HEARSAY
The legal podcast

Episode 9: Summary

Episode name: The Voluntary Administration Regime
Guest(s): Jason Harris

What area(s) of law does this episode consider?

This episode centres around Jason's PhD research which focuses on the effectiveness of the voluntary administration (VA) regime set out in Part 5.3A of the *Corporations Act 2001* (Cth).

Why is this topic relevant?

As at 30 June 2019, the Australian Bureau of Statistics reports that there were 2,375,753 actively trading businesses in Australia. The success and future of these businesses are not guaranteed. The COVID-19 pandemic is a threat to many businesses as is evident by the recent appointment of voluntary administrators to Virgin Australia, TM Lewin, Seafolly, LJ Hooker and the Sydney arts centre Carriageworks.

One of the most common forms of insolvent external administrations for companies, and one path to a business turnaround, is the VA regime. VA is a process where an independent person is appointed to take control of a financially distressed company for a short period of time to consider restructuring options; during this time a statutory moratorium operates to provide the company with breathing spaces to consider its options. Having a high-level understanding of the process and effectiveness of the VA regime is important for all commercial lawyers – particularly at the moment, with predictions of increased corporate and personal insolvencies on the horizon.

What legislation is considered?

Part 5.3A of the *Corporations Act 2001* (Cth)

Chapter 11 United States Bankruptcy Code

A brief overview of Jason's thesis

Jason's PhD research involves a study of 5% of all voluntary administrations from 1993 to 2018 – which is a sample of 2440 companies – to analyse the effectiveness of the regime in achieving the object of Part 5.3A.

The object of Part 5.3A is to provide for the business, property and affairs of an insolvent company to be administered in a way that maximises the chances of the company continuing in existence, or if it is not possible for the company or its business to continue in existence, results in a better return for the company's creditors and members than would result from an immediate winding up of the company.

Jason has completed extensive research which includes conducting interviews with insolvency practitioners and general accountants and ascertaining their views on the different processes available to companies experiencing financial distress, such as the Safe Harbour regime under s 588G introduced in 2017. He also analyses data extrapolated from records maintained by ASIC; in addition to developing a survey for ARITA and CPA members, from which he received 500 responses.

What are the main points or findings Jason discussed?

- **Is the VA regime effective for SMEs?** While the regime is generally considered appropriate for larger businesses, it is not as effective for SMEs. While the VA regime typically lasts 20-25 business days; this timeframe can be increased. For example, the voluntary administration of ABC Learning lasted for 19 months. The

stringent reporting requirements and the sheer cost of the VA process often makes it inaccessible for SMEs who may instead opt for a liquidation process. This could include a creditors' voluntary liquidation, a process which is a fait accompli in the sense that it provides no mechanism to consider any form of a turnaround or compromise with creditors.

- **The cost of the VA regime:** A VA will cost upward of $40k, being a cost that is generally paid in priority before any payment to creditors. This creates a challenge for both insolvency practitioners and directors. For insolvency practitioners, they may be reluctant to accept an appointment and the obligations needed to comply with the VA regime unless they are comfortable their fees will be paid. After all, no one wants to work for free! For directors of businesses, there may not be sufficient assets to cover this cost, so unless the directors are willing to provide an indemnity to the insolvency practitioner for the estimated fees, they may be faced with no other option but to liquidate the company.

- **Comparative analysis**: Jason compares insolvency regimes in the US and UK to that of Australia. Chapter 11 of the Bankruptcy Code in the US enables a company to operate as a "debtor in possession" and maintain its board of directors as well as management throughout the case thereby preserving a continuity of operations. This is a key difference to the Australian VA regime, where the company's directors are deprived of any power during the administration process, which is conducted by an independent insolvency practitioner. In the UK, a company can enter into a company voluntary arrangement (often referred to as a CVA) which is implemented under the supervision of an insolvency practitioner, and similar to the Chapter regime in the US, the existing management remains in place throughout the term of the CVA.

- **The obligation to investigate:** Much of the cost associated with administering a VA relates to the statutory obligation to investigate. A voluntary administrator is expected to investigate the reason(s) why the company is financially distressed, any inappropriate conduct of the directors and also identify where external third parties, such as creditors, have been preferred. Recently, there is an increased focus on identifying phoenix activity during these investigations.[1] These investigations can take up an extensive amount of time and, as a result, increase costs. The purpose of such investigations is to identify potential claims that could be brought by the company/it's voluntary administrators. Even when claims are identified and reported to creditors, often there are insufficient funds to enable the voluntary administrators to pursue such claims. Jason poses a very interesting question: should we be relying on insolvency law, and the VA regime, to address these issues, that is instances of directors breaching their duties and/or engaging in phoenix activity?

- **What about a 'debtor in possession regime?'**: Jason discusses how the introduction of a 'debtor in possession' regime in Australia, where the director(s) remains running the business under the supervision of an administrator, could reduce both costs and risk for the insolvency practitioner. Some insolvency practitioners have expressed doubts about the effectiveness of such a model,

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[1] Phoenixing refers to a practice where a new company is created to continue the business of an existing company that has been deliberately liquidated to avoid paying outstanding debts, including taxes, creditors and employee entitlements. Ordinarily, the liabilities of the existing company are segregated with assets being transferred into the new company. The Economic Impact of Potential Illegal Phoenix Activity Report found that illegal phoenix activity costs employees between $31 and $298 million in unpaid entitlements and costs the government around $1,660 million in unpaid taxes and compliance.

where the flow of information to the administrator depends on the individual director in control.

What are the practical takeaways?

- Broadly speaking, the VA regime is effective when dealing with large-scale corporate insolvencies. Whereas directors of smaller and medium sized companies have to grapple with the cost of the VA process – including potentially giving indemnities to administrators for those costs.
- 10-15,000 companies experience an external administration process each year; 50-60% of these companies show contraventions by directors, whether that be trading whilst insolvent, or failing to maintain books and records, or engaging in transactions intended to defraud creditors. Who should investigate these contraventions, ASIC or insolvency practitioners? Should the VA regime be used to police directors or should it be used to try to turnaround and rescue businesses?
- Insolvency practitioners, once appointed, are somewhat viewed as 'gatekeepers' by ASIC, but Jason proposes that insolvency practitioners focus more on turnaround and business rescue, leaving issues of compliance and misconduct to ASIC and the ATO.
- In terms of reform, Jason suggests that building more flexibility into the system with regard to reporting obligations and the way information is delivered to creditors, could make the regime more cost-effective and practically more useful for creditors. Utilising technology, shortening reports and rethinking engagement with creditors will help to achieve a more accessible system.