CLAYTON UTZ

PPB

IPAA National Conference

Perth
28-29 October 2004

DOCAs and Creditors' Trust Deeds

Rob McKenzie, Clayton Utz
Jeff Herbert, PPB

The Clayton Utz contact for this document is
Rob McKenzie on + 61 8 9426 8000
Clayton Utz
Lawyers
QV1 250 St Georges Terrace Perth WA 6000 Australia
GPO Box P1214 Perth WA 6844
T + 61 8 9426 8000 F + 61 8 9481 3095

Legal\80807423.1

DOCAs AND CREDITORS' TRUST DEEDS

1. Objects of Voluntary Administration

The stated object of the administration regime in Part 5.3A of the *Corporations Act 2001* (Cth) ("Corporations Act") is enshrined in section 435A which provides:

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

The obiter comments of Goldberg J in *Re Ansett Australia Ltd* (2001) 39 ACSR 355 confirm that it is the duty of an administrator to strive first to attain the primary object (continuation). If that can't be done, the aim is to achieve the secondary object (better return than in an immediate winding up). A further unstated object which is implicit in the general administration provisions is that speed is important.

Although section 435A puts the Principal Object in the form of a choice between two alternatives, the use of a creditors' trust deed together with a deed of company arrangement allows for a combination of the two. The result is that the company, and at least part of its business, continues in existence thereby providing a better return to the company's creditors and members than would result from immediate liquidation. This paper shows how both can be achieved.

2. Scope of meetings and outcomes

On appointment of a voluntary administrator the first meeting of creditors has only a limited function. It deals with affirmation of the administrators' appointment, or the administrators' replacement, and with whether or not a committee of creditors should be appointed and if so its composition.

There are essentially three potential outcomes the creditors can resolve upon at the second creditors' meeting:

(a) to execute a deed of company arrangement ("DOCA"); or

(b) to end the administration; or

(c) to wind up the company.

In addition, prior to a final decision being made the creditors can adjourn the second meeting. Outcome (b) might eventuate where the company is basically sound but needed the (brief) respite afforded by the period between the first and second meeting of creditors. Assuming a truly insolvent company, it is unlikely to occur. Outcome (c) is the fate that Part 3.5A is designed to allow the company, if possible, to avoid. From the inception of Part 3.5A, attention has focussed on outcome (a) - execution of a DOCA.

3. Extension of time to effect reorganisation

Putting together a proposal for the reconstruction of a listed company often, if not always, requires a longer period than is formally prescribed by the Corporations Act for the calling of the second meeting of creditors. There are a number of ways to extend the time available to effect a reorganisation under Part 5.3A. These are:

(a) by applying to the Court for an order under section 439A(6) extending the time for calling the second meeting;

(b) by adjourning the second meeting using section 439B(2), which method in any event has a restriction in that the extension can only be for a maximum of 60 days; or

(c) by entering into a 'holding DOCA', which achieves the extension without requiring recourse to the formal methods set out in paragraphs (a) and (b) above.

All three methods of extending time require Court or creditor approval and work within the framework of the regime, so checks and balances apply. Disgruntled creditors could also apply to the Court under sections 447A and 447B to review the operations of an administrator. The statutory object of speed is traded off in consideration for the extension of the period of the administration regime, in the hope that a better outcome can be achieved. Extension of time is therefore particularly appropriate with more complex situations and companies.

4. Extension of range of application of voluntary administration

The voluntary administration regime was not originally intended to be used to reorganise major listed corporations. The wording of section 435A(a) of the Corporations Act suggests a relatively simple composition with creditors involving a discharge of debts and a continuation of 'business as usual', whereas the wording of section 435A(b) suggests a continuation of business (perhaps to get a better price for the company's assets and undertaking as a going concern), but possibly with delayed (not "immediate") winding up in view. It was generally considered that schemes of arrangement under Part 5.1 would still be utilised for complex reconstructions. However, the convenience and speed of the new regime appealed to the participants in the insolvency industry, who realised it was flexible enough to accommodate virtually all situations. Within the broad framework of Part 5.3A and general legal constraints, the scope of a DOCA is potentially very wide and is left to the imagination of the proponents. A DOCA is also much cheaper and quicker to implement than a scheme of arrangement, which required two court appearances and significantly greater administrative procedures. Even after its basic features had been agreed, it usually took a minimum of three months to finalise the formalities of a scheme, and often considerably longer.

Once Part 5.3A of the Corporations Act came to be seen as a vehicle for reconstructing a listed company, three important factors emerged. The first was that the company itself, although then (presumably) insolvent, might have an intrinsic value to potential investors that could be unlocked for the benefit of the creditors. The second was that it might take time to identify and develop the reconstruction proposal that offered the best return for creditors and members. The third was a matter of timing. If the company was to be recapitalised and relisted, it needed to be solvent by being freed of its pre-administration debts, and it needed to have emerged from administration. Completion of a DOCA would do both, but completion was usually contingent on financial input from the recapitalisation. What was needed was a mechanism whereby the DOCA itself could be effectuated (resulting in a discharge of pre-administration debts and termination of the DOCA) but the distribution to creditors (partly funded by the proceeds of reconstruction) could take place at a later time.

The first and second factors can be dealt with by what has come to be known as a 'holding DOCA'. The third factor can be accommodated through a creditors' trust deed. In combination, these two innovations have greatly extended the range of application of voluntary administrations, particularly of listed companies.

5. Proposals for reconstruction

When a listed company is to be restructured, the administrator, after obtaining the necessary extension of time, must seek out proposals to achieve the Principal Object. The proposals may deal with the sale of the assets or business of the company, or seek to harness the company's intrinsic value to investors through the reconstruction of the company itself, keeping part of the assets or business, or injecting more assets and businesses, or be a combination of all of these. There may be several proposals running at the same time, for example some assets may be sold while the Company itself, with its remaining assets, is being reconstructed. In practice, extension of time through execution of a holding DOCA offers the greatest flexibility in obtaining and implementing proposals.

6. Holding DOCA

Under a holding DOCA the administrator is entrusted by the creditors with the task of seeking out proposals, one or some of which will be implemented as a specific DOCA. The arrangement is usually finalised by a creditors' resolution amending the existing holding DOCA. However, sometimes the scope of the original document is wide and flexible enough to cover the new proposal without amendments.

In *Re Open Telecommunications Ltd (Subject to Deed of Company Arrangement)* Hamilton J of the Supreme Court of NSW (Equity Division), in granting directions that an administrator would be justified in giving effect to a DOCA and a creditors' trust deed, was comforted by the fact that the arrangement would be put into effect only if the creditors voted in favour of it at a further creditors' meeting proposed to be called. As a result of Hamilton J's comments it appears that it may be prudent to call a further creditors' meeting to pass the necessary resolution, but it may not be essential in some circumstances.

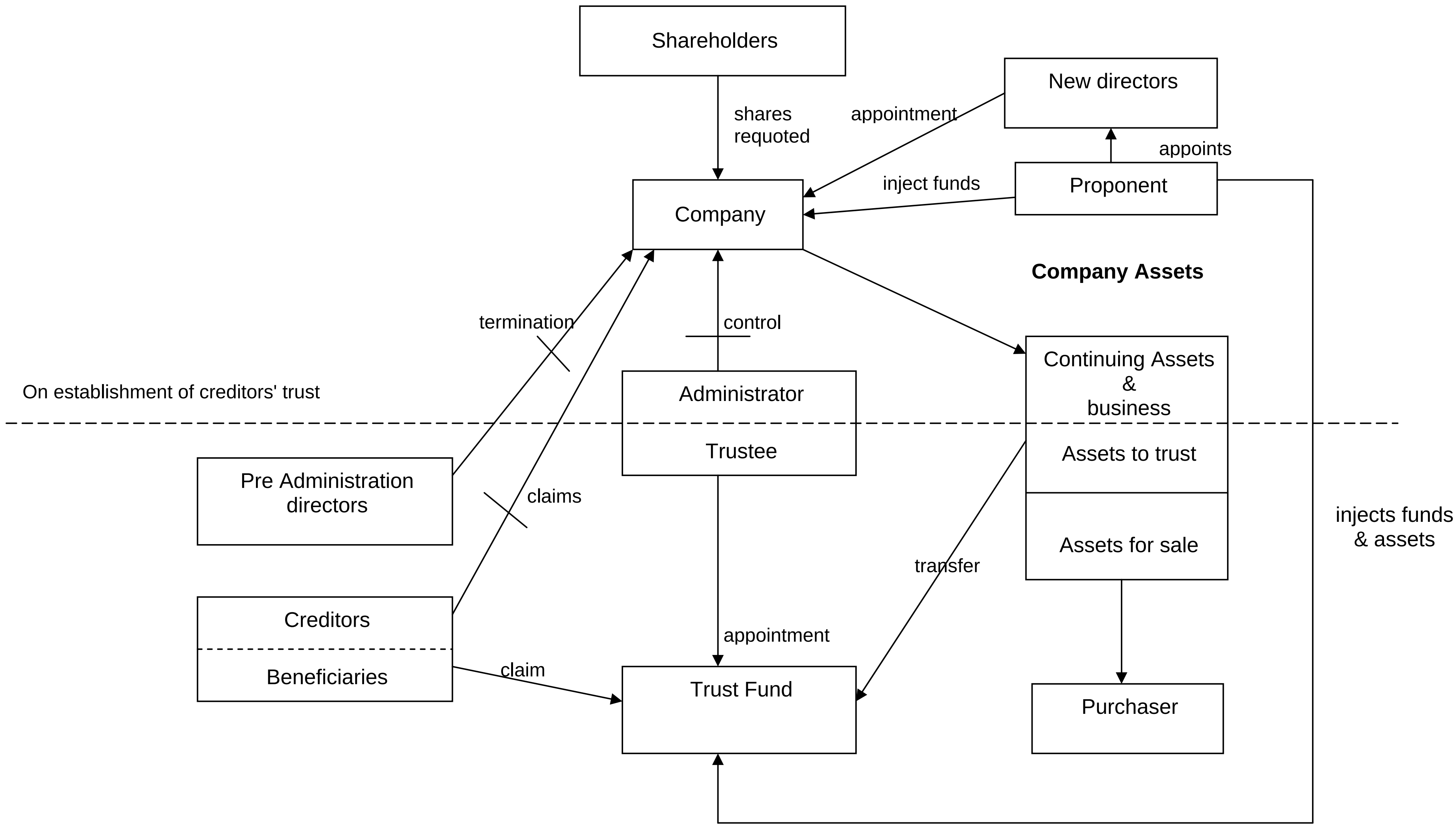
Usually a holding DOCA provides for a committee of creditors to be appointed. The committee assists the administrator in inviting and assessing proposals and acts as a sounding board. The administrator usually retains all powers and discretions to make necessary decisions and merely takes advice from the committee.

7. Creditors' trust deed

With a listed company, once reconstruction is decided upon, speed in freeing a company of its creditors is essential to preserve the listing. In about 1998 a reconstruction of a public listed company under Part 5.3A of the Corporations Act utilised a creditors' trust deed for the first time. This was done to speed up part of the process so the listing was not lost. Assets for distribution to the creditors are transferred to the trust. Creditors' claims could be left to be dealt with under the trust, the DOCA terminated and the company, being freed of its liabilities, was then able to have its shares reinstated for quotation on the Australian Stock Exchange ("ASX"). The creditors' trust was an innovative addition to the voluntary administration regime and holding DOCA, which enhanced the prospects of the Principal Object being fulfilled. It not only ensured the achievement of the primary objective of continuing the existence of the company and its business (or part of them), but also the secondary one of maximising the return to creditors and members. A DOCA in combination with a creditors' trust can be diagrammatically represented as follows:

CLAYTON UTZ

PPB



Legal\80807423.1

8. Administrators' Report outlining DOCA and creditors' trust deed

Usually the decision to utilise a creditors' trust is made prior to the provision of the section 439A report to creditors and the second meeting of creditors or, if there is a variation to an existing DOCA, the section 445F report. The explanation of the proposal to creditors in the administrators' report should prescribe the procedure for and details of the creditors' trust and its implementation and operation, as part of the DOCA to be approved by a requisite majority of creditors.

ASIC is currently scrutinising these reports thoroughly, so it is essential that they be succinct but comprehensive in describing the arrangement.

9. Timing of creditors' trust deed and DOCA termination

A creditors' trust deed may be used in conjunction with a DOCA essentially to allow for the adjudication of creditors' claims and payment of dividends to occur after the company has been reconstructed. The company can enjoy the benefits of early release from the DOCA, and this allows the shares of the company to be reinstated for quotation on the ASX.

Under the creditors’ trust deed the DOCA administrator usually becomes the trustee of the trust. The creditors' trust usually comes into effect on the satisfaction of the conditions specified in the DOCA, immediately triggering the termination of the DOCA. In some instances the creditors' trust is established before the DOCA terminates and for a period they co-exist. The disadvantage with this latter structure is that if the DOCA and creditors' trust fall over the trust must be wound up and assets dealt with in some other way. The advantage is that assets can be transferred to the trust more conveniently and expeditiously before the DOCA is terminated. Timing of the satisfaction of the conditions, termination of the DOCA and commencement of the creditors' trust is often quite complex.

10. Creditors' Trust Assets and Claims

Where a creditors' trust is used, creditors' claims in the DOCA become claims in the creditors' trust. Similarly the specific assets available for distribution to creditors, details of which are usually set out in the final DOCA, are transferred to the creditors' trust for distribution to the creditors, who in turn become beneficiaries of the trust.

11. Benefits of creditors trust

The benefits of the company entering into a Creditors' Trust in a reconstruction are often significant as the trust provides:

(a) an early release from deed administration;

(b) a release from the requirement of section 450E(2) of the *Corporations Act* which prescribes that the company must, until a deed of company arrangement terminates, set out in every public document of the company, after the company's name where it first appears, the expression "(subject to deed of company arrangement)";

(c) a mechanism for the adjudication of creditors' proofs of debt in substitution for the DOCA regime, by which any disputes about those proofs can be dealt with without delaying the termination of the DOCA;

(d) the company with the ability to emerge quickly from the DOCA free of debt;

(e) for re-quotation of the company's shares on the ASX quite expeditiously;

(f) the company with the ability to undertake an equity raising and reorganisation of its share capital and continue with some or all of its ordinary business activities;

(g) greater impetus for investors to contribute funds, as investors are mostly unwilling to contribute funds unless the company emerges from DOCA swiftly.

12. Contents of DOCA with creditors' trust

A DOCA proposal for the implementation of the creditors' trust deed is likely to include:

(a) provisions dealing with the matters required by section 444A(4) of the *Corporations Act* to be specified in every DOCA;

(b) the usual, additional DOCA provisions such as the date it takes effect, limitation of the Administrators' liabilities, indemnities, liens, remuneration, reports, meetings, proving claims, adjudication, distribution, committee of creditors and termination;

(c) timing of the execution of the creditors' trust deed and termination of the DOCA, which will often, but not always, occur contemporaneously;

(d) the DOCA administrators acting as trustees of the creditors' trust;

(e) the details of the creditors' trust and how it will operate;

(f) payment of certain monies or transfer of assets by a certain date to the deed administrator by the scheme proponents, the directors or the company, to be held in the creditors' trust;

(g) reconstruction of the share capital of the company to occur in a manner and at the time approved by shareholders; and

(h) the mechanism for the DOCA administrators to transfer the monies and other property to the creditors' trust.

13. Creditors' trust deed contents

A creditors' trust deed usually includes clauses which detail the following:

(a) the declaration of trust and name of the trust;

(b) the trustee;

(c) the powers of the trustee;

(d) the trust fund and the assets comprising the trust fund;

(e) the beneficiaries of the trust fund, being the creditors;

(f) a perpetuity period;

(g) the methodology of determining the proving and adjudication of creditors' claims including the incorporation of equivalent provisions to those of the *Corporations Act* and *Corporations Regulations* with changes necessary to reflect the trusteeship;

(h) the method and priorities for the distribution of the trust fund.

(i) provision for meetings of creditors and if necessary a committee of creditors;

(j) an indemnity and lien for the trustee;

(k) the remuneration of the trustee;

(l) limitation of the liability of the trustee;

(m) resignation of the trustee;

(n) termination of the trust;

(o) variation of the creditors trust.

Effectively the provisions should set out a contractual trust regime which reflects the Corporations Act regime applicable to DOCAs as closely as possible. The powers of the trustee should be drafted very widely and should seek to extend the trustee's powers which may otherwise be limited or not covered by relevant state trustee legislation.

14. Contractual nature of creditors' trust deeds

It should be reiterated that provisions imported into the creditors' trust deed from the *Corporations Act* or *Corporations Regulations* will not have statutory effect as under a DOCA, and therefore cannot be enforced in the same way by the courts. The provisions do however apply as between the parties to the contract, in this case the trust deed. The creditor beneficiaries to the creditors' trust deed are forced to become parties to the trust by virtue of the statutory effect of the DOCA pursuant to the creditors' resolution which binds all of them, even those who voted against it. A different statutory regime applies to trustees. Any application to the Court pursuant to the creditors' trust deed will need to be brought under the relevant State or Territory's *Trustees Act*[1] rather than the *Corporations Act*, which is now Federal legislation.

15. Efficacy of Creditors' Trusts

The courts have decided only a few cases concerning creditors' trust deeds. These cases do however give some comfort as to the efficacy of creditors' trust deeds.

The Western Australian Supreme Court in *Re Trustees Act 1962; Francis (As Trustee Of The West Australian Shed Commercial Pty Ltd Creditors Trust Deed and West Australian Shed Co Pty Ltd Creditors Trust Deed)*[2003] WASC 39 (6 February 2003) was asked to consider a variation to the proposal. In doing so the Judge obviously had to consider the Creditors' Trust Deed mechanism. There was no power in the trust deed in that case for the trustee to vary the trust deed. Under the DOCA and Trust Deed the Company was to pay to the trustee half of the Company's net profits for 2 years. The variation proposed to the Trust Deed was to pay a slightly lower sum than was estimated in the DOCA, but the payment would be approximately the same if the time preference for immediate money was taken into account. Slightly more than 90% of the creditors (now trust beneficiaries) voted in favour of the variation. About 9% voted against it and the balance could not be contacted. The Judge ordered the variation on the basis that the transaction would be in the best interests of the beneficiaries. It should be noted that section 89(1) of the WA Trustees Act which gave the Judge power to make the order, is wider than the power in other Trustees Acts such as section 81 of the *Trustee Act 1925* (NSW).

In *Re Open Telecommunications Ltd (Subject To Deed of Company Arrangement)* [2003] NSWSC 1198 (3 December 2003) Hamilton J gave directions under section 447A of the Corporations Act that the

---

[1] Trustee Act 1925 (ACT); Trustee Act (NT); Trustee Act 1925 (NSW); Trusts Act 1973 (Qld); Trustee Act 1936 (SA); Trustee Act 1898 (Tas); Trustee Act 1958 (Vic); Trustees Act 1962 (WA)

administrator was justified in executing and giving effect to a varied DOCA and a creditors' trust deed which was proposed. Again he considered the creditors' trust mechanism. He gave his directions on the basis that the arrangement must be approved by the creditors to be implemented, and after a thorough analysis and consideration of the arrangement.

At present there is a case before the Supreme Court of Western Australia where the plaintiff creditor bank has appealed the rejection of the bank's proof of debt by the trustees of a creditors' trust. The application has been made under section 94 of the *Trustees Act 1962* (WA) and alternatively under section 1321 of the *Corporations Act* and regulation 5.6.54 of the *Corporations Regulations.* The Court is yet to hear and determine the matter which should shed light on the relevant issues in this emerging area..

16. Who should act as trustee of the creditors' trust?

Usually the administrator of the DOCA becomes the trustee of the creditors' trust deed. This allows for continuity in the processing of creditors' (beneficiaries) claims, and reduces costs. However, there appears to be nothing precluding the appointment of an independent third party as the trustee. The trustee need not be a registered liquidator. There has been at least one example where a corporate entity operated by the insolvency practitioner acted as DOCA administrator.

17. Corporations Act and Trustees Legislation

Whilst detractors of creditors' trusts may argue that the *Corporations Act* 2001 and *Corporations Regulations* prescribe the appropriate regime pursuant to which the administration of a company should be governed and the use of creditors' trust deeds attempts to circumvent that regime, each State and Territory of Australia has legislation governing the operation of trusts. It is useful to consider the provisions of the *Trustees Act 1962* (WA) and similar State and Territory legislation and some of the issues that may arise by reason of the use of Creditors Trust Deeds.

18. Duties and powers of Trustee imported from the Corporations Act

A creditors' trust deed usually imports the proof of debt and ranking of claim provisions of the *Corporations Act* and *Corporations Regulations* to provide an appropriate mechanism for dealing with these issues. The relevant provisions are Subdivisions A, B, C, D and E of Division 6 of Part 5.6 of the Act commencing at section 553 , and 5.6.37, and 5.6.39 to 5.6.72 inclusive, of the Regulations, with sufficient modification so that the references to liquidator are references to the trustee and references to winding-up are references to the creditors' trust deed. References to the Court are also varied so they apply to a court with jurisdiction under the Trustees Act rather than the Corporations Act. As mentioned before, those provisions imported into the creditors' trust deed from the *Corporations Act* or *Corporations Regulations* apply as between the parties to a contract and do not have the force of the *Corporations Act*.

However, in addition, there is also a statutory regime which applies to trustees under the various State Trustee Acts which provide powers which a trustee can rely on. A trustee also has certain duties imposed, some of which are discussed below.

19. Scope of trustees' duties under the Trustees Act

19.1 Fiduciary duty

Section 18 of the *Trustees Act* (WA) imposes a duty on trustees, subject to the instrument creating the trust, which requires the trustee, in exercising a power of investment, if the trustee's profession includes acting as trustee or investing money on behalf of other persons, to exercise the care, diligence and skill that a prudent person engaged in that profession would exercise in managing the affairs of other persons, and if it is not in the trustee's profession, to exercise the skill a prudent person would exercise in managing the affairs of other persons.[2] In any event a trustee owes a fiduciary duty to the beneficiaries.

Likewise, pursuant to section 437B of the *Corporations Act*, a deed administrator is deemed the agent of the company. An agent generally owes fiduciary duties to its principal. There would seem to be a similar duty owed by a trustee pursuant to a creditors' trust deed.

In *Wood v Laser Holdings Ltd* (1995) 19 ACSR 245 at 266 it was not denied that an administrator of a company is in the position of a fiduciary in relation to the creditors. It is clear that the proper performance by him of his various duties under section 438A and section 439A is fundamental to satisfaction of the requirements of the process leading to the execution of a DOCA.

However, in the case of *Re NC Re Capital Limited* (1999) 32 ACSR 418 it was held that until such time as winding-up begins, or is imminent, the voluntary administrator of a company is simply bound by the same general law obligation as would bind its displaced board, to a company which faces a prospect of insolvency. This duty is to act in the interests of the company, and not to act contrary to the interests of the creditors as a whole.

These cases concern the position of the administrator of a company, not the deed administrator of a DOCA. It appears the safer view is for an administrator to act on the basis that a fiduciary duty is owed to the creditors, which is similar to the position of a trustee to the beneficiaries of the trust. The latter may have more extensive fiduciary obligations to creditors (all of whom are bound by a DOCA) than the former.

19.2 Replacement of trustee of creditors trust deed

Sections 7 and 77 of the *Trustees Act* (WA) provide for the appointment of new trustees. Section 7 empowers the surviving or continuing trustee or trustees or the personal representatives of the last surviving or continuing trustee to appoint a person or persons to be a trustee or trustees in place of the trustee in need of replacement.[3] Section 77 of the *Trustees Act* (WA) provides the court with the power to appoint new trustees.[4]

19.3 Right of indemnification and remuneration of trustee of creditors trust deed

Section 19(2) of the *Trustees Act* provides that any rules and principles of law or equity that relate to a provision in an instrument creating a trust that purports to exempt, limit the liability of, or indemnify a trustee in respect of a breach of trust, continue to apply.[5] This preserves the general law in relation to such provisions.

Pursuant to section 71 of the *Trustees Act 1962* (WA) a trustee is entitled to reimbursement out of trust property for all expenses reasonably incurred in execution of the trust's powers.[6] Subsection 98(5) of the *Trustees Act 1962* (WA) provides that, in the absence of anything to the contrary in the trust instrument, a trustee who is engaged in a profession or business and for whom no benefit or remuneration is provided for in the instrument, is entitled to charge and be paid from the trust property all usual professional or business charges for business done, time expended and acts done by him and his firm in connection with the trust. In any case, subsection 98(1) provides the Court with the power to award remuneration out of the trust property up to a maximum of 5% of the gross value of the trust property, but taking into account payments made under subsection 98(5).

Pursuant to section 449E, a deed administrator is entitled to apply to the court where no remuneration is fixed by a resolution of creditors, and to apply to the Court to review the remuneration so fixed and confirm, increase or reduce it. If no remuneration is fixed, the administrator may also apply to the Court to fix it.

---

[2] ACT - section 14(a); NT section 6: NSW - section 14(a); Qld - section 22; SA - section 7; Tas - section 7; Vic - section 6.

[3] ACT - section 6; NT - section 11; NSW - section 6; Qld - section 12; SA - section 14; Tas - section 13; Vic - section 41.

[4] NT - section 27; NSW - section 70; Qld - section 80; SA - section 36; Tas - section 32; Vic - section 48.

[5] ACT - section 14(b); NT - section 7; NSW - section 14(b; Qld - Trusts Act section 23; SA - section 8; Tas - section 9; Vic - section 7.

19.4 Rights of beneficiaries - Procedure to review administrators' acts

Pursuant to section 94 of the *Trustees Act 1962* (WA), any person who has, directly or indirectly, an interest whether vested or contingent in any trust property and who is aggrieved by an act, omission or decision of a trustee may apply to the Court to review the act, omission or decision, and the Court may require the trustee to appear before it to substantiate and uphold the grounds of his conduct.

Under sections 447A and 447E of the *Corporations Act* the Court has power to make wide orders relating to supervision of the administrator.

20. Implementation Deed

In most cases the administrator of a company will seek proposals from third parties to assist in the reconstruction of the company in a DOCA. This often occurs in conjunction with the company entering a creditors' trust deed. The company through its administrator may enter into an implementation deed with some or all of the DOCA proponents, the directors, secured creditors and any other relevant parties to ensure they are bound to perform all obligations and tasks necessary for the reorganisation to be successfully completed. The terms may include the following:

(a) conditions subsequent and precedent;

(b) specific details of the proponent's funding, which funds are often directed to the creditors' trust fund to provide dividends for creditors and funding for the company and its reconstruction;

(c) a clause regarding obtaining necessary shareholder and ASX approvals (and that parties use reasonable endeavours to effect the re-quotation of the company on the ASX);

(d) the steps necessary to be achieved to complete the reconstruction, such as consolidation of share capital, converting debt to equity and private placements;

(e) the allocation of the task of preparation of meeting materials and arrangements for calling the meetings;

(f) release by the secured creditors of their securities over assets required to transfer the trust assets to the trust;

---

[6] ACT - section 59(4); NT - section 26; NSW - section 59(4); Qld - section 72; SA - section 35(2); Tas - section 27(2); Vic - section 36(2).

(g) a clause regarding the appointment of the directors that the proponent selects for appointment to the company, the removal of existing directors and the timing for this to occur;

(h) a clause regarding delegation of the administrator's powers to the proponent's directors to undertake specific tasks such as preparing documents for scheduling of and holding of meetings of shareholders;

(i) a clause regarding completion, including the timing and details of payments and transfers to the trust fund after satisfaction or waiver of any conditions precedent;

(j) a clause about the termination of the DOCA and commencement of the Creditors' trust and their timing;

(k) a costs clause establishing who will pay for what;

(l) an indemnity for the administrator;

(m) a clause providing limited warranties by the administrator; and

(n) a clause dealing with the position of employees.

21. Resolutions for reconstruction of company

Once it is determined to reconstruct the company, a notice of meeting and explanatory memorandum must be prepared and sent to shareholders, usually by the proponents, convening a shareholders' meeting and proposing ordinary resolutions which often deal with some or all of the following:

(a) consolidation of capital of existing shareholders pursuant to section 254H of the Corporations Act;

(b) reduction of capital of the company pursuant to section 256C and 258F of the Corporations Act;

(c) issue of new shares in accordance with ASX Listing Rule 10.11 and if necessary sections 208 and 611 item 7 of the Corporations Act;

(d) issue of a prospectus in accordance with ASX Listing Rules 7.1 and, if necessary, section 611 item 7 of the Corporations Act;

(e) approval for proposed directors to apply under the prospectus for an issue of shares in accordance with ASX Listing Rule 10.11 and section 208(1) of the Corporations Act;

(f) appointing proposed directors as directors of the company;

(g) change of company name; and

(h) the adoption of a new constitution for the purposes of section 136 of the Act.

22. ASX Listing Rule requirements

22.1 Meeting ASX's profit test or assets test

ASX listing rules 11.1 to 11. 3 will usually apply when an entity significantly changes the scale or nature of its activities or its main undertaking. In particular listing rule 11.1.3 provides:

> "*If ASX requires, the entity must meet the requirements in chapters 1 and 2 as if the entity were applying for admission to the official list.*"

One purpose of ASX listing rule 11.1 is to ensure that ASX's admission requirements are not circumvented by the use of an existing listed entity. listing rule 11.1.3 ensures that a listed entity again meets the admission requirements if the proposed change to its activities could otherwise have taken the form of a new listing.

Compliance with the admission requirements involves (among other things) the following:

(a) issuing a prospectus;

(b) meeting the spread requirement (listing rule 1.1 condition 7), that is, either:

(i) at least 500 holders each with a parcel of the main class of securities with a value of at least $2,000; or

(ii) 400 holders with a parcel of securities with a value of at least A$2,000, and persons who are not related parties must hold at least 25% of securities to be quoted.

A prospectus may be required not only to satisfy listing rule 1.1 condition 3, but to attract new investors to satisfy the spread requirement.

(c) meeting ASX's profit test or assets test (listing rule 1.1 condition 8);

(d) having the entity's quoted securities (except options) issued or sold for at least 20 cents in cash (listing rule 2.1 condition 2); and

(e) having the entity's options exercisable for at least 20 cents in cash (listing rule 1.1 condition 11).

Generally, ASX requires compliance with the admission requirements if it thinks that the proposed change is such that the entity will, in essence, be a different entity after the change, although ASX may require compliance in other circumstances as well.

22.2 Profit test

The profit test is set out in ASX listing rule 1.2 and will generally not apply in the situation of a company being reconstructed under a DOCA. If the company had been trading profitably there would have been no need for the appointment of administrators.

ASX listing rule 1.2.4 requires:

> "The entity's aggregated profit from continuing operations for the last 3 full financial years must have been at least $1 million."

ASX listing rule 1.2.5 requires:

> "The entity's consolidated profit from continuing operations for the 12 months to a date no more than 2 months before the date the entity applied for admission must exceed $400,000. "

22.3 Assets test

The requirements to meet the assets test is found in ASX listing rule 1.3 and provides that to meet the assets test, an entity must satisfy rules 1.3.1, 1.3.2 and 1.3.3.

ASX listing rule 1.3.1 provides:

> "At the time of admission, the entity must have net tangible assets of at least $2 million after deducting the costs of fund raising, or a market capitalisation of at least $10 million".

ASX listing rule 1.3.2 provides:

> "Either:
>
> (i) less than half of the entity's total tangible assets (after raising any funds) must be cash or in a form readily convertible to cash; or
>
> (ii) half or more of the entity's total tangible assets (after raising any funds) are cash or in a form readily convertible to cash, and the entity has commitments consistent with its business objectives to spend at least half of its cash and assets in a form readily convertible to cash. The business objectives must be clearly stated and include an expenditure program. If the prospectus, Product Disclosure Statement or information memorandum does not contain a statement of the business objectives, the entity must give a statement of its business objectives to ASX".

ASX listing rule 1.3.3 provides:

"The entity must satisfy each of the following:

(i) If its prospectus, Product Disclosure Statement or information memorandum does not contain a statement that the entity has enough working capital to carry out its stated objectives, the entity must give ASX one from an independent expert.

(ii) The entity's working capital must be at least $1.5 million, or if it is not, it would be at least $1.5 million if the entity's budgeted revenue for the first full financial year that ends after listing was included in the working capital. For mining exploration entities, the amount must be available after allowing for the first full financial year's budgeted administration costs and the cost of acquiring plant, equipment and mining tenements. The cost of acquiring mining tenements includes the cost of acquiring and exercising an option over them".

22.4 ASX guidance note 12

ASX guidance note 12 provides:

"*Moribund entities*

29. If an entity has disposed of its main undertaking and has either no activities or only residual activities, any proposal for it to undertake a new activity is a change of activities to which listing rule 11.1.3 will be applied.

30. A change in activities may be associated with a change of control of the entity. However, change of control is not a pre-requisite to the application of listing rule 11.1.3. Even where there is no change in control, the entity may, in essence, be a different entity after the change.

Transaction - based comparisons

31. Among other things, ASX uses transaction-based comparisons to decide what requirements an entity contemplating a change to its activities must meet under the listing rules. The comparisons are:

- Total consolidated assets as a result of the transaction by the entity or its child entity compared to total assets in the entity's latest audited, consolidated financial statements.
- Total equity interests as a result of the transaction by the entity or its child entity compared to total equity interests in the entity's latest audited, consolidated financial statements.
- The number of securities issued by the entity as a result of the transaction compared to the number on issue before the transaction.

- The projected annual profit (before tax and extraordinary items) of the entity (or group) after the transaction compared to the annual profit in the entity's (or group's) latest audited, consolidated financial statements.

- The projected annual revenue of the entity (or group) after the transaction compared to the annual revenue in the entity's (or group's) latest audited, consolidated financial statements.

- The projected exploration expenditure of the entity (or group) for its next reporting period after the transaction compared to the aggregated exploration expenditure over the pervious period".

As a rule of thumb, although it is not expressed in ASX guidance note 12, typically ASX has considered that if one or more of the matters in transaction-based comparisons changes by 100% or more, then ASX may apply listing rule 11.1 to the transaction. In these circumstances companies are encouraged to consult with ASX privately before implementing the transaction, in order to determine whether or not listing rule 11.1 may be applied and if so how it will be applied.

22.5 Continuity of business test

Our experience has indicated that the ASX in Perth will consider allowing a listed company to be reconstructed without recourse to listing rule 11.1.3 in situations where a meaningful business proposition for the company is put to ASX. The proposal will require a reasonably significant part of the business to be continued, and the proponents of a reorganisation must be prepared to commit capital of $1.5 to $2 million to develop the remaining business and assets over a relatively short period of say 2 years. Examples of assets retained in a company which ASX has allowed to be reconstructed are patents and tenements which have reasonable prospects and which are worthy of developing. ASX must be convinced that the company should be able to survive, be worthy of having money invested in it, have reasonably worthwhile assets and business and have potential to earn reasonable income. In order to convince ASX it is usually important to submit a budget and business plan for the company to ASX. It is essential to liaise closely with ASX to ensure it approves the Company's plans so the shares can ultimately be requoted.

Often a reconstructed company will branch out later into other businesses, often by acquisition, in addition to continuing the residual business.

23. Employees in reconstruction

One of the major issues facing an administrator of a listed company is how to deal with the employees. Sometimes employees are terminated by an administrator on commencement of voluntary administration. In many instances the employment of a number of employees is continued by the administrator.

23.1 Continuing employees

When considering any proposed restructure, an administrator should pay out continuing employee entitlements or ensure they are preserved where the reconstructed company trades on. Not only is this a prudent, socially responsible course of action, but it may avoid protracted disputes and bad publicity later. The law as to whether an administrator may be liable for pre-administration employee entitlements is not yet settled. Basic principles seem to indicate that it is unlikely that an administrator would be held liable in these circumstances. It is, however, better to be cautious and safeguard the employees' position to the maximum extent possible.

Whilst it is usually the case that the appointment of an administrator does not of itself terminate a contract of employment, pursuant to section 443A an administrator is personally liable for post-administration debts incurred for services rendered (and also goods supplied and property hired, leased, used or occupied) and is also responsible for liabilities the administrator adopts. Except to this extent, the administrator is not liable for the company's debts. We do not consider an administrator causes the company to incur a debt for pre-administration services. This happens when the employee is employed, or at least when the employee performs the pre-administration services. The administrator should however be careful not to adopt an employment contract in a way that also adopts the company's debt for pre-administration services, or builds the pre-administration debt into the post-administration remuneration.

Pursuant to section 437B an administrator is also deemed the agent of the company. We do not consider that this advances the case against the administrator, as a disclosed agent is not usually liable for the debts of its principal. On that basis, we consider administrators should not be held personally liable for the wages of pre-administration employees retained after their appointment, unless the employment contract is renegotiated, novated or adopted by the administrator. However, as there is a lack of settled case law on this point, it is constructive to consider receivership cases which are based on principles like those relating to incurring of debt and agency which are similar to those applicable to administration.

In the case of *Whitton v ACN 003 266 886 Pty Ltd (in liq)* (1996) 42 NSWLR 123, Bryson J considered the liability of a receiver for the long service leave and redundancy claims of a pre-receivership employee which arose during the receivership. Section 419 of the *Corporations Act*, which is similar to section 443A, provides that a receiver is "liable for debts incurred". Bryson J held that the liability to pay employee entitlements was incurred at the time the contract was executed and not incurred by the receiver upon their appointment.

The decision of *Whitton v ACN 003 266 886* was subsequently considered by Finkelstein J in *McEvoy v Incat Tasmania Pty Ltd* [2003] FCA 810. This case concerned the liability of a receiver for annual leave, long service leave and retrenchment entitlements of employees. In deciding the case, his Honour stated:

> "*Staff are kept on and are often unaffected by the receivership. In those cases, a construction which places employees of a company in receivership on the same footing as employees of a company which has been wound up will operate in a discriminatory fashion, as the former employees will both keep their jobs and be paid out as though they had lost them.*"

Given the similarity of the relevant sections and the agency relationship of both a receiver and an administrator, it is submitted that these decisions apply equally to an administrator's liability for employees' entitlements.

Whilst an administrator is unlikely to be liable for pre-administration employee entitlements, the DOCA and creditor's trust deed should be structured so that the pre-administration claims of continuing employees, if they are not paid out, are not extinguished by operation of the DOCA and creditors' trust deed. As a matter of prudence, it is suggested that the continuing employees be excluded from the DOCA to preserve their pre-administration entitlements in the post-restructure entity, so that their claims for entitlements are preserved on a priority basis, thereby limiting any claim against the administrator should the post-restructure company fail. The position adopted in respect of the continuing employees should be made very clear to them in the administrators' report, at the meeting and in the creditors' resolutions.

23.2 Transferring employees to a different group entity

Sometimes when an administrator proposes a restructure of a company or group of companies, employees may be moved from one company to another as part of the restructure. The decision of Merkel J in *McCluskey v Karagiozis* [2002] FCA 1137 is particularly instructive regarding the transfer of an employee's employment to another employer.

Administrators were appointed to the Coogee Group of companies and subsequently a restructure of those companies was proposed. The matter which came before the Court was the purported transfer of the employment of approximately 240 employees employed by the pre-restructure employer in the Coogee Group to the proposed post re-structure employer in the Coogee Group. However, the post re-structure companies had no assets of substance and were unable to pay the transferred employees their employee entitlements, which exceeded $2,500,000. It was revealed in evidence that the transferred employees were not informed about the proposal to transfer their employment nor was their assent to the transfer sought or obtained. In relation to this finding of fact, his Honour stated:

> "*The law is clear. As was stated by Lord Atkin in Nokes v Doncaster Amalgamated Collieries Ltd [1940] AC 1014 at 1026, there is no power in an employer:*

> *... to transfer a man without his knowledge and possibly against his will from the service of one person to the service of another. I had fancied that engrained in the personal status of a citizen under our laws was the right to chose for himself whom he would serve: and that right of choice constituted the main difference between a servant and a serf.*"

Viscount Simon LC stated at 1020 that it was a fundamental principle of the common law that:

> *"... a free citizen, in the exercise of his freedom, is entitled to choose the employer whom he promises to serve, so that the right to his services cannot be transferred from one employer to another without his assent."*

The corollary of His Honour's findings of fact was that:

> "*... in so far as their contractual relationship with their employer was concerned, their employment with their pre-restructure employer did not cease and their employment with their post-restructure employer did not commence. Accordingly, subject to certain exceptions, it is appropriate to make orders giving effect to that conclusion*".

Administrators must therefore seek the consent of employees if they propose to effect a transfer of an employee's employment from one company to another in a reconstruction.

23.3 Employment contracts with redundancy provisions and GEERS

Pursuant to the General Employee Entitlements and Redundancy Scheme (GEERS) the Commonwealth Government pays employees their employee entitlements to the prescribed scheme limits pursuant to the scheme where there was a redundancy provision incorporated into the employee's employment contract. Payments are made by an advance from GEERS to the relevant insolvency practitioner, for the benefit of the claimants. The Commonwealth Government seeks to recover these advances from the company in the event that distribution of assets or other proceedings provide the opportunity to recover those funds.

Usually, the Commonwealth Government relies on the priority provided by section 560 of the *Corporations Act 2001* in an attempt to secure payment of advances paid under GEERS should there be sufficient funds in the administration, with moneys normally recovered from the insolvency practitioner as funds become available. GEERS payments are made on the basis that:

> "*in the event of liquidation, the Commonwealth would be a priority creditor under section 560 of the Corporations Act 2001 to the extent of the amount that it has advanced;*
>
> *if a Deed of Company Arrangement is proposed and the creditors vote for a deed rather than for the company to be wound up, the deed would include the priorities of subsection 556(1) of the Corporations Act 2001 in relation to the entitlements to be paid to employees. Further, in relation to its advances for payments of employee entitlements, the Commonwealth would require that any deed that is presented to the creditors for their consideration, provide for the same priority as the Commonwealth would receive under section 560 of the Corporations Act 2001 in relation to such an advance under a winding up; and*
>
> *if at the end of the administration the company is restored to the directors (other than pursuant to a Deed of Company Arrangement) and continues to trade, the loan which the*

Commonwealth has advanced would be repaid within 4 weeks of the end of the administration."

Practitioners have often included a clause similar to the following as a possible means of ensuring that these requirements are provided for in the Deed of Company Arrangement:

"Any payment made by the Commonwealth in respect of amounts that would ordinarily be payable under this Deed to employees of the Company by way of employee entitlements shall be payable to the Commonwealth in accordance with section 560 of the Corporations Act as if the references to the liquidator were references to the Administrators, references to winding up were references to this Deed and with such other modifications as are necessary to give effect to this Deed."

Whilst the Commonwealth Government pursuant to the GEERS scheme seeks to invoke the provisions of section 560 of the Corporations Act as mentioned above, those sections of the Act imported into a DOCA or creditors' trust deed will not have the force of statute but operate as between the parties as a contract. Therefore, while the Commonwealth Government may seek to invoke the priority afforded to it in a winding-up it seems that the priority does not apply in the case of terminated employees where the company proceeds into a DOCA or creditors' trust deed unless the creditors so resolve. The Government would have to apply to the court to set aside the deed if the creditors resolved that the company enter into a DOCA without the required provision. The result of the Court application would be uncertain.

Further, whilst the Commonwealth Government pursuant to GEERS states that payments under the scheme will only be made on certain conditions (detailed above), it is submitted that those conditions do not have the force of statute as they are not prescribed by legislation and as such are merely a directive from the relevant Government Department.

24. Conflicts between Creditors and Shareholders

An interesting question that can arise in the reconstruction of a public listed company is the extent to which shareholders should have a right of veto over the process.

24.1 Brash's case

In the *Brash's* case[7], the relevant question was whether the administrators of a public company could dispose of its assets and undertaking without the consent of shareholders. Beach J, having considered section 437A(1)(c) of the Act held that:

"in my opinion, … the Administrators have the power to dispose of the business and property of the Company without convening a general meeting of members of the Company".

[7] *Brash Holdings Ltd & others v Shafir 14 ACSR 192 at 195.*

24.2 Pasminco case

In the Pasminco application before the Takeovers Panel[8], the relevant question was whether the administrators could issue 99% of the issued shares of the Company to creditors, in settlement of their debts, without shareholder approval.

No doubt concerned that shareholders would try to drive a hard bargain in exchange for their consent, the administrator applied to ASIC for exemption from the takeover provisions of the *Corporations Act*, on the ground that the shareholders' interests were worthless, the company being insolvent.

When ASIC refused to grant the exemption requested, the administrator applied to the Takeovers Panel. The Panel was prepared to grant an exemption on the grounds that, when a company is insolvent, it would be anomalous for shareholders to have a right of veto of a transaction that would benefit creditors.

24.3 Canadian Joint Task Force

The same conclusion was reached by a Canadian Joint Task Force. When considering the relative rights of creditors and members in an insolvent company, the Task Force decided that a law providing a right of veto to shareholders in those circumstances would inappropriately "give them significant leverage, which translates into an opportunity to extract hostage payments in return for their approval".

24.4 Kaefer case

In the Kaefer Technologies No.2 application before the Takeovers Panel 2004, shareholders applied for an order that the sale of the company's business to its majority shareholder should be subject to the approval of shareholders, other than the majority shareholder, and that no such sale should be implemented until such approval had been given.

Shortly before the appointment of Jeff Herbert and Cliff Rocke of PPB as administrators, the company had failed to win support from 75% of the minority shareholders for a buy back offer of 3 cents a share that, if accepted, would have left the majority shareholder with 100% of the issued share capital.

In support of their application, the minority shareholders argued that sale to the majority shareholder without shareholder approval would contravene ASX listing rule 10.1 and section 208(1) of the *Corporations Act* dealing with related party transactions.

---

[8] Takeovers Panel 05/02 Pasminco

Having examined submissions from the dissenting shareholders, the administrator and the majority shareholder, the Takeovers Panel declined to commence proceedings on the grounds that it had no evidence of the "unacceptable circumstances" alleged by the applicants.

This, however, left unanswered the question of whether the administrator was bound by the provisions of the ASX listing rules to seek shareholder approval to the sale.

This issue was resolved by the ASX granting a waiver from the requirement under the ASX listing rules, which was applied for on the grounds that:

(a) if a company is in administration, the rights of shareholders are subordinated to the rights of creditors'; and

(b) in those circumstances, shareholders do not have and should not be granted rights which, if exercised, could prevent or overturn a transaction which is in the best interests of creditors.

25. Value of creditors' trusts in reorganisations

Between 1998 and September 2004, approximately 103 ASX listed companies have gone into administration. 32 of these have been successfully relisted, 34 are still subject to the process and 37 have been delisted. To our knowledge 20 relisted companies, 10 companies still subject to the process and 3 delisted companies have utilised creditors' trusts. A number of the reorganised companies have been successful. These figures indicate that the use of creditors' trusts has been very beneficial in assisting listed companies to achieve the Principal Object of Part 5.3A of the *Corporations Ac*t.