

## **UNDERSTANDING THE LEGAL AND COMMERCIAL REALITIES OF VOLUNTARY ADMINISTRATION**

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The introduction of the voluntary administration (VA) scheme into the Companies Act 1993 (the Act) on 1 November this year was one of the most significant developments in corporate insolvency law in New Zealand in the last 15 years. The stated objectives of the VA scheme for an insolvent company, or a company facing insolvency, are twofold:

- (a) to provide an alternative rehabilitative model to maximise the prospects of the company's continuing existence; and
- (b) if rehabilitation is not possible, to provide an alternative to immediate liquidation where it is considered that VA will provide a better return for creditors.

This paper considers the key issues that companies and their advisors must be aware of when deciding whether to take the VA route.

### **Voluntary Administration in a nutshell**

The VA scheme is closely based on the Australian legislative model and is designed to provide a more user-friendly business rehabilitation option for companies. The following are the key features of the VA scheme:

- the administration commences on the appointment of an Administrator, who may be appointed by:
  - the board of directors;
  - a secured creditor who has a charge over all, or substantially all, of the company's property;
  - a liquidator or interim liquidator of the company; or
  - the Court (on application by a creditor or the Registrar of Companies);
- the Administrator controls the business, property, and affairs of the company and the directors' powers are suspended;
- a moratorium is imposed on creditors taking any action against the company, or an owner or lessor of property occupied or used by the company seeking to repossess the property, unless:
  - the creditor, owner, or lessor has commenced enforcement action prior to the administration commencing; or
  - the goods are perishable in nature;
- a secured creditor may not enforce a charge over the company's property (without the Administrator's consent or a Court order) unless the secured creditor holds a charge over all, or substantially all, of the company's property and the creditor takes enforcement action within the first 10 working days of being notified of the appointment of the Administrator;
- a transaction or dealing that affects the company's property is void (without the Administrator's consent or a Court order);
- a person may not commence or continue Court proceedings against the company (without the Administrator's consent);
- shareholders cannot transfer any shares, and rights and liabilities of shareholders cannot be changed (without the Administrator's consent or a Court order);
- a lender may not enforce a guarantee in respect of the company's liabilities given by a director or their spouse or relative (without a Court order);
- the Administrator must investigate the affairs of the company (and has the same powers as a liquidator to request documents and examine people on oath);
- a creditors' meeting must be called shortly after the commencement of the administration at which the Administrator must table an interests statement and the creditors will vote on:
  - whether to appoint a creditors' committee; and
  - whether to replace the Administrator;
- a second creditors' meeting, named the Watershed Meeting, must then be called by the Administrator at which the Administrator is required to provide a report about the company, stating his or her recommendation whether:
  - a deed of company arrangement (DOCA) be entered into, and the details of the proposed DOCA;
  - the administration be terminated; or

- the company be placed into liquidation;
- the creditors then vote on whether to accept the Administrator’s recommendation or approve an alternative option;
- the administration ends when:
  - the time period for a Watershed Meeting expires without such a meeting taking place (or without a Court approved extension);
  - the creditors vote against a DOCA at the Watershed Meeting;
  - the time for executing a DOCA expires;
  - a DOCA is executed; or
  - the Court otherwise orders;
- if a DOCA is approved, it will bind all unsecured creditors, all secured creditors who voted for it, all owners or lessors of property who voted for it, the company, its directors and shareholders, and the Deed Administrator;
- if a DOCA is approved the Administrator is replaced by a Deed Administrator who then takes over the management of the company. The Deed Administrator is frequently the same person as the Administrator;
- while the DOCA is in force, no person bound by it may (without a Court order) seek to:
  - liquidate the company;
  - issue or continue Court proceedings against the company; or
  - commence or continue enforcement action against company property.

## When to opt for VA – evaluating the criteria

The alternative legislative options to the VA scheme for a distressed company have not been changed by the recent amendments to the Act, and consist of:

- (a) a creditor approved Part XIV compromise;
- (b) a Court approved Part XV arrangement, amalgamation or compromise;
- (c) receivership; or
- (d) liquidation.

A clear advantage for a company considering whether to pursue a Part XIV package or opt for VA is the “breathing space” that results from the automatic statutory moratorium under the VA scheme. Although the number of creditor votes required to approve a DOCA or a Part XIV compromise is the same (75% of creditors in value and 50% of creditors in number), and although it is possible under a Part XIV compromise to seek a stay from the Court, the automatic stay under the VA scheme will mean that the company can seriously pursue a rescue package without simultaneously fighting off creditors or without incurring cost and delays in seeking a Court stay. Furthermore, the VA scheme has the advantage of an external Administrator being appointed – which is of potential benefit to the management of the company, and should provide some level of objectivity and, hence, reassurance to concerned creditors.

Similarly, the VA statutory moratorium is a clear advantage for a company in contrast to a Part XV arrangement (which has none). VA also avoids the costs required in obtaining Court approval of a Part XV option, and the associated uncertainty of how the Court will exercise its discretion. It is for these reasons that Part XV arrangements are seldom used by failing companies in New Zealand.

A possible advantage of VA over receivership is the stigma attached to the two rehabilitation models. Although receivership is not intended to result in a company being subsequently placed into liquidation as a matter of course, the negative stigma attached to it frequently results in otherwise potentially sound businesses being wound up as creditors “abandon ship”. The more inclusive role of creditors in the VA scheme may reduce the inevitability of subsequent liquidations.

If the continued existence of the company proves not to be a viable option, the VA scheme may be used for the second of its stated objectives: to provide greater returns for creditors than under immediate liquidation. It is likely that many companies facing imminent threats of liquidation from creditors will seek to rely on the VA scheme for temporary respite. It may also be used by companies as an alternative to the “friendly liquidation” scenario many terminal companies seek. However, unless the VA scheme is used consistently with the objectives of the Act, using the VA scheme will be an abuse of process. Companies and management considering opting for the VA route should obtain professional advice to ensure they do not commit an abuse of process and/or breach their director’s duties.

Section 301 of the Act has also been specifically amended to impose potential liability against a director in respect of the action the director took in the appointment of an Administrator.

Although the VA regime is a welcome addition to the company rehabilitative framework, it is critical in every case to determine whether the VA model is the appropriate tool to be used. The use of the VA scheme in inappropriate circumstances will inevitably result in failure, together with the associated wasted time and expense for all involved. Worse though, it may also prevent an otherwise viable alternative proving successful. But before a rescue plan under the VA scheme can have any prospect of success, the company must convince a number of different parties that the VA option is preferable. Those considerations are considered in the next section.

## Implications of VA rules for different stakeholders

Different stakeholders will be affected by the VA scheme differently. This section considers the impact it is likely to have on particular groups of stakeholders.

### Secured creditors

A secured creditor with a charge over all or substantially all of a company's property may, in fact, be the party that elects the VA route itself by appointing an Administrator. As discussed above, for secured creditors such as banks, the VA route may prove to be a preferred alternative to appointing a receiver.

If a secured creditor has not commenced the VA, it will be necessary for the company to gain the support of the secured creditors if the VA is to successfully operate as a rehabilitation model. Secured creditors still have significant powers under the statutory provisions, including:

- the power to override the statutory moratorium and enforce its charge where the secured creditor holds a charge over all, or substantially all, of the company's property, and the creditor commences enforcement action (including by the appointment of a receiver) within the first 10 working days of being notified by the administrator of the VA; and
- the power to enforce its security if it does not sign any DOCA (unless a Court orders otherwise).

Therefore, a company wishing to have the support of a secured creditor will need to ensure a reputable and experienced insolvency practitioner is appointed as Administrator. One of the biggest criticisms of the recent insolvency reforms is the failure to include a registration scheme for insolvency practitioners. Practically anyone over 18 years, who is not bankrupt and has not had a continuing business relationship or provided advice to the company in question in the past two years can be appointed an Administrator, receiver or liquidator in New Zealand. This leads to abuse by some companies who seek to make "friendly" appointments, whereby reducing returns for creditors and undermining creditors' faith in the statutory rehabilitative and winding up schemes. Thus, appointing a reputable, experienced Administrator will be vital in obtaining the support of many secured creditors.

### Unsecured Creditors

As stated above, unsecured creditors may be more willing to agree to a VA for three reasons:

- a third party Administrator will take control of the business;
- the Administrator will provide a report to the creditors stating whether he or she believes a restructuring plan should be implemented, the administration brought to an end, or the company placed into liquidation; and
- the creditors have some say in the restructuring plan.

Full agreement by unsecured creditors is, however, unnecessary as the company only requires approval of a DOCA by 75% of creditors in value (which will frequently be comprised largely of secured creditors) and 50% of creditors in number. There may be a number of unsecured creditors who do not approve of the VA and subsequent DOCA, but they will be bound by it if the sufficient number of votes are otherwise obtained by the company.

### Inland Revenue Department

Unlike Australia, the recent amendments to the Act have not changed the IRD's status as a preferred creditor in liquidations (which entitles the IRD to receive payment ahead of unsecured creditors). Frequently, the IRD is a sizeable creditor of a struggling company

and, as such, the IRD may have significant voting power at a creditors' meeting under a VA. The IRD has indicated that it will consider each administration on its own merits and won't simply vote against all DOCAs to ensure the IRD obtains the full preferences it is entitled to in liquidation. The IRD has also indicated that it is likely to be more flexible on some issues than others. As a result, it will be important to communicate clearly with the IRD in advance of the Watershed meeting.

## Issues relating to DOCAs

An Administrator, like a receiver, is required to quickly review a company's performance, business structure, and management to determine the status and value of the company. But while a receiver undertakes that analysis to determine the best way of recovering value for the secured party by whom they were appointed, an Administrator undertakes the analysis to determine whether the company can be saved and, if so, the best way to restructure the company. It will require a person with greater business knowledge and experience than is needed in many receiverships and will require someone who is able to persuade a number of different stakeholders to agree to the DOCA. Creating a DOCA that adequately and efficiently provides an achievable restructure for the struggling company, and one that is acceptable to a range of stakeholders, will be a challenging exercise for Administrators.

The Act requires certain mandatory provisions to be included in all DOCAs, namely:

- who the Deed Administrator is;
- the property of the company that will be available to pay creditors;
- the nature and duration of any moratorium period for which the DOCA provides;
- the extent to which the company will be released from its debts;
- the conditions (if any) for the DOCA to come into operation and continue in operation;
- the circumstances in which the DOCA terminates;
- the order in which the proceeds of realisation of the property will be distributed among creditors who are bound by the DOCA; and
- the day (which is called the "cut-off day" and which must not be later than the day when the administration began) on or before which creditors' claims must have arisen if they are to be admissible under the DOCA.

In addition, regulations have been passed in accordance with the Act listing a number of prescribed provisions which are deemed to be included in the DOCA unless they are expressly excluded. The following are the current prescribed provisions under the regulations:

- the Deed Administrator is deemed to be an agent of the company (like a receiver);
- the Deed Administrator has all the powers necessary to carry on the business of the company and the other specific powers of a liquidator in Schedule 6 of the Act;
- the Deed Administrator must apply the property of the company in the same order of priority that a liquidator would apply if the company were in liquidation;
- creditors must accept their entitlements under the DOCA in full satisfaction and complete discharge of the debts or claim against the company;
- if the Administrator has paid to the creditors their full entitlements under the DOCA, all debts or claims of the company are extinguished;
- the DOCA may be pleaded by the company against any creditor in bar of any debt or claim that is admissible under the DOCA and a creditor must not, before termination of the DOCA, institute or prosecute any legal proceedings in relation to any debt incurred before the day when the administration began, exercise any right of set-off or cross-action, or commence or take any further step in any arbitration against the company;
- the provision of the Act relating to creditors' claims apply to the DOCA as if references to the liquidator were references to the Deed Administrator;
- the provisions of the Act relating to creditors' meetings apply to meetings of creditors;
- rules relating to the appointment, membership and procedures of creditors' committees;
- if the Deed Administrator has applied all of the proceeds of the realisation of the assets available for the payment of creditors, the Deed Administrator must certify to that effect in writing and lodge a notice of termination of the DOCA with the Registrar of the Companies Office; and

- the notice of termination of the DOCA.

Although the creditors of the company must vote at the Watershed Meeting whether to execute a DOCA, the exact terms of the DOCA may be finalised at a later date. The Act allows for the exact terms of the DOCA to be finalised after the Watershed Meeting, circulated to creditors, and then executed. A DOCA is executed when it has been executed by both the company and the Deed Administrator.

It is also possible for a DOCA to be subsequently varied. A Deed Administrator is required to call a creditors' meeting if requested to do so by creditors representing 10% or more in value. At that meeting, creditors may pass a resolution approving a variation to the DOCA. Surprisingly, the Act does not require the same execution requirements for a variation as it does for the initial DOCA. The Supreme Court of Western Australia, (when considering the equivalent Australian provision) read in a requirement that the Deed Administrator must also consent to the variation. It is not clear how the New Zealand Courts will interpret the variation provisions under the Act. However, the Court is granted a power under the Act to cancel or vary a variation on the application of a creditor if it is just and equitable to do so.

### Key procedural aspects of the VA

A company can be placed into VA very quickly. With the significant limits the moratorium places on the rights of creditors and third parties to otherwise deal with the company, Parliament has incorporated important procedural provisions into the VA legislation in an attempt to limit the extent to which the VA procedure can be abused.

As set out in the table below, strict time frames are a key feature of the legislation:

DAY	STEP
Prior to	
1	Obtain consent of Administrator to be appointed.
2	Administrator must notify secured creditors who hold a charge over all, or substantially all, of the company's property of his/her appointment.
3	Administrator must notify creditors of first creditors' meeting.
5	Directors must provide statement of company's position to Administrator.
8	First creditors' meeting must be held.
20	Administrator must give notice of Watershed Meeting.
25	Watershed Meeting must be held.
35	Draft DOCA must be circulated to creditors (if not already executed).
38	Creditors may comment on draft DOCA.
40	DOCA must be executed.

In addition, the Court, and to a limited extent the Administrator, has power to extend various deadlines, including retrospectively in some circumstances. In particularly large or complex VAs, it will be inevitable that extensions will need to be granted to enable the VA to operate (and applications to the Court of this nature are common in Australia). These tight timeframes will be particularly challenging while Administrators initially come to terms with their new responsibilities under the Act, and will remain a challenge in instances where the VA scheme is used by large companies. It will be crucial for Administrators to obtain clear legal advice in advance because they simply will not have time to learn as they go.

Although the Court has deliberately been excluded from the general operations of the VA scheme (whereby reducing the related costs and delays), it still provides a valuable back-stop to parties in a number of circumstances, including:

- ruling on the validity of the appointment of an Administrator;
- extending statutory timeframes, including retrospectively;
- ruling on the validity of a DOCA;
- providing directions to Administrators;
- reviewing Administrator's decisions; and
- making various orders to protect creditors' interests.

A review of Australian case law shows that the Australian Courts have had a relatively prominent role in dealing with VAs. As with the Australian legislation, the Courts in New Zealand are given a significant power under the Act to make any orders the Court thinks fit as to how the statutory provisions are to operate in relation to a particular company. Applications for the Court to exercise this power can be brought by the company, a shareholder, a creditor, the Administrator, the Deed Administrator, the Registrar of Companies, or any interested person. The equivalent Australian provision has been widely interpreted by the Australian Courts to cure defects and alter obligations otherwise provided for in the Act. Aside from the litigation that usually accompanies new legislation, it is possible that the New Zealand Courts will also have a significant role to play in assisting with and monitoring the VA scheme.

## Conclusion

It is not known to what extent the VA scheme will be preferred in New Zealand over the more established alternatives. In Australia, in comparison to other external administrations (including receiverships and liquidations), VAs are used approximately just over a third of the time. Although the New Zealand VA scheme is closely modelled on the Australian VA scheme, there are some important differences between the New Zealand and Australian models. The most notable difference is that Australia has abandoned any priority for the Revenue Department in liquidations, instead making directors personally liable for the company's outstanding tax. However, the director's liability is extinguished if the company is placed into VA. That is, the VA scheme operates to incentivise directors to take early action to restructure a company rather than let it slide into liquidation. Significantly, there are no equivalent incentives for directors in New Zealand.

The VA scheme is not, of course, a sure solution for a struggling company. It is simply a statutory procedure which a company and creditors can elect to follow in an attempt to restructure a failing company, or to maximise returns when there is no prospect of rescuing the company. However, if the process is mismanaged or poorly implemented, the VA scheme will prove to be of no assistance to companies, and will instead result in even greater losses for creditors. Although the VA scheme has some clear advantages over other existing options, the costs of VAs are frequently substantial. Properly understanding the VA scheme (including its limitations) and understanding and managing the competing interests of stakeholders will be key to the success of the scheme for a company electing to take the VA route.