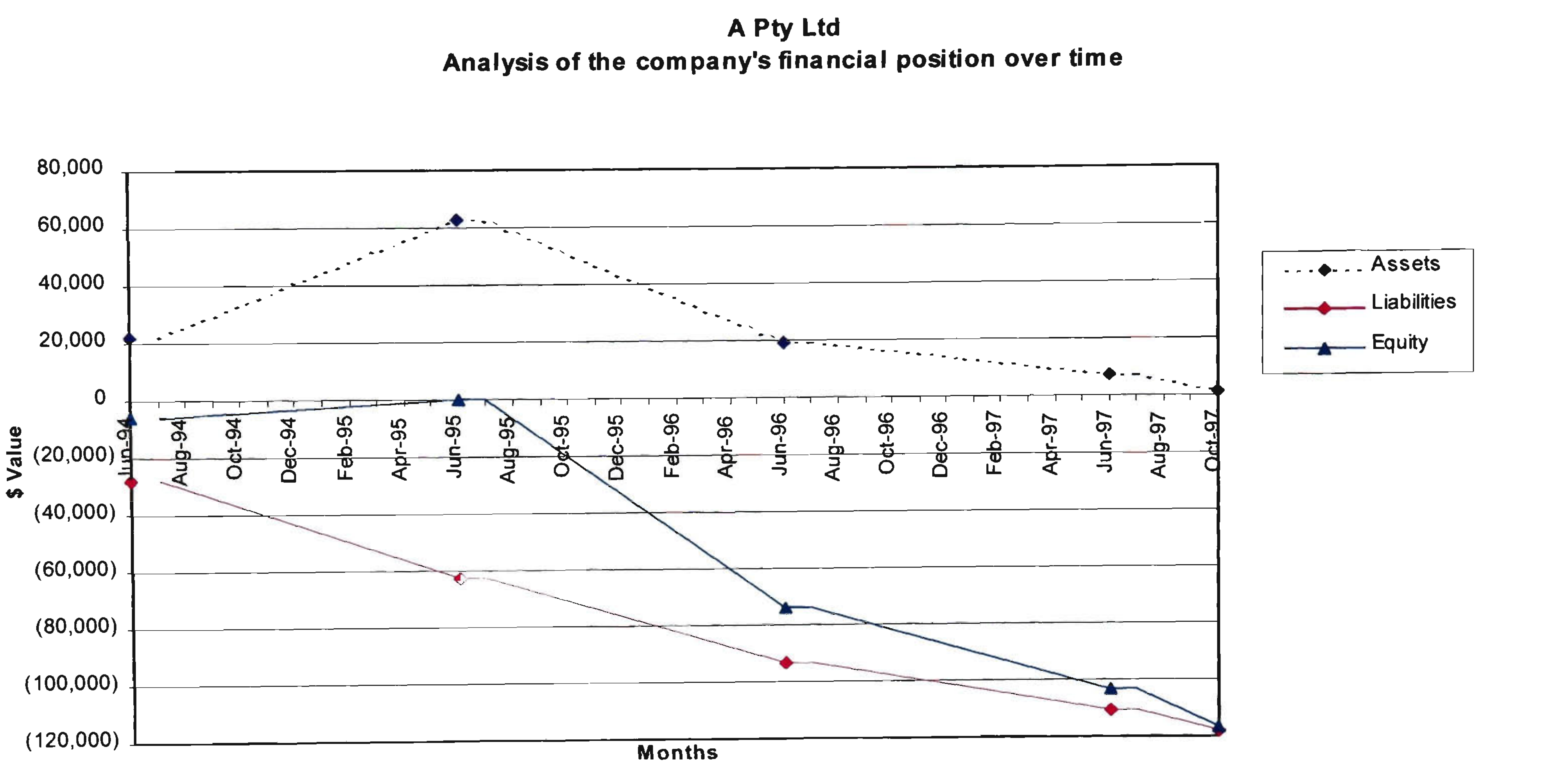
- 13: Company begins to experience financial difficulty
- 17: M issues Statutory Demand against company
- 21: A issues proceedings to set aside Statutory Demand
- 22: M issues another Statutory Demand for additional claim
- 23: A issues claim against M to set aside Statutory Demand
- 25: Federal Court sets aside Statutory Demand in favour of A
- 27: County Court proceedings set down to trial in August 1997
- 37: A files a Notice of Dis-continuance for County Court proceedings

  M immediately seeks to recover debt. On 29 July 1997 a summons for final judgement issued
- 38: A fails to appear. Judgement made in favour of M
- 39: Notice of motion filed with A due to be lodged by 19 November 1997

  On 21 October 1997 Administrator Appointed

DIAGRAM 5.5

A graph showing movements of company A Pty Ltd Assets and Liabilties over time



5.2.1 Review of the Administrator's report under Section 439A of the Corporations Law

A review of the Administrator's report dated 10 November 1997 provides a brief insight into the company. Included in the report is a proposal for the company to enter into a Deed of Company Arrangement and the Administrator's recommendations therein. Details are as follows:

1. Assets as at date of report:

	$
Stock (estimated realizable value)	1,300.00

All other assets were subsequently transferred to related party creditors or sold prior to the business ceasing to trade in May 1996.

2. Liabilities as at date of report:

	$
Secured Creditors	$16,600.00

Secured creditors consist of related parties holding a Registered Mortgage Debenture over borrowings.

	$
Unsecured Creditors	$101,441.35

A breakdown of unsecured creditors is as follows:

	$
one (1) trade creditor	45,324.35
one (1) tax liability	233.00

five (5) related party debts[116]	55,884.00

The one trade creditor is M Pty Ltd. As noted above, this creditor filed an application to wind up the company which was heard on 19 November 1997 (refer to diagram 5.4).

3. A proposal for the company to enter into a Deed of Company Arrangement provides the following:

    3.1 all related parties will not seek to prove in the administration;
    3.2 funds to be provided to all remaining ordinary unsecured creditors of the company;
    3.3 funds are to be made available within 30 days of execution of the Deed.

4. Administrator's recommendations in the report:

The proposal put forward by the director is expected to provide for a greater return to creditors than if the company were to proceed in to liquidation. As such, the Administrator was of the opinion that it was in the best interest of creditors to enter into a Deed of Company Arrangement.

Should creditors enter into a Deed of Company Arrangement with the company and the terms of the Deed be complied with, the following dividend would be paid to creditors:

Total Assets available to realize	1,300.00
Funds contributed by third party under the Deed	12,000.00
Total Funds Available	13,300.00

[116]Related party debts consist of interrelated company debts. These amounts have been shown separately. Should creditors accept the terms of a proposal to enter into a Deed of Company Arrangement, these creditors will not normally prove in the administration and will not receive a dividend.

Less Administrator's Remuneration and Costs	5,000.00
Total Available to Proved Creditors	8,300.00

Therefore should the Stock be sold at the above mentioned value and the Administrator's fees be no more than $5,000, the anticipated dividend available to admitted creditors would be approximately 18 cents in the dollar.

5.2.2 Hypothetical Scenario if Unsecured Creditors had the right to earlier appointment of a Voluntary Administrator

If M Pty Ltd had the right to initiate the appointment of an Administrator against the company in February 1996, when M Pty Ltd issued a Statutory Demand against the company and this resulted in the appointment of an Administrator in April 1996 (due to time delay in seeking appointment, see Chapter 7), it is suggested that unsecured creditors would receive a greater return than that which was offered to creditors under the current administration. This however is wholly dependent upon the following:

1. M Pty Ltd is prepared to initiate the appointment of an Administrator;
2. The directors of the company are able to guarantee that a third party would contribute $12,000.00 to creditors under a Deed of Company Arrangement; and
3. Related party creditors would not prove in the administration.

A summary of the financial accounts (estimates as shown in Diagram 5.5) as at April 1996 are as follows:

Total Assets	28,000.00
Total Liabilities	(88,000.00)
Net Equity	(60,000.00)

Notes:

Total Assets include Goodwill of $5,000.00.
Total Liabilities include related party debts of $20,360.00.

Therefore, the calculation of the dividend payable is as follows:

Total Assets available to realize[117]	28,000.00
Funds contributed by third party under the Deed	12,000.00
Total Funds Available	40,000.00
Less Administrator's Remuneration and Costs	5,000.00
Total Available to Proved Creditors	35,000.00
Total admitted creditors[118]	67,640.00

Therefore, should all assets be realized, creditors could expect a dividend in the vicinity of 51.7 cents in the dollar. If however, related parties were to prove in the administration a dividend to creditors would be significantly less. Accordingly, the calculation is as follows:

Total Assets available to realize	28,000.00
Funds contributed by third party under the Deed	12,000.00
Total Funds Available	40,000.00
Less Administrator's Remuneration and Costs	5,000.00
Total Available to Related Party Secured Creditor	16,600.00
Total Available to Unsecured Creditors	18,400.00
Total admitted creditors	71,400.00

Should all creditors prove in the administration, the dividend to unsecured creditors would be 25.8 cents in the dollar. Therefore, the hypothesis that the return to unsecured creditors would increase if they had the right to appoint an Administrator sooner in the period of a company's financial difficulty is supported.

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117 Total assets available to realize takes into consideration goodwill noted in the financial statements of \$5,000.00. This amount has not been removed due to the option of selling the business as a going concern.

118 Calculation of Admitted creditors as follows: \$88,000.00 - \$20,360.00 = \$67,640.00

5.3 CASE STUDY 2 - B PTY LTD

Chronology of Occurrences

A brief history of the company is provided below in order of occurrence. Diagrams 5.6 and 5.7 provide a summary of this information.

1. B Pty Ltd first commenced trading as a supplier to the printing and advertising industry in 1991. However, in October 1995, the company started experiencing difficulties in collecting moneys from its debtors. The situation was exacerbated when a major debtor company MC Pty Ltd went into liquidation. The net value of this debt totaled approximately $85,000.00. As a consequence of this liquidation, the Liquidator of MC Pty Ltd made claims against B Pty Ltd for preferential payments received prior to MC's demise.

2. Combined with a diminishing cashflow, the company experienced a dramatic downturn in trading during November and December 1995. It became obvious in May 1996 that the company's equipment was becoming obsolete with competitors upgrading to newer and more advanced systems.

3. At this time, the company sought approval from their bank for an increase in their overdraft facility. The directors anticipated that this would assist with the company's cashflow problems. The bank approved the increased overdraft facility in March 1996. Staff levels were reduced to lower costs.

4. According to the Administrator's investigations, correspondence relating to payment plans to creditors in respect of the company's debts go back to March 1996. This is an indicator that the company may have been trading whilst insolvent.

5. By April 1996, the company had not shown signs of any improvement and continued to suffer financially.

6. On 1 May 1996, the company's business was sold to NA Pty Ltd. Under the Sale Agreement, NA Pty Ltd was to satisfy creditors' claims from funds collected from the debtors of B Pty Ltd in such a manner as NA Pty Ltd determined. Payment to creditors were offered over a 10 month period based on an estimated return of 36 cents in the dollar to all B Pty Ltd creditors in return for a release of the full debt due to them by B Pty Ltd. However, the Australian Securities Commission (ASC) made inquiries as to the sale of the business. The ASC confirmed that the sale could continue as the same situation would occur if the company proceeded to be wound up or sought the appointment of an Administrator.

7. On 9 July 1996, an unsecured creditor, R Pty Ltd obtained judgment against the company for a debt totaling $4,421.00.

8. On 26 July 1996, a writ was served upon the directors of the company by a major unsecured creditor. The amount of the claim was $138,947.00.

9. In December 1996, it became apparent to the directors of the company that an Administrator would need to be appointed due to an impending hearing of a petition to wind-up the company. The winding-up application was made by VP Pty Ltd, a major unsecured creditor of the company whose debts totaled $26,249.00. The petition was heard on 3 December 1996 and was adjourned to 3 February 1997.

10. A Deed of Company arrangement was executed on 22 January 1997.

On 30 May 1997, a meeting of creditors was held as the company had failed to comply with the terms of the Deed. Creditors resolved to terminate the Deed and wind-up the company.

DIAGRAM 5.6

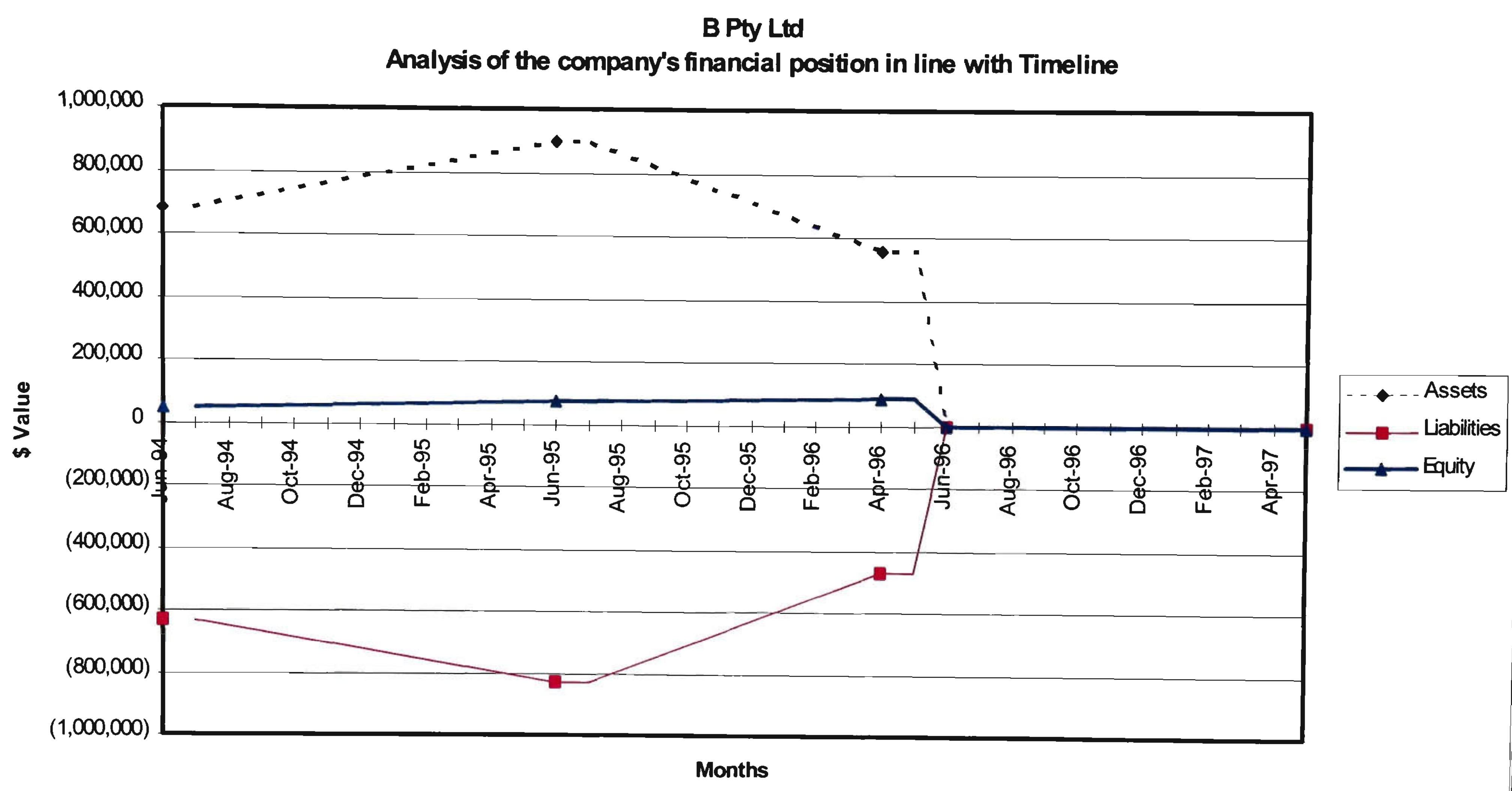
Timeline of B Pty Ltd showing the company's Assets and Liabilities over the period and points at which debt recovery action was undertaken by creditors

	Jun-94	Jun-95	Oct-95	Nov-95	Jan-96	Mar-96	Apr-96	May-96	Jul-96	Dec-96	Jan-97	May-97
	$	$	$	$	$	$	$	$	$	$		
Assets	679,421	897,079					557,918					
Liabilities	633,906	825,482					471,721					
Equity	45,515	71,597					86,197					

Months	Event
0	
1	
13	Company starts to experience financial difficulty due to large bad debts
17	Company experiencing dramatic downturn in trading for Nov and Dec
18	Company seeks approval for increase in overdraft facility
20	Company's bank approves overdraft facility. Staff levels reduced to lower costs Signs of trading whilst insolvent
22	Company continues to suffer financially
23	Company's business sold to NA Pty Ltd Payments to creditors in the vicinity of 36 cents in $
24	9/7/96 Creditor - R Pty Ltd seeks judgement against company for $4,421.00 26/7/96 Major unsecured creditor serves writ against company for debt totalling $138,947.00
26	Becomes apparent to directors of the company that an Administrator needs to be appointed due to an impending hearing of a petition to wind up company. Winding-up application made by VP Pty Ltd. Petiton heard on 3/12/96 but adjourned to 3/2/1997.
31	Deed of Company Arrangement executed on 22/1/97
32	On 30/5/97 a meeting of creditors held as the company fails to comply with the terms of the Deed. Creditors resolve to wind-up the company.
36	

DIAGRAM 5.7

A graph showing movements of company B Pty Ltd Assets and Liabilities over



5.3.1 Review of the Administrator's report under Section 439A of the Corporations Law

A review of the Administrator's report dated 23 December 1996 gives a brief background of the company. Included in this report is a proposal for the company to enter into a Deed of Company Arrangement and the Administrator's recommendations therein. Details are as follows:

1. Assets as at date of report:

   As noted above, all assets of B Pty Ltd were subsequently sold to NA Pty Ltd in May 1996. There are no remaining assets within the company.

2. Liabilities as at date of report:

   The majority of lease liabilities held by the company have since been assigned to NA Pty Ltd as per the Sale Agreement or subsequently been paid out in full. The only creditors which remained outstanding as at the date of the Administrator's report were unsecured creditors. The total amount outstanding to this class of creditor at the date of the report numbered sixty-nine (69) for amounts totaling $551,531.00.

3. Informal arrangements were entered into by a number of creditors through a pro-rata payment of 36 cents in the dollar on their claim. From information provided to the Administrator, the value of these released debts total approximately $336,777.82. Some creditors however, received payment of their claims in full. The total known creditors for which this occurred is approximately $39,032.00.

4. As already noted, VP Pty Ltd filed an application to wind-up the company which was heard on 3 December 1996 and adjourned to 3 February 1997 (refer to diagram 5.6).

5. A proposal for the company to enter into a Deed of Company Arrangement provides for the following:

   - The contribution of $100,000.00 by directors of the company, representing unallocated funds held by NA Pty Ltd at the date of the Administrator's report. This payment would be payable by 10 equal monthly installments beginning 31 January 1997 or sooner;

   - An undertaking by the directors of the company that should creditors accept this proposal, they will not lodge a claim in respect of any distribution made;

   - An undertaking by NA Pty Ltd to meet all obligations currently outstanding with respect to all arrangements, agreements, releases executed by creditors, leases, hire purchase agreements and employee entitlements which are currently in place and when they fall due.

6. The Administrator was of the opinion that the proposal put forward would provide for a greater return to creditors than if the company were to proceed in to liquidation. Accordingly, the Administrator recommended creditors enter into a Deed of Company Arrangement.

7. Should creditors do so and the terms of the Deed be complied with, a dividend in the vicinity of 20 cents to 30 cents would be paid. Details are as follows:

	$
Total Assets available to realize	Nil

Funds contributed by third party under the Deed	100,000.00
Total Funds Available	100,000.00
Less Administrator Remuneration and Costs	30,000.00
Total Available to Proved Creditors	70,000.00
Total Creditor's Claims at 31 May 1996	551,531.00
Amount of Debt Released	336,777.82
Amount Settled For	136,179.76
Amount Actually Paid	107,443.00
Non Settlement Creditors (Admin Creditors)	231,033.08

On the above data, the anticipated dividend rate on creditor's claims would be 30.29 cents in the dollar.

5.3.2 Hypothetical Scenario if Unsecured Creditors had the right to earlier appointment of a Voluntary Administrator

If an Administrator was appointed in March 1996 through pressure exerted by unsecured creditors on directors of the company, rather than seven months after the business was sold, the following could have occurred:

	$
Total Assets as at April 1996	557,918.00
Total Liabilities as at April 1996	471,721.00
Equity as at April 1996	86,197.00

If we can make the assumption that the assets and liabilities remained the same in both March and April 1996, theoretically, there should have been sufficient funds to provide creditors with payment in full on their respective claims if assets of the company were realized.

However, the company's assets consisted of Goodwill of $120,000.00 and Formation Expenses of $1,017.00, both of which would not be expected to realize funds in the sale of the company's assets. Accordingly, if we take out these amounts, the following occurs:

	$
Total Assets adjusted to reflect anticipated realizations	436,901.00
Total Liabilities adjusted to reflect anticipated realizations	471,721.00
Surplus/Deficiency of funds (required)	(34,820.00)

As such, if the company appointed an Administrator in March or April 1996, creditors may have expected a return of approximately 84 cents in the dollar (includes Administrators costs of $40,000.00) provided the company's assets realized their book value.

Critics may argue that as the purchaser took on all the employees of B Pty Ltd and continued to operate the business, the sale agreement was successful and did not need the formal appointment of an Administrator. However, contrary to this argument, a major portion of the company's creditors have yet to receive payment in satisfaction of their claims.

The hypothesis that the return to unsecured creditors would increase if they had the right to appoint an Administrator sooner in the period of a company's financial difficulty is also supported in this case study. However, in addition to this, if unsecured creditors had the right to appoint an Administrator sooner, a return to all creditors would have occurred as opposed to the informal arrangement in which some creditors received payment in full and others no return at all.

5.4 LIMITATIONS/DELIMITATION'S OF THE RESEARCH APPROACH

5.4.1 Limitations

As previously noted in this chapter, the case studies above take into account various conjectures, some of which were discussed in Chapter 3, namely:

1. Unsecured creditors if given the opportunity, would seek to initiate the appointment of an administrator earlier than directors of a debtor company; and

2. Unsecured creditors are willing to take swift debt recovery action to recover their claims.

Whilst case study 1 and 2 appear to support the argument that larger unsecured creditors may be more willing to incur the costs associated with debt recovery over smaller unsecured creditors a study conducted on a broader range of companies may provide additional support.

Prior to the completion of the case study, it was submitted that (as per the hypothesis), if unsecured creditors were given the right to appoint an Administrator, the return to all creditors would increase. The analyses undertaken in the case studies support this view. Given that a procedure is unavailable at this time, it is impossible to test whether any other variables may affect the hypothesis.

As the case studies reviewed two relatively small companies in Administration, it is possible that the same study may produce different results where larger entities are analyzed. Identifying whether unsecured creditors would be more willing to pursue a large company for their claim over a smaller one could be analyzed.

5.4.2 Delimitation's

Time constraints were a contributing factor to the overall size of the study. As such, a comparison between a group of larger and smaller companies was not undertaken. Whilst access to information was not a major factor in the study, collection of detailed data relating to debt recovery action undertaken by creditors was, in part, restricted to details available on the external Administrator's file.

An analysis of the case study results follows in chapter 6 of this study.

CHAPTER 6

ANALYSIS OF THE RESULTS

6.1 ANALYSIS OF THE RESULTS, A COMPARATIVE TO THE HYPOTHESIS

This chapter analyses the results of the case studies conducted in Chapter 5. It compares these results to the study hypothesis, that is, that the return to unsecured creditors would increase if they had the right to appoint an Administrator.

In analyzing these results, the hypothesis is broken down into the following parts:

1. unsecured creditors would react quickly to recover their claims and would be willing to incur those costs associated with this; and

2. returns to unsecured creditors would be higher if an Administrator was appointed sooner in the period of a company's financial difficulty.

Whilst it is not possible to directly test the hypothesis given that the procedure is unavailable to unsecured creditors at this time, the results of the case studies indicate that unsecured creditors do react quickly to recover their claims and would be willing to incur those costs as suggested in part 1 of the hypothesis. The size of the unsecured creditor's claim appears to have some impact on the speed at which recovery action is taken, that is large unsecured creditors appear to react fastest. It is suggested that the risk of incurring 'unbearable' losses may be one of the driving factors. Furthermore, the results of the case study also support part 2 of the hypothesis, that should an Administrator be appointed sooner, the overall return to creditors will increase.

Whilst both companies analyzed have quite separate financial situations and backgrounds, they do share one thing in common, namely, they both have unsecured creditors who are willing to proceed with debt recovery action to recover their claims.

In the case of B Pty Ltd, unsecured creditors sought to recover their claims as early as March 1996, two months before the business was sold to NA Pty Ltd and eight months before an Administrator was appointed over the company. The time taken to achieve judgment by R Pty Ltd appears to have resulted in four months of time lost before any action was forthcoming. The directors sought the appointment of a VA, six months after the company's business was sold and, on the face of it, only to appease a winding-up application brought about by a large unsecured creditor of the company.

The case study of B Pty Ltd supports the suggestion that if unsecured creditors had the opportunity to initiate the appointment of an Administrator, appointment would occur earlier than that which may be undertaken by directors of the company.

Whilst B Pty Ltd originally chose to sell its assets to a third party who under a contractual sale agreement was obliged to pay to the creditors of B Pty Ltd a distribution of funds equal to that which they would have received if the company went into Administration, many creditors did not receive a distribution. In this instance, there was a lack of formal control over payments to creditors. If an Administrator were appointed sooner, however, creditors could have expected a better return and appropriate control over the distribution process as noted in section 5.3.2.

The suggestion that larger unsecured creditors would be more likely to be informed as to the avenues of debt recovery available to them over smaller unsecured creditors is illustrated in the case study of A Pty Ltd. In this instance, there was a large creditor and a large debt. The costs associated with this debt recovery proceeding would have been significant. It is unlikely that a smaller creditor would be able to afford such an action over such a lengthy period of time, that is twenty-one months. However, it is not uncommon to find smaller companies which have reached a point of technical insolvency pursuing an action in anticipation of success.

In conclusion, whilst the hypothesis cannot be directly tested given that the procedure is unavailable, evidence from the case study suggests that if an Administrator was appointed sooner in a company's period of financial difficulty, the return to unsecured creditors may be greater.

Whilst unsecured creditors may not always react by pursuing an outstanding claim against a debtor company quickly and may not be willing to incur the associated costs, this study examines two companies in which this reaction has occurred. To test part 1 of the hypothesis in more detail in order to be able to generalize the results would require a significant number of sample companies which is beyond the scope of this thesis.

Chapter 7 contains a discussion of suggested methods by which an Administrator may be appointed. It also outlines the limitations and strengths of each method suggested and reviews areas which would require further study. In addition, chapter 7 provides an analysis of the thesis in general and a conclusion to its findings.

CHAPTER 7

SUGGESTED MECHANISMS TO RESOLVE THE PROBLEM, AREAS FOR FURTHER STUDY AND CONCLUSION.

INTRODUCTION

Part 7.1 suggests a number of mechanisms which allow unsecured creditors the right to seek the appointment of an Administrator. Part 7.2 identifies limiting factors which may exist within the suggested mechanism and Part 7.3 concludes the findings of the report.

A system in which unsecured creditors would have the right to appoint an Administrator would need to be timely, efficient and relatively inexpensive in order for it to achieve the objectives as stated throughout this thesis. More so, the system would need to be capable of determining whether it would be in the best interest of the company to appoint an Administrator.

A strong model can be seen in use by the Australian Taxation Office which under the Income Tax Assessment Act has the power to issue a Section 222AOE notice requiring directors of a debtor company to provide payment of an outstanding tax liability within 21 days of the notice being served or to place the company into external administration. Failure to comply with the requirement under this notice will render the directors of the company personally liable for the outstanding claim.

Debt recovery procedures as noted in chapter 2 of this report can take many months to achieve desired results. The procedure instigated by the Australian Taxation Office generally takes only 21 days. The procedures suggested below aim to achieve a similar result.

7.1 PROPOSED METHODS OF APPOINTING AN ADMINISTRATOR THROUGH AN ACTION INITIATED BY UNSECURED CREDITORS

In this report statistical evidence which supports the provision of unsecured creditors with the right to appoint an Administrator has been provided. The hypothesis that should an Administrator be appointed sooner, the return to unsecured creditors could expect to be better than that which is currently occurring, has been analyzed, tested, and supported by the results.

A variety of mechanisms which would allow unsecured creditors the right to seek the appointment of an Administrator is now suggested. Three options will be discussed. Their origin is from current practice in order that they support the community's commercial and economic processes and they are aimed at enabling both debtor and creditor to participate with the least possible delay and expense.[119]

7.1.1 PROPOSAL 1 - Appointing a Voluntary Administrator via the Statutory Demand Procedure. Incorporating the right to unsecured creditors.

It is proposed that the Statutory Demand notice or an equivalent of this notice, be adapted to incorporate a mechanism which demands directors of a debtor company who fail to comply with the notice within the requisite 21 day period the option to seek the appointment of a VA within 21 days after this date (see Chart 7.1). A failure to comply with this demand will automatically allow the petitioning creditor the right to apply for a winding-up of the company as currently occurs under the 509H notice[120].

As with current practice, the creditor's claim should be $2,000 or greater to comply with the minimum amount allowed to proceed with a statutory

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[119] Source: Australian Law Reform Commission, General Insolvency Inquiry - Report No: 45 (The Harmer Report) - Par 33.

demand.[121] The purpose of using this method of debt recovery is that unlike other methods noted in Chapter 2 of this report, the statutory demand method does not require the creditor to have a judgment debt[122] making it the fastest method available to achieve the required results[123]. Whilst the equivalent of this method would need to incorporate current practice, it would also be flexible enough to instigate an administration without unsecured creditors actually having the right to do so.

The reason behind not giving unsecured creditors the right to appoint an Administrator fits within the current practice of the Statutory Demand notice in which a Liquidator is appointed via the Courts. In much the same way, the proposed method demands that the directors of the debtor company pay the debt, come to a suitable arrangement with the creditor or apply to have the notice set aside within 21 days.

It is proposed the current method simply be extended so that the company must appoint an Administrator within 21 days of failing to comply with the notice. The reason for choosing 21 days was to restrict the time taken for directors to consider appointing an Administrator. This fits within the aims of the hypothesis tested in Chapter 5 in which it was suggested that a greater return to creditors may occur if an Administrator was appointed sooner in the period of a company's financial difficulty.

It is proposed that failure to comply with the demand to seek the appointment of an Administrator will not automatically cancel the notice but rather allow the petitioning creditor the right to apply to the Court for a winding-up order within the stipulated time frame. However, as the company would be deemed to be insolvent, it would be in the best interests of the directors to seek the

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[120]See Section 2.2.5 Winding-Up procedures in this thesis.

[121]See Section 2.2.5 Winding-Up procedures in this thesis.

[122]For more information on the process of achieving judgment see chapter 2 of this thesis. This process can take from 3 to 6 months on average to achieve this.

[123]See Chapter 2, Diagram 2.1 for a indication of the time frame required to achieve a judgment debt.

appointment of an Administrator. It should be noted however, where an Administrator decides that it is not appropriate to consent to the appointment, the administration would not occur and the company would proceed into liquidation should the creditor proceed with the application.

As the time taken to appoint an Administrator is crucial to the survival of the company or and/or the level of return creditors may receive, this method of appointment aims to limit the time taken to 42 days, i.e.: 21 days for the notice and 21 days for the demand for appointment of an Administrator. The 21 day period for the notice fits within the current practice of the statutory demand. Upon expiry of the 21 day notice period, it is considered commercially acceptable to allow directors of a company 21 days in which to seek the appointment of an Administrator. This would allow sufficient time for a prospective Administrator to review the company's financial position and decide whether the appointment would be suitable. It would also allow directors time to seek guidance from a registered insolvency practitioner as to the best option in dealing with their matter. By comparison, the time taken to wind-up a company can take as long as 13 to 16 weeks.[124]

The anticipated costs of seeking to initiate the appointment of an Administrator would be expected to be significantly less than those costs associated with a winding-up of the company. For example, there are no costs associated with the appointment of an Administrator by the creditor as the appointment is still made by directors of the company. In addition, the cost of the statutory demand is the only cost borne by the creditor to initiate the appointment process.

[124]See Chapter 2, Section 2.2.5 Winding-Up procedures

Diagram 7.1

SUGGESTED METHODS OF APPOINTING AN ADMINISTRATOR BY UNSECURED CREDITOR

PROPOSAL 1 - APPOINTMENT VIA THE STATUTORY DEMAND PROCEDURE, INCORPORATING THE RIGHT TO UNSECURED CREDITORS

CURRENT SYSTEM

1 An application to wind-up and place a debtor company into liquidation can be undertaken by a creditor of the company with a debt $2,000 or greater. (It is not necessary to have judgement in place for this to occur.)

2 A "Statutory Demand" or "509H Notice" must be made in the prescribed form pursuant to Section 459E of the Corporations Law.

3 Upon service of the notice, the debtor is required to either pay the debt, come to an arrangement with the creditor or apply to the court to set aside the notice within 21 days of receiving the notice.

4 The debtor company cannot lodge an application to set aside the notice after the 21 day period.

5 Where an application is lodged within 21 days of receiving the notice, a Statutory Demand may be set aside provided:
1. There is a genuine dispute over the existence or size of the claim; or
2. If the demand notice originally lodged is defective.

6 Where the debt remains unpaid or an arrangement has not been made within 21 days of service of the notice, the company will be deemed to be insolvent.

7 The creditor has the option of applying to the court for a winding-up order within 3 months from the date of the notice. The application and supporting affidavits must be issued and served on the debtor and details of the hearing advertised in the Government Gazette and local paper. In addition a notice must also be lodged with the ASC.

8 Upon completion of the above process, the matter is listed for hearing by way of filing of an application. This will normally take 10 to 12 weeks from the date of the application being filed. Once the Winding-up order has been obtained, the applicant (creditor) must advertise the order, serve a copy of the order on the liquidator and publish a notice in the Goverment Gazette.

9 Notice of the order must also be lodged with the ASC within one day following the date on which the order is filed at court.

PROPOSED SYSTEM

1 Where a creditor has a debt greater than $2,000 against the debtor company, the creditor can make an application to:
1. wind-up the debtor company and place it into liquidation; or
2. seek an order that the company appoint a VA within 21 days of failing to comply with the statutory demand.

(like the current system, it is not necessary to have judgement for this to occur, however, the information requirements required in order for this to occur would need to be strictly adhered to in order to verify the purpose of seeking appointment.)

2 Form of Statutory Demand or equivalent must be in the prescribed Form.

3 Upon service of the notice, the debtor is required to either:
1. pay the debt;
2. come to an arrangement with the creditor; or
2. apply to the court to have the notice set aside within 21 days of receiving the notice.

4 Where an application is made to set aside the notice, all relevant information would be required to be supported by Affidavit. It is sugggested that in order for a notice to be set aside, there must exist a materially different variance between the creditor's claim and the debtor's details.

5 Where a notice is set aside for the purposes of clarifying a variance a period of 21 days should be provided to both debtor and creditor to produce additional information in respect of the claim. Failure to provide additional information by the debtor will render the Statutory Demand effective immediately. Failure to provide additional information by the creditor will render the notice invalid.

6 The debtor company cannot lodge an application to set aside the Statutory Demand after the expiry of 21 days.

7 Where a debt remains unpaid or an arrangement has not been made within 21 days of service of the notice, the company will be deemed to be insolvent or likely to become insolvent in the near future.

8 The creditor has the following options:
1. Apply to the court for a Winding-up order within the 3 months from the date of the notice;
2. By virtue of the debtor failing to pay the debt or come to an arrangement, at the expiry of the Statutory Demand, the debtor will be required to seek the appointment of an Administrator within 21 days of this date.

Where the debtor company fails to comply with the notice, the debtor company will automatically be subject to Winding-up procedures.

9 Where the debtor company is subject to a winding-up order, the matter will be listed for hearing by way of the filing of an application. This will take approximately 10 to 12 weeks from the date the application is filed. Where a debtor company fails to appoint an Administrator in the required period, the debtor company will lose the right to appoint an Administrator within the three months up to the hearing. This gives the petitioning creditor the right to still maintain control of the situation over any adverse actions which may be undertaken by directors of the company. The purpose behind the 21 days VA period is to minimise the time taken by directors of the company to seek the appointment of an Administrator, i.e; maximise chances of company surviving and/or maximise returns to creditors.

10 Directors of the debtor company must notify the petitioning creditor of the appointment of an Administrator. Notice of the appointment will be lodged with the ASC by the Administrator.

7.1.2 PROPOSAL 2 - Appointing a Voluntary Administrator via an Application to the Court where a Winding-up application is in process.

Another option available to unsecured creditors generally is to seek the appointment of an Administrator via an application to the court. Essentially, this would work in the same manner as a Statutory Demand issued by a creditor who failed to comply with the notice followed by an application by the creditor for a winding-up of the company. In this instance, an application could be made by directors of the debtor company, the petitioning creditor or any other interested body of creditors. The advantage to such a system is the level of control over the appointment process of an Administrator. The disadvantage is that it may take up to 13 to 16 weeks to achieve appointment (based on a normal application to wind-up company hearing).[125] Whilst additional court involvement may be beneficial, it is anticipated that such a system would cost more and may not necessarily achieve a better result due to the time taken to instigate such an appointment (refer Section 4.4 hypothesis of this study).

Similar to the UK system which requires input from the Courts to initiate the appointment of a VA, it is proposed that the Supreme and Federal Courts have power to appoint a VA upon an application by an Unsecured Creditor where it is considered by the court efficient to do so.

7.1.3 PROPOSAL 3 - Appointment via the Court upon application by larger unsecured creditor

As discussed in Chapter 3, the economic consequence of a bad debt which may only be insignificant for a larger unsecured creditor may prove fatal to a smaller creditor. It is submitted under this proposal, that providing all unsecured creditors with the right to appoint a VA would require a limiting factor in which particular criteria are met before "an act to seek the

[125] See Chapter 2, Section 2.2.5 Winding-Up procedures

appointment of an external Administrator" would be permitted either by a Court or by application as noted in the first proposal.

It is proposed that as larger creditors are likely to be more willing, informed and financially capable of pursuing a claim against a debtor company this class should be provided with the right to seek the appointment of an Administrator under Section 436A of the Law where particular criteria are met. It is this class of creditor, which in real terms makes up as much as 10%[126] to 20% of a debtor company's total debt, that may be more willing to incur the costs associated in pursuing their claim against the debtor company. For example:

Example 7.1

Company A			% of total debt
Total Liabilities:		$350,000	100%
Made up of:	Secured Creditor	$100,000	28.58%
	Unsecured Creditors	$230,000	65.71%
	Others (Contingent)	$ 20,000	5.71%
Unsecured Creditors - detailed			
Creditor			
X		$ 60,000	17.14%
Y		$ 40,000	11.43%
Z		$ 20,000	5.71%
ZA		$ 18,000	5.14%
ZB		$ 15,000	4.29%
ZC		$ 10,000	2.86%
Other Creditors ($1 to $9,999)		$ 67,000	19.14%
		$230,000	

In the above scenario, it is proposed that the secured creditor would still be within its rights to appoint a receiver. If the charge held by the secured

[126] Note: 10% is considered significant under AASB 1031 "Materiality", para 4.1.6.

creditor is over the whole or substantially the whole of Company A's assets, a VA could also be appointed by the secured creditor.

Creditor X and Creditor Y however, being the two largest individual unsecured creditors and which are defined as 'large', that is, holding greater than 10% of the total debt, have no right to seek the appointment of a VA to protect their interests even though they make up a significant portion (43%) of all unsecured creditors' claims.

If Creditor X were to utilize the current debt recovery procedure, which although quite effective is not necessarily time efficient, the procedure could drag for several months resulting in a winding up Order and total dissolution of the debtor company's asset base. Instead, it is proposed that the overall return to Creditor X and all other unsecured creditors could be increased by offering a speedier method of appointment in order to avoid larger losses and at worst prevent a domino effect of creditor failures.

In the meantime it is expected that Creditor Z through to Creditor ZC would find the cost of pursuing their claims against Company A affected by other actions underway, including the action by Creditor X or Creditor Y. That is, legal proceedings by other creditors may reduce the possibility of recovery. As such, the end result would most likely be an order winding up the company with a receiver being appointed over secured assets of the company with the possibility of little or no return to the remaining creditors a likely outcome. Further, where multiple unsecured creditors proceed to seek recovery of their debts, only one may be awarded costs should a winding up Order be made against the company and there are insufficient funds to pay other creditors.

It is possible for Creditor X and Creditor Y to seek to register an interest ('charge') over assets of the company by way of a registered debenture. The overall benefit of exercising a charge over Company A will predominantly be subject to the assets available on which to affix a charge. The first secured creditor would have priority in ranking to Creditor X and Creditor Y's registered debentures. Also, should Company A be placed into liquidation within six months of a charge being registered, the debentures would be considered void against the Liquidator of Company A.[127] As such, it is proposed that a mechanism be introduced in which an unsecured creditor, or class of unsecured creditors, hold 10% or more of the value of a company's debts (excluding related party debts), be given the right to seek the appointment of a VA. This would reduce the deterioration of the debtor company's asset position caused by a continued decline in trade or legal costs. The intention of such a proposal is to maximize returns to creditors.

The appointment process could be initiated by way of a Statutory Demand which could be served upon the debtor company. Failure to comply with the demand would result in an application being placed with the court to wind-up the company, however, as discussed in proposal 1, a period of 21 days would be allowed in which directors of the company would have the right seek the appointment of a VA. Failure to do so could institute proceedings to a winding-up of the company.

In summary, the current options available to unsecured creditors are limited to the debt recovery procedures as discussed in chapter 2 or an informal payment arrangement, which if executed would constitute an unfair preference under the claw-back provisions of Law.[128] It is therefore proposed that unsecured creditors should be provided with the right to appoint an Administrator. This has been argued on the following basis. Firstly, as they make up a large portion of the debtor company's total debt and they do not hold security over their interest in the company, their rights would be better served by providing this class of creditor with such a right. Secondly, due to the overall size of the debt, large unsecured creditors are likely to be more willing to pursue their claim through debt recovery proceedings, and thus may

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[127]See Section 588(FE) voidable transaction and Section 588(FA) unfair preferences under the Law.

[128]Source: Section 588 of the Law.

be more willing to act quickly to recover their claims against the debtor company.

Thirdly, as unsecured creditors are generally the last to receive a distribution from proceeds received from the sale of assets of the company in a liquidation or dividend under a Deed of Company Arrangement, they risk to lose more and would be willing to act sooner if this action is likely to minimize losses.

Whether the appointment of a VA results in a compromise of debts by the creditors or a structured payment plan, the concept is still aimed at maximizing the chances of a company surviving and minimizing losses to creditors, which is in accordance with the objectives of the current Voluntary Administration scheme.

However, it must be recognized that this can usually only be achieved by prompt action and recognizing the early warning signs of financial difficulty. As unsecured creditors are the last to receive payments from a financially troubled company, and given their inability to recover their claims quickly and the diminution of the available asset base over the extended time period, it is proposed that the debt recovery procedure swiftly incorporate the appointment of a VA.

7.2 LIMITATIONS/STRENGTHS OF THE SUGGESTED MECHANISMS

In discussing the limitations and strengths of each of the three proposals outlined in this chapter, it should be noted that all three aim to act to improve the return to unsecured creditors. The strength of these proposals predominantly lies in their capacity to produce better returns for the unsecured creditors. Their weakness lies in the cost and time it takes to achieve a return.

Proposal 1

As proposal 1 requires an unsecured creditor who is prepared to incur the costs associated with the preparation of a Statutory Demand and the willingness to proceed, this method cannot guarantee the appointment of an Administrator. Further, the costs associated with the preparation of the Statutory Demand may be irrecoverable. There is also a high risk that the demand will be set aside on some minor technicality.

Proposal 1 has some significantly positive aspects. In particular, it is relatively quick to initiate and is relatively inexpensive and effective without altering current practice in any major form.

Proposal 2

As this process follows the Statutory Demand process it may take up to 13 to 16 weeks to initiate the appointment of an Administrator, the end result being a system which fails to appoint an Administrator in a timely manner. More so, as the process is Court driven, it may become costly and cumbersome in practice, (similar to the that of the UK system[129]). It derives its strength from the fact that the system has a control mechanism in the Courts.

Proposal 3

Proposal 3 creates a sub-class within a class, that is, larger unsecured creditors over smaller unsecured creditors. Whilst there is no difference in the voting power of the large and small unsecured creditor, power rests with those holding the greatest portion of the company's debts. Although dependent upon the mechanism adopted, the system may become costly where an application to appoint an Administrator is made via the Court.

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[129] See Chapter 4, section 4.3

The strength in this proposal is in the conjecture that larger unsecured creditors would be more willing to appoint an Administrator quickly as they have a high risk of losing a large amount. In addition, this system relies upon an arbitrary measure of large and small.

Whilst all three mechanisms are different in their operation, they all share the objective of reducing the inequity between different classes of creditors (secured and unsecured) which currently exists within our system.

7.3 CONCLUSION AND AREAS FOR FURTHER STUDY

7.3.1 Conclusion

Throughout this report the social and economic impact borne by unsecured creditors as a class has been analyzed. A statistical analysis to identify the significance of the problem was conducted, and a case study of two companies to assist in supporting the hypothesis was undertaken[130].

In the past, little has been done to identify and amend the problem. Evidence suggests however, that introducing the 'right' may improve the return to all creditors. Whilst it may be that the 'law' has aimed to highlight to directors their responsibilities and obligations, it is questionable whether this has occurred.

Educating directors of financially troubled companies to seek professional guidance earlier in the process would be the optimal outcome of any such proposal. It is suggested that this procedure may alert directors to their responsibilities to creditors who, from a social and economic point of view, cannot afford to sustain considerable losses. With the introduction of stricter penalty provisions within the Corporations Law, an increase may be expected in the appointment of VAs as a side effect. However, the aim should not be

[130] see Section 4.4

to rule by the sword but rather by the awareness of these mechanisms, that is, encourage rather than regulate.

Critics may argue that it may not be commercially efficient to let every company survive. It is not the aim of this report to recommend so. Rather, it comes back to a matter of minimizing losses to creditors in order to reduce the gap between potentially destructive losses to more bearable levels.

7.3.2 Areas for further study

To seek to develop the above study would benefit the current operations under Part 5.3A of the Law.

If we were to compare the personal equivalent to the Voluntary Administration scheme and analyze the Part X regime under the *Bankruptcy Act 1966*[131], we may learn where the VA scheme is heading. In recent times the Part X scheme has become a rarity to the Insolvency Practitioner. The only plausible explanation is that creditors are more willing to see their debtors go bankrupt. Should this be the case with the VA scheme, it could be that use of the scheme will diminish in light of bad publicity and misuse. However, unlike the Part X regime, there are many indicators which show that VAs are here to stay.

On this basis and given the aims of the above study, it would be of great interest to undertake a study which could clearly identify how many directors of insolvent companies are pursued for insolvent trading under the Law. Complementary to this would be a study which takes a sample of company directors and reviews their knowledge of the VA scheme, its function and purpose, and the requirements of the Corporations Law, including those provisions which deal with insolvent trading and antecedent transactions.

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131 The aim of Part X of the Bankruptcy Act is to allow an individual debtor to propose (and ideally execute) a formal arrangement with his or her creditors whereby creditors would accept a reduced return on their claim in satisfaction of their total debt.

It would be particularly useful to conduct a study as to the type of creditor who can afford priority of a registered charge over a company. Whilst only a presumption, it is suggested that this class of creditor is probably a financial lending institution or a significantly large individual trade creditor of the debtor company. Due to the general size of the "individual" debt, this creditor holds enough power to ensure an advantageous position over other creditors. The result is an inequity in the system between creditors of different magnitude.

Another area for useful future research would be to compare the US and UK systems of administration with Part 5.3A of the Law and review the overall return to creditors achieved under each system.

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