

CORPORATE VOLUNTARY ADMINISTRATION IN AUSTRALIA

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BACKGROUND TO THE VOLUNTARY ADMINISTRATION SCHEME

In 1983 the then Attorney-General requested the Australian Law Reform Commission ('the Commission') to inquire into the law relating to insolvency.

The Commission was directed to have regard to international developments in bankruptcy and company law and practice including, in particular the recommendations of the United Kingdom Insolvency Law Review Committee (known as the Cork Report). Those recommendations had led to the introduction of a corporate administration procedure in the United Kingdom.

At the time the Commission was requested to conduct the review, the schemes available for rescue/rehabilitation of insolvent companies in Australia were:

- schemes of arrangement; and
- official management.

Schemes of arrangement were time consuming and costly. Official management was cumbersome and not often used.

The only other formal schemes for dealing with insolvent companies were receivership and liquidation. After an exhaustive consultation procedure, the Commission completed its report in 1988. The report's official title is *General Insolvency Inquiry*, but is more commonly referred to as 'the Harmer Report' (after the Commissioner-in-charge of the Insolvency Reference, Mr R.W Harmer).

In the Harmer Report, the Commission expressed the view that the schemes then available in Australia for dealing with the affairs of a company in financial difficulty were too conservative. They placed insufficient emphasis upon encouraging a constructive approach to corporate insolvency by, for example, focusing on the possibility of saving the business (rather than saving the company) and preserving employment prospects. The Commission stated that:

“A constructive approach to corporate insolvency requires the preservation, if practical and possible, of the property and business of the company in the brief period before creditors are in a position to make an informed decision. This assists in an orderly and beneficial administration whether creditors decide to wind the company up or accept a compromise. An ordered form of administration of the affairs of an insolvent person is at the centre of insolvency law — whether, in the case of an insolvent company, that law offers the prospect of a winding-up or continuation of the corporate business. This approach is similar to that taken by insolvency law inquiry bodies in many overseas countries, such as the United States of America, Canada, the United Kingdom and some of the European nations.

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The Commission does not suggest that its approach will result in the salvation of failed companies or even companies which show signs of failing. Nonetheless, the aim is to encourage early positive action to deal with insolvency. It will be worthwhile and a considerable advantage over present

procedures if it saves or provides better opportunities to salvage even a small percentage of the companies which, under the present procedures, have no alternative but to be wound up.”¹

The Australian Government ('the Government') was inclined to implement the recommendations in the Harmer Report, especially since they then enjoyed a substantial degree of support within the professional community. In 1991, the Government commenced the corporate insolvency law reform process by issuing discussion papers to peak professional and business bodies. Those papers focused on aspects of the Harmer Report and preceded the exposure of draft legislation.

The voluntary administration ('VA') reforms became part of a package of insolvency reforms that were incorporated in the Corporate Law Reform Bill 1992. The Bill was released for three months public exposure in February 1992. Over 2,000 pages of submissions were received. Also, hearings and forums on the Bill were conducted in every major Australian city by the Attorney-General's Department and a parliamentary committee. After a rigorous assessment of the submissions, further consultation took place, culminating in meetings with committees of expert insolvency practitioners. As a result of these consultations, some changes were made to the Bill.

The Bill was to become the *Corporate Law Reform Act 1992*. The Act abolished the official management regime, and replaced it with the regime known as the voluntary administration scheme which is now Part 5.3A of the Australian Corporations Law ('the Law'). The scheme commenced operation on 23 June 1993.

The objective of Part 5.3A, as stated in section 435A of the Law, is to allow the

“business, property and affairs of an insolvent company to be administered in such 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 voluntary administration scheme seeks to overcome the shortcomings of the schemes available previously by providing a flexible and relatively inexpensive procedure pursuant to which a company may obtain some breathing space, so that it can attempt a compromise or arrangement with its creditors. The voluntary administration scheme is intended to be an alternative to situations in which a company limps along, continuing to trade after it has lost the capacity to repay, playing innocent third party creditors off against one another. The breathing space should enable directors in smaller companies to take a rest from “bush fire fighting”, and contribute some technical expertise back to the business.

THE LEGISLATIVE FRAMEWORK

Part 5.3A of the Corporations Law contains the main provisions dealing with voluntary administration scheme. The primary purpose Part 5.3A is to provide a flexible and relatively inexpensive procedure pursuant to which a company may obtain a breathing space, so that it can attempt a compromise or arrangement with its creditors aimed at saving the company or the business and maximising the return to creditors. If successful, the arrangement will be set out in a deed of company arrangement, which binds the company and the creditors. However, if the attempt fails, the legislation provides for an automatic transition to liquidation.

THE ADMINISTRATION

¹ Australian Law Reform Commission, *General Insolvency Inquiry* (Report No. 45, 1988), paras 53 and 54.

The appointment of an administrator has some immediate and important consequences. On appointment, control of the company and its property, business and affairs is vested in the administrator. The administrator acts as the company's agent, and the powers of all other officers of the company may not be exercised except with the administrator's written approval. Under the Law, the company's directors must give such assistance to the administrator as reasonably required by the administrator, including details of company assets and liabilities, and handing over books and company records.

Having taken control of the company's affairs, the primary task for the administrator is to investigate the financial position of the company, with a view to making a recommendation to a meeting of creditors about what should be done with the company and its business.

Who may appoint an administrator?

An administrator may be appointed by the following persons to take over the affairs of a company:

- firstly, (and most commonly), by a majority of the company's directors — where those directors think, either that the company is insolvent, or that it is likely to become insolvent at some time in the future, they may pass a resolution to appoint such administrator; or
- secondly, a liquidator or provisional liquidator of the company; or
- thirdly, a chargee entitled to enforce a charge over the whole or substantially the whole of the company's property.

The administrator must be a qualified liquidator registered by the Australian corporate regulator, the Australian Securities and Investments Commission ('ASIC'). Those persons are usually private sector insolvency specialists. Their fees for conducting the administration are paid for out of the assets of the company.

Points to note

Appointment by the company

The voluntary administration procedure may be initiated by the company alone. There is no requirement for any application to be made to the Court.

The administration procedure is open to companies that are not insolvent at the time the resolution is passed. The directors merely have to be satisfied that it is likely that the company will become insolvent at some future time. The directors will therefore be able to initiate the procedure when insolvency is impending, but before the duty arises to prevent insolvent trading.

Appointment by the liquidator or provisional liquidator

Where the appointment is made by a liquidator (or provisional liquidator), that person may also act as the administrator provided that the Court's leave is obtained.

Circumstances in which a liquidator may wish to utilise the administration procedure could include where the company is in members' voluntary winding up and the view has been formed that the company is insolvent or is likely to become insolvent. There may also be circumstances where the moratorium provided for by Part 5.3A would assist a liquidator or provisional liquidator in implementing a plan to dispose of the business of the company as a going concern.

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

The holder of a charge on "the whole, or substantially the whole, of a company's property" may also appoint an administrator, if the charge has become and remains enforceable.

Consent of the administrator

The written consent of the person to be appointed administrator must be obtained before the appointment is made.

The moratorium

One of the most important effects of the appointment of an administrator is the triggering of a moratorium on actions against the company.

The reasons for placing a freeze on all actions against the company during the period of administration is to give the administrator and the creditors a chance to assess the situation and work out the best course of action. If one or more creditors were allowed to pursue their individual claims, the administrator would have to become involved in defending the proceedings. That would detract from the other important work the administrator has to do in a short amount of time and would incur considerable expense, which would operate to the detriment of the other creditors, the members and the company. If the administration is followed by a winding up or a deed, the creditor can always prove for the claim in the winding up or the deed.

Amongst other things, the moratorium:

- prevents the company being wound up;
- prevents charges being enforced (subject to some exceptions-see below);
- prevents an owner or lessor recovering property which is being used by the company (also subject to exceptions);
- prevents proceedings being commenced or continued against the company and any enforcement action in relation to proceedings already; and
- prevents a guarantee by the company's directors or relatives being triggered.

Exceptions to the moratorium

There are a number of exceptions to the moratorium.

The most important exception to the moratorium is that which allows a chargee of the whole or substantially the whole of the company's property to appoint its own receiver. The chargee must act, however, within 14 days of the appointment of the administrator.

The phrase "the whole, or substantially the whole, of the property of a company" is not defined in the Law. However, the rationale for the exception is that the holder of such a charge will be in a position to achieve an orderly realisation of the company's assets. In deciding whether a charge is "on the whole, or substantially the whole, of the company's property", the issues include whether the charge covers sufficient of the assets of the company to enable the chargee, or a receiver appointed by the chargee, to control and carry on the business of the company with a view to achieving such an orderly realisation. A standard full fixed and floating charge over all the company's property will amount to such a charge.

The enforcement by the secured creditor of a charge or charges over the whole, or substantially the whole, of the company's property does not bring the administration to an end. However, as the whole, or substantially the whole, of the company's property will be under the control of the chargee, or a receiver appointed by the chargee, the administrator will effectively have no assets to administer, and no indemnity out of the assets of the company subject to the charge once written notice of enforcement is given to the

administrator. In practice, therefore, potential administrators would be likely to ascertain the attitude of such a chargee to an administration before accepting an appointment as an administrator.

Other exceptions are that:

- a creditor who takes steps to enforce a charge prior to the appointment of an administrator, may continue to enforce that security;
- a creditor may enforce a charge in relation to perishable property, notwithstanding the appointment of an administrator; and
- where an owner or lessor of property used by the company takes steps, before the beginning of the administration, to recover that property, that recovery process will be allowed to continue.

Point to note

If one of the exceptions to the moratorium applies, that isn't the end of the matter. The administrator can still apply to the court for an order restricting any of the owners or chargees of the property from exercising their rights. But the court will only make such an order if it is satisfied that what the administrator proposes to do during the administration will 'adequately protect' that person's interests.

First meeting of creditors

In order to ensure that creditors are kept fully informed during the course of an administration, the administrator is required to call a first meeting of creditors within five business days of his or her appointment.

At that meeting, the creditors will consider whether:

- to remove the administrator, and appoint someone else in his or her place;
- a committee of creditors should be appointed.

The function of any committee of creditors will be to liaise with the administrator during the administration. The creditors' committee cannot give directions to the administrator, other than to require the administrator to report to the committee about matters relating to the administration.

Meeting to determine the company's future

Assuming the administrator hasn't been replaced at the first meeting, he or she will have been busily going about investigating the company's affairs. Having formed an opinion about what should be done in relation to the company, the administrator is required to call a meeting of creditors to determine the company's future. Generally the meeting will have to be held within 28 days (in the usual case) or 35 days (where Christmas or Easter intervenes) of the administrator's appointment.

A number of reports and statements must accompany the notice of the meeting to determine the company's future, including the details of any arrangement with the creditors, proposed by the administrator. The administrator must send the creditors a statement containing an opinion as to each of the following three options:

- whether it would be in the interests of the company's creditors to execute a deed of company arrangement;
- whether it would be in the interests of the company's creditors for the administration to end; and

- whether it would be in the interests of the company's creditors for the company to be wound up.

Under the Law, there are no other options that the administrator can recommend.

The administrator must also send to creditors an opinion regarding whether there are any transactions which might be voidable and which might enable a liquidator to recover money, property or other benefits.

The creditors may resolve at the meeting to:

- execute a deed of company arrangement;
- terminate the administration;
- have the company wound up; or
- adjourn the meeting for a further period of up to 60 days. No further extension beyond 60 days is possible.

Voting at the meeting

Most of the rules in relation to how voting is to be conducted are found in Part 5.6 of the Corporations Regulations.

A vote on a resolution is determined on the voices, unless a poll is demanded. If no poll is demanded, the Chair of the meeting (who, under the Corporations Regulations, is usually the administrator) must decide whether it is carried, carried unanimously, lost or so on. The Chair's declaration is conclusive evidence of the result unless a poll is demanded.

A poll can be demanded by the Chair, any two creditors or anyone present or voting by proxy with at least 10% of the voting rights. If a poll is taken, the resolution is determined by simple majority by number and value of debts owed.

If there is a deadlock, which can happen either if the voting is 50/50 or, more commonly, where the majority by number vote one way but the majority by value vote another way, then the Chair gets a casting vote.

The exercise of a casting vote by the Chair can be reviewed by the Court on the application of a dissatisfied creditor.

In many cases, some of the creditors are related somehow to the company or its directors. The legislation recognises that votes could be unduly influenced by related parties, particularly in smaller companies where there could be director finance. Accordingly, the Law permits the Court to set aside a resolution or order that a meeting be reconvened if it finds that:

- the vote would have gone another way if the votes of related parties are disregarded; and
- the result of the vote is contrary to the interests of creditors as a whole, or likely to prejudice the interests of creditors who voted the other way.

THE DEED OF COMPANY ARRANGEMENT

Assuming the resolution is not set aside, the company will enter into a deed of company arrangement. The deed of company arrangement is really what the voluntary administration scheme is all about—the rest of it is all about how to get to this point, and ensuring that it is reached quickly.

Most deeds will be in one of two forms, or a combination of both. In a moratorium type of deed, the creditors agree to accept payment at a later time, usually in instalments (like a drip-feed arrangement). In a compromise deed, the creditors agree to accept less than 100 cents in the dollar in full satisfaction of their claims. In many cases compromise deeds will provide that some third party will make a contribution to the assets of the company.

What does the deed contain?

Where a company's creditors resolve that the company execute a deed of company arrangement, the legislation sets out broadly what the deed of company arrangement must contain. It must identify: the property that is to be available to pay creditors' claims;

- the nature and duration of any moratorium period for which the deed provides;
- the extent to which the company is to be released from its debts;
- the conditions (if any) for the deed to come into operation;
- the conditions (if any) for the deed to continue in operation;
- the circumstances in which the deed terminates;
- the order in which the proceeds of realising the property available to satisfy creditors' claims is to be distributed; and
- the day (not later than the day when the administration began) on or before which claims must have arisen if they are to be admissible under the deed.

The deed will also be taken to include the provisions set out in the Corporations Regulations unless the deed provides otherwise. The prescribed provisions are only a general guide—in many cases they won't be especially suitable for the specific type of arrangement contemplated.

Effect of the deed

The company has 21 days after the end of the meeting of creditors to determine the company's future (subject to any extension granted by the Court), to then execute the deed. Once the deed is executed, the administration of the company ends and the moratorium on actions against the company is replaced by more limited restrictions on actions against the company.

These restrictions are that, while the deed is in place, all persons bound by the deed are prevented from:

- applying for the company to be wound up;
- bringing or continuing a proceeding against the company or its property; or
- attempting to levy execution or other enforcement process,

except with the leave of the Court.

Who is bound?

All unsecured creditors will be bound by the deed, but only those secured creditors that agree to be bound will be bound.

Where a particular secured creditor has not agreed to be bound by the deed and that creditor's dissent threatens the viability of the entire deed, the court is permitted to order that the creditor refrain from exercising its security.

The deed administrator

The administrator of the company will become the administrator of the deed of company arrangement unless the creditors resolve otherwise. The deed administrator's role will be set out in the deed. A long list of powers and functions are set out in the Corporations Regulations, but it is not necessary to include those in every deed.

In the bigger administrations it will usually be appropriate for the administrator to play a role in the management of the company's affairs. But, for smaller companies, the deed administrator's role may be limited to things like making sure the deed is complied with. The day-to-day management of the company may essentially be handed back to the directors while the deed administrator takes a less active role.

Variation of a deed

Once the deed is in place, the deed may be varied by resolution of the creditors. The administrator of the deed may convene a meeting for this purpose at any time, and is required to do so if requested in writing by creditors holding claims against the company in excess of 10 per cent of the value of all creditors' claims.

The Court has the power to cancel a variation of a deed either wholly or in part on the application of any creditor and make such other orders as it thinks appropriate.

Termination of a deed

A deed of company arrangement terminates if:

- the Court so orders on application by: the company; a creditor; or any interested person (the grounds on which the Court may terminate the deed include where the resolution that led to the company executing the deed was based on materially false or misleading information, where there has been a material contravention of the deed, or where the deed is oppressive or unfairly prejudicial to one or more creditors or is contrary to the interests of the creditors as a whole);
- the creditors of the company so resolve at a meeting; or
- the conditions specified in the deed for termination are met.

TRANSITION TO WINDING UP

It may be, of course, that the creditors decide at the meeting called to decide the company's future that the company should be wound up. In that case, the company will be deemed to have entered into a creditors' voluntary winding up and the administrator will be deemed to have been appointed as the liquidator of the company.

A similar transition from administration into a deemed creditors' voluntary winding up will also occur:

- where the company fails within 21 days to execute a deed of company arrangement agreed upon by the creditors; or
- where the creditors terminate a deed of company arrangement and resolve that the company should be wound up.

However, the Court may stay or terminate the winding up process, for example in circumstances where the company can establish that it is in fact solvent (for the directors may place the company in administration

where they believe that the company *will become* insolvent at some future time, so it is possible that the company may still technically be solvent).

THE ROLE OF THE COURT

It was a core aim when introducing the VA system to maximise speed and efficiency by eliminating unnecessary Court involvement. In many cases, VAs proceed from beginning to end without any consideration by the Court whatsoever. However, the potential for Court involvement, particularly to supervise its operation where a party considers the scheme is being abused, is a critical feature of the VA scheme.

The Court is given numerous powers to make orders of a supervisory nature on the application of creditors, administrators and other interested persons (including ASIC). For example, the Court is given powers to:

- make any order about how Part 5.3A of the Law (the VA provisions) should operate in relation to a particular company;
- make any order it thinks necessary to protect the interests of a company's creditors while the company is under administration (ASIC or a creditor of the company may apply);
- make an order declaring that the appointment of an administrator of a company or a deed, is valid;
- grant leave to a person who, although qualified to be appointed as administrator, is precluded from doing so by virtue of a professional or commercial relationship stipulated in the Law;
- review the administrator's remuneration if fixed by creditors;
- remove an administrator;
- excuse an administrator from personal liability;
- extend the time periods for meetings (up to certain statutory limits) and in certain cases, cure failures to comply with mandatory time periods; and
- grant leave to an administrator to dispose of property the subject of a charge or that is owned or leased by a third party to the company under administration, where the Court is satisfied that adequate arrangements have been made to protect the secured creditor, owner or lessor.

Court involvement at some stage of the process is a common occurrence, particularly in larger administrations. However, usually this has not led to significant delays and often the Court's intervention by way of making a supervisory order has facilitated timely progress of administrations.

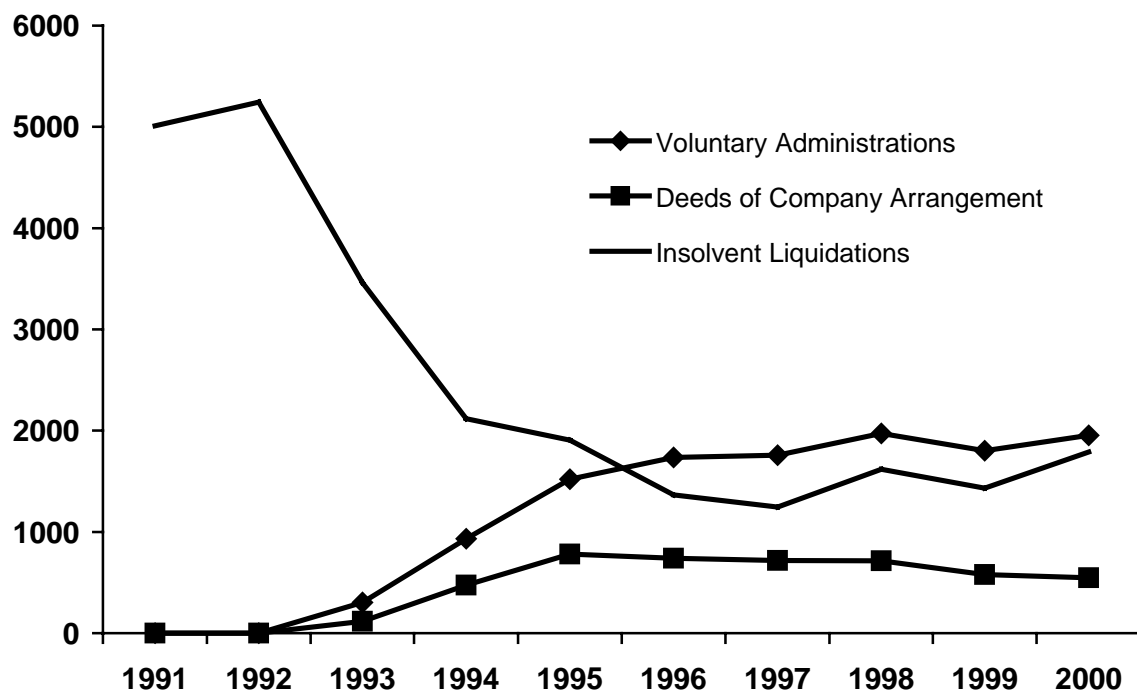
Point to note

The administrator of a company or a deed may also apply to the Court for directions about a matter arising in connection with the performance or exercise of any of the administrator's powers or functions, and anything arising in connection with the operation, or giving effect to the deed.

AUSTRALIA'S EXPERIENCE WITH VA

If numbers alone are a guide, VA has been and continues to be hugely successful in Australia. The chart below shows the number of VAs and deeds of company arrangement entered into on an annual basis since its commencement. Also shown, by way of comparison, are the numbers of insolvent liquidations (either court-ordered or voluntary). VA is now the single most popular formal procedure for dealing with companies in financial difficulty.

ANNUAL RATES OF VOLUNTARY ADMINISTRATION, DEEDS OF COMPANY ARRANGEMENT AND INSOLVENT LIQUIDATIONS IN AUSTRALIA
(SOURCE: AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION MONTHLY STATISTICS)



The chart indicates that, generally, somewhere between 25 and 50 percent of voluntary administrations are successfully converted into deeds of company arrangement. The vast bulk of the remainder would proceed into liquidation, as very rarely is a company that enters VA found to be in a sound financial condition and able to be returned immediately to the hands of the directors to continue business as usual.

Perceived difficulties

Despite its popularity, there have been some concerns expressed from time to time about the VA system. Most commonly, complaints are from creditors who consider that the system is being abused by directors by, for example, appointing a 'friendly' administrator who acts in the interests of the directors when advising on the best course of action rather than the interests of the creditors. These complaints often centre on the failure to advise creditors effectively about returns from potential actions against directors or related parties if the company were to be placed into immediate liquidation rather than enter into a deed of company arrangement.

More recently, the number of complaints about possible abuse has diminished. It may be that, as creditors become more familiar with how the scheme operates, and their own roles, rights and responsibilities, they

are becoming more active in ensuring that their interests are protected. Some support for this view may be found in the statistical data that indicates the proportion of companies now entering deeds of company arrangement is somewhat less than the number doing so at the commencement of the scheme.

Other concerns raised are of a more technical nature, such as the length of the statutory time frames and the details of the voting procedures. These matters have been examined by the Legal Committee of the Companies and Securities Advisory Committee, which has produced a detailed report on the VA scheme. That Committee has made a number of recommendations about 'fine tuning' of the VA system, which are expected to be considered by the Government as part of an upcoming wide-ranging review of the corporate insolvency provisions generally. However, it is not expected that any major structural changes to the scheme will need to be made as part of that review.

CONTEXT OF THE VA SCHEME

As with all insolvency systems, it is very important in gaining an understanding of its operation to consider not only the scheme itself, but also important contextual factors.

AVOIDANCE OF PERSONAL LIABILITY BY DIRECTORS

Directors of an insolvent company may be personally liable to pay group tax debts (federal tax on the salaries of employees) if they do not act quickly to put the company into VA or liquidation when the Australian Taxation Office issues a certain notice. That notice sets out that the company has failed to remit certain group tax or other deductions, and that the directors are to be personally liable for the debts unless they act within a certain period. Commonly directors will, on receipt of such a notice, place the company in VA.

Also, under the Law, directors have a specific duty to prevent the company from engaging in insolvent trading. Breach of this duty exposes directors to liability to personally compensate the company (or its creditors) for any loss suffered as a result of the company trading while insolvent. Placing a company in VA at an early date is a means of avoiding this potential liability if the directors think the company is either insolvent or likely to be so in the future.

The above factors are likely to explain, to a some degree, the popularity of the VA scheme.

INSOLVENCY PROFESSION

One of the critical factors in the success of the VA scheme in Australia is the availability of skilled, honest and independent administrators. As mentioned above, these are drawn from registered insolvency professionals, specifically licensed to do this kind of work.

Also, as mentioned above, most complaints about the scheme relate to alleged abuses by administrators who are perceived to be 'too close' to management. The means of ensuring that administrators are independent is one of the key issues that are likely to be considered in the review of the VA framework.

DEBTORS AND CREDITORS

Australian debtors and creditors are now quite familiar with the concept of the VA scheme and, by and large, consider it as a useful tool. During the earlier years of its operation there were some 'teething difficulties', but through accumulation of court decisions and experience creditors (particularly professional creditors such as financial institutions) accept the VA scheme as a legitimate means of dealing efficiently with a debtor company in financial difficulties. They see the potential for getting a larger return than would occur with immediate liquidation and are getting more skilled at identifying rehabilitation proposals that are likely to be successful, and rejecting proposals that are not viable.

CONCLUSION

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Rather than place hurdles before debtor companies seeking relief from creditors through rehabilitation procedures, Australian insolvency laws actively encourage corporate debtors in financial difficulties to enter administration voluntarily at an early stage. Entering the procedure early prevents problems escalating, further debts being incurred and further creditors being adversely affected. A key to the success of this approach is that the procedure is very short in time frame, relatively inexpensive, and therefore interference with the rights of creditors, particularly secured creditors, is kept to a minimum. It is usually the need to prevent undue interference in the rights of creditors that drives other systems to have elaborate legal requirements concerning use the rehabilitation procedure.

Despite its ‘creditor-friendly’ nature, in terms of the proportion of companies entering the scheme that are successfully rehabilitated, VA compares quite favourably with other schemes that are widely considered more ‘debtor-oriented’.

The Court has quite a limited role in VA compared to a number of other rehabilitation frameworks. It is not required to make decisions on commercial matters such as the prospects for success of a plan—those decisions are left solely to the creditors on the advice of the administrator. However, the existence of an efficient and competent body to take on the role of general supervision of the process and making binding rulings where disputes arise is critical to the operation of the scheme.

Also playing a large role in the success and popularity of the VA scheme are Australia’s private sector insolvency practitioners and the attitudes of debtors and creditors themselves to the procedure. Encouraging companies to enter the scheme by use of incentives for management is also important.

It is helpful to consider that between the two extremes of an informal ‘out of court’ compromise and a formal rehabilitation mechanism which has a high level of court involvement, there are ‘in between’ semi-formal systems. The Australian VA scheme is one such system. However, when considering possible models it is just as important to examine the surrounding context in which a scheme operates as the details of the scheme itself.

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