2013 ARITA Terry Taylor Scholarship Report

A sample review of Deeds of Company Arrangement under Part 5.3A of the Corporations Act

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Executive Summary

Deeds of company arrangement - an integral feature of Part 5.3A of the *Corporations Act 2001* (Cth) which commenced in 1993 - appear to be something of a modest success. However, the observed outcomes and use of DOCAs (and the costs of the voluntary administrations which precede DOCAs) raise legitimate questions as to whether the modest returns achieved by DOCAs might be improved by legislative reform.

A sample review of 72 deeds of company arrangement ("DOCAs") effectuated between 1 August 2012 and 31 July 2013 – and associated reports and returns - yielded the following headline observations:

- A weighted average dividend return to ordinary unsecured creditors across the sampled DOCAs in the range of 5.86 cents to 7.55 cents in the dollar, and a median dividend return of 5.4 cents in the dollar;
- 85% of DOCAs addressed what might be described as 'small company insolvencies'. The assets, turnover and number of employees of most of the sampled companies fell below the threshold criteria of a 'small company' defined in s 45A of the Corporations Act. A more striking observation was that 77% of the DOCAs sampled related to insolvent companies whose aggregate participating ordinary unsecured debts were $1.5 million or less (those participating debts usually excluding related party claims);
- The DOCAs sampled can be broadly classified into two types. 72% of the DOCAs were straightforward compositions (compromises) akin to liquidations, effected to avert windings up and usually entailing no (or very limited) substantive trading-on of the company's business under the DOCA. 28% of the DOCAs comprised compositions which facilitated more creative outcomes in the way of genuine company/business rescues or work-outs involving some sort of substantial trading-on of the company's business;

- The typical life span of a DOCA – from its execution to effectuation - is around 11 to 12 months;
- The typical cost (in insolvency practitioner fees) of a voluntary administration which precedes a 'small company' DOCA is around $31,500, while the typical amount of remuneration charged by a deed administrator for the administration of a DOCA is $28,700;
- Most DOCAs substantially deliver the dividend outcomes projected in s 439A reports to creditors. The s 439A reports more often than not predict that no dividend will likely be paid to unsecured creditors in the event of an a liquidation. Compared to what is otherwise on offer, DOCAs appear to often provide and deliver to ordinary unsecured creditors a modestly attractive alternative;
- That said, the typical rates of dividend returns from DOCAs warrant further consideration and debate as to the effectiveness of Part 5.3A and whether a separate legislative regime - more attuned to the characteristics and realities of small company insolvency - is desirable;
- Given the comparatively modest levels of typical practitioner remuneration in a small company voluntary administration, a 'streamlined' administration regime for such companies may not necessarily deliver dramatically improved outcomes for unsecured creditors in the way of dividend returns;
- Therefore, potential amendments or improvements to Part 5.3A (or other laws designed to promote corporate/business rescue) will have to address the realities of the small balance sheets of companies which commonly enter the voluntary administration process at a time when options for 'creative solutions' are inherently limited;
- The final prescribed returns (eg, Form 524) required to be lodged with ASIC by deed administrators might be amended or expanded to ensure the capture of more useful 'hard data' regarding the actual outcomes - rather than mere expectations - of DOCAs, in order to better inform the law reform process.

Contents

Why conduct a sample review of DOCAs?

An empirical review of the operation of Part 5.3A of the *Corporations Act 2001* (Cth) ('the Act') is timely given that Australia's corporate rescue regime recently marked its 20 year anniversary. Part 5.3A commenced operation in 1993 (pursuant to the *Corporate Law Reform Act 1992* (Cth)) and was introduced into Australia's corporate insolvency statute to implement a key recommendation of the 1988 Harmer Report.[1] In recommending the introduction of the voluntary administration procedure, the Australian Law Reform Commission stated its approach to 'be worthwhile and a considerable advantage over present procedures if it saves or provides better opportunities to salvage even a small percent of the companies which, under the present procedures, have no alternative but to be wound up.'[2]

Part 5.3A of the Act is entitled 'Administration of a company's affairs with a view to executing a deed of company arrangement', which reflects the significance and importance of the deed of company arrangement ('DOCA') within the voluntary administration regime. In keeping with the approach of facilitating or accommodating *alternatives* for insolvent companies, the Harmer Report foreshadowed the notion of an 'arrangement' as one of the main features of the proposed voluntary administration procedure:

> If the company proposes an arrangement with its creditors, the arrangement need not require that the company meet its debts in full, nor that the company should necessarily survive. An arrangement could amount to an immediate composition of the debts and liabilities of the company (for example, where the creditors are invited to accept payment of less than the full value of their claims payable immediately or over a period of time). Again, it may propose a

[1] ALRC 45 – General Insolvency Inquiry, 1988, Vol 1, Part II ('Company Insolvency'), Ch 3 recommended a new voluntary procedure for insolvent companies with the same main features as those upon which Part 5.3A was subsequently structured. Part 5.3A of the Corporations Law (now the *Corporations Act*) commenced on 23 June 1993.
[2] Ibid, 29.

> 'trade on' for part or all of the trading or business operations of the company until that business can be conveniently sold with a composition or winding up to follow. Alternatively, an arrangement may amount to an extension of time in which to meet debts and liabilities in whole or in part while refinancing or the injection of additional capital is negotiated to enable that result to be achieved. These, however, are examples only. They are not intended as the only types of arrangement that might be possible.[3]

Prevalence of voluntary administrations and DOCAs: Recent statistics

Recent Australian Securities & Investments Commission ('ASIC') statistics reveal that while the average annual number of voluntary administration appointments has significantly decreased since 2009/2010, the average number of deed administrations has remained relatively more constant since 1999/2000. The average number of deed administrations over the eight years from 2004/2005 to 2011/2012 was 575 deed administrations per year[4], which was followed by 418 new deed administrations in 2012/2013 - the lowest annual number since 1999/2000. There have already been 337 deed administration appointments in the 9 months from July 2013 to March 2014, indicating that the year 2013/2014 will again see something in excess of 400 new deed administrations. (The same 9 month period has seen 989 voluntary administration appointments.) In short, while the average annual numbers of both voluntary administration appointments and DOCAs have decreased since 2009,[5] DOCAs have not decreased at the same rate (or as markedly) as voluntary administration appointments. Indeed, the proportion of voluntary administrations which convert to DOCAs now appears to have increased, further reinforcing the important role of DOCAs in Part 5.3A's operation.

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[3] Ibid, 31.

[4] Statistics sourced from ASIC's 'Australian insolvency statistics' (Series 2) released in May 2014 (available at https://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Statistics).

[5] Over the eight years 2001/2002 through to 2008/2009 the average annual number of voluntary administration appointments and DOCAs was 2,546 appointments and 656 DOCAs per year. From 2009/2010 to 2012/2013 the average number of voluntary administration appointments was 1,633 appointments per year while the average number of DOCAs for those four years was 502 DOCAs per year.

Previous empirical studies

In 2010 Herzberg, Bender and Gordon-Brown sought to address the question of whether Part 5.3A satisfies its legislative objectives.[6] Herzberg, et al conducted a review of a sample of s 439A(4) reports to creditors and a statistical analysis of outcomes for the companies which were the subject of a recommended DOCA. Their review also addressed the outcome or 'fate' of companies which executed a DOCA (ie, whether they remained registered, were deregistered or entered another external administration) and the 'survival rate' of companies which entered a Part 5.3A procedure. However, this analysis did not involve any review of the substance (eg, terms, conditions and content) or reported outcomes of actual DOCAs which were executed and effectuated.

2013 Terry Taylor Scholarship : a sample review of the <u>substance</u> and <u>outcomes</u> of DOCAs

The research project culminating in this report entailed a review of a random sample of 72 executed DOCAs (and associated reports and returns) which were effectuated between 1 August 2012 and 31 July 2013. This sample review of DOCAs was undertaken with the intention of producing a 'snapshot' of current practices and trends pertaining to DOCAs – ie, average (or typical) rate of dividends paid, the outcomes or goals which DOCAs customarily achieve (eg, genuine company rescues, workouts, enhanced asset realisations or 'quasi-liquidations'), the profile of the companies executing DOCAs and the average term/duration of DOCAs.

The purpose and value of this sample review was to empirically assess the use and effectiveness of one important aspect of Part 5.3A of the Act and to further inform consideration and debate as to whether changes are warranted to Australia's voluntary administration regime. A sample review of DOCAs (as they are actually utilised in practice) provides a valuable profile of one of the key outcomes of the Part 5.3A voluntary administration process and will (it is hoped) inform the ongoing debate about the success or otherwise of Australia's voluntary administration regime.

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[6] Herzberg A, Bender M, Gordon-Brown L, 'Does the voluntary administration scheme satisfy its legislative objectives? An exploratory analysis' (2010) 18 *Insolvency Law Journal* 181.

The sample

A customised report was requested (and purchased) from ASIC which listed all 'effectuated' DOCAs – ie, for which Forms 5056 were lodged - between 1 August 2012 and 31 July 2013.[7] The customised report disclosed 350 effectuated DOCAs for this 12 month period. From those 350 DOCAs, 72 DOCAs were randomly selected for review (broadly sampled across the 12 month period). With the benefit of some generous and informal input from a government agency statistician, it is understood that a sample of around this size (out of a population of 350 'recently-effectuated' DOCAs) produces respectably 'robust' results.[8]

The rationale for sampling a recent pool of *effectuated* DOCAs is to provide a more informative and current picture of both how DOCAs are used *and their outcomes*. A review of DOCAs on a 'start to finish' basis sheds more light on current trends than would an examination of DOCAs which may have been more recently executed but remain unimplemented (ie, not yet effectuated).

Obtaining the data and scope of the review

Executed DOCAs and related Forms 5056 ('Notice that deed wholly effectuated') and Forms 524 ('Presentation of accounts and statement') are publicly available from ASIC for a prescribed fee. However, purchasing all the data from ASIC necessary to ensure a statistically-significant sample of 72 deeds was an expensive proposition.

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[7] Following effectuation of a DOCA the deed administrator is required to lodge a Form 5056 ('Notice that deed wholly effectuated') pursuant to s 445FA of the Act.

[8] A sample size of 72 yields a confidence interval of 10.31% with a 95% confidence level. The author acknowledges the generous assistance of Ms River Paul, Statistician with the Australian Financial Security Authority ('AFSA') for her valuable input on the author's proposed sampling methodology.

Accordingly, deed administrators were identified through public Gazette notices and ASIC's new Insolvency Notices publication website. The relevant insolvency practitioners were then approached directly by correspondence to seek their assistance and support in providing copies of the following documents for each randomly selected DOCA:

1) The DOCA itself;
2) The relevant final Form 524; and
3) The relevant s 439A report for the creditors' meeting at which it was resolved that the company enter into the DOCA.

Given that the documents sought were already publicly available from ASIC (save for the s 439A reports), no significant confidentiality issues were encountered in respect of the requests. Naturally, this report (as promised) does not identify or name any specific companies, practitioners, firms or deeds but seeks to provide an 'aggregated' analysis of the data and observations compiled in the course of the review of the sampled DOCAs.

It is important to note that s 439A reports were not able to be obtained for all 72 randomly sampled companies. This did compromise the review at one level in that the s 439A report which preceded a DOCA often provides the most informative picture of the underlying context, objectives and projected outcomes of the relevant DOCA which was ultimately approved by creditors at their second meeting. The profile and composition of the ultimate sample – in terms of documents – is summarised in tabular form below.

Table 1: Profile of Sample (by various documents)

Document	Number obtained/sampled
Deed of Company Arrangement ('DOCA')	68
Final Form 524	72
Section 439A Report	48

Subject matter of DOCA sample review - what information was captured?

The template 'Record of Data (DOCA) Review' – **Appendix 'A'** to this report - sets out the scope of information observed and 'captured' in respect of each of the DOCAs and associated documents sampled and reviewed. The template record partially 'mirrors' some of the information requested in ASIC's new Form 5047[9] – an approach premised on the view that some consistency with that new prescribed form may prove useful at a later point in time.

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What follows is an account of the findings of the review and some conclusions and recommendations arising from the observations made.

[9] ASIC's Form 5047 was updated (revised) on 1 July 2013.

FINDINGS

Profile of companies by industry and size

Breakdown of DOCA companies by industry

Each of the relevant companies which had entered into the sampled DOCAs were classified according to their industry, using the same dichotomy found in ASIC's new Form 5047. The only document to hand in the sample which could verify the industry in which each company traded was the s 439A report. Accordingly, in this aspect the sample was limited to 51. (21 companies were not able to be attributed to an industry by reference to the DOCA or Form 524.) The breakdown of companies by industry is as follows:

Table 2: Profile of sampled DOCA companies by industry

Industry in which company traded	No.	%
Construction (including property development)	13	25.5
Other (Business & Personal) services	8	15.5
Retail trade	4	7.8
Manufacturing	4	7.8
Arts and Recreation Services	3	5.8
Information Media and Telecommunications	3	5.8
Wholesale Trade	2	4
Rental, Hiring and Real Estate Services	2	4
Financial & Insurance Services (FIS) – Other financial services	2	4
Mining	2	4
Health Care and Social Assistance	2	4
Others (various 'one-offs')	6	11.8
Total	**51**	**100%**

Breakdown of DOCA companies by company size – legislative criteria

In terms of distinguishing companies by size (ie, 'small' or 'large'), there are various views as to how to precisely define or identify a small to medium-sized company (or business).[10] In ASIC's Report 372 'Insolvency statistics: external administrators' reports (July 2012 to June 2013)' a company's size is determined by the number of full time equivalent ('FTE') employees.[11] For the purposes of this sample review of DOCAs, reference was made to s 45A of the Act which provides three threshold criteria for the definition of a small or large proprietary company. For a company to be deemed as 'small' for a financial year for the purposes of the Act, two of the following three criteria need to be satisfied:

(a) Consolidated revenue of the company (and any entities it controls) is less than $25 million;
(b) Value of consolidated gross assets of the company (and any entities it controls) is less than $12.5 million; and
(c) The company and any entities it controls have fewer than 50 employees.

As an alternative (or comparative) reference point, it is worth observing that for the purposes of the small company moratorium (CVA) regime in Schedule A1 of the UK Insolvency Act 1986, the notion of a 'small company' is determined by reference to three similar threshold criteria, two of which must also be met to render a company eligible for the regime: [12]

(a) Annual turnover of £6.5 million or less;
(b) Balance sheet total of £3.26 million or less; and
(c) 50 or less employees.[13]

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[10] For example, see 'SMEs call for universal definition of small business' (undated) on the 'News' section of Dun & Bradstreet Australia Small Business website at http://dnbsmallbusiness.com.au/News/SMEs_call_for_universal_definition_of_small_business/indexdl_8518.aspx.
[11] ASIC Report 372 'Insolvency statistics: external administrators' reports (July 2012 to June 2013)', 17. The report states that '[i]n 2012-13, 80.8% of reports related to companies with less than 20 employees'.
[12] These three criteria are in turn drawn from s 382(3) of the Companies Act 2006 (UK).
[13] A Keay & P Walton, *Insolvency Law: Corporate and Personal* (Jordan Publishing Ltd, Bristol, 3rd ed, 2012), 157 [8.2.2].

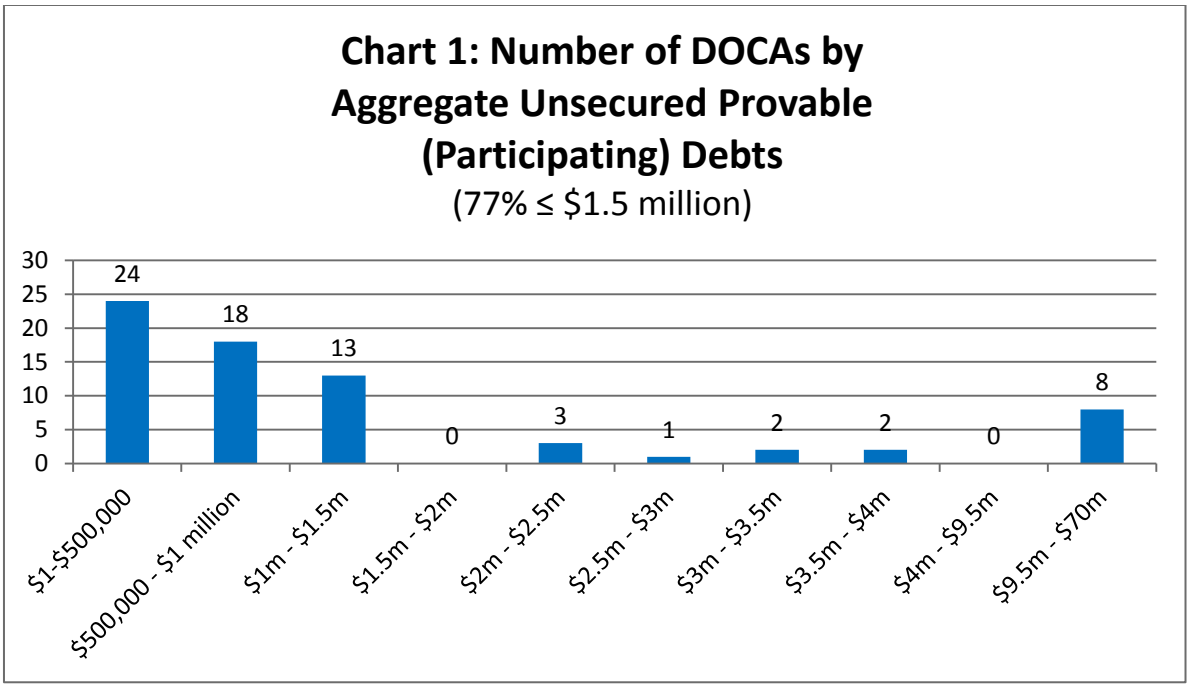
Naturally, s 45A of the Act does not purport to establish criteria for the purposes of the insolvency provisions of the Act. If Australia was to consider the concept of a small company insolvency procedure, some further reflection would be required as to the appropriate eligibility thresholds (possibly setting them lower than those provided in s 45A of the Act).

Aggregate unsecured debts: a possible criterion for defining 'small company insolvency'?

An aggregate unsecured debt threshold might be considered in framing a small company insolvency regime, along the lines of that which currently exists for debt agreements under Part IX of Australia's *Bankruptcy Act 1966* (Cth) (an alternative to bankruptcy sequestration for individuals with low levels of debts, assets and income). In that context, the sampled DOCAs were analysed according to the level of aggregate, unsecured, provable (participating) debts to which the respective DOCA responded in the way of a distribution/dividend. The findings were striking in that 55 (77%) of 71 DOCAs each addressed total participating unsecured claims in their respective DOCA funds of $1.5 million or less.

It should be noted that in 87% of cases, related-party claims were excluded from participating in the DOCA fund. Therefore, the aggregate ordinary unsecured claims participating in the DOCAs usually represented what might be described as the body of 'arms-length' creditors.

The profile of the sampled deed administrations in terms of aggregate ordinary unsecured debts of the relevant companies is reflected in the following chart.



If consideration is given to establishing some sort of small company insolvency regime, the findings of this sample review of DOCAs may suggest $1.5 million of unsecured (non-related party) debts as a possible eligibility threshold.

Profile of DOCA companies according to size: the result

Applying a combination of the above criteria – ie, the s 45A thresholds and the unsecured participating debts threshold of $1.5 million - all but 11 of the 72 sampled DOCAs (85%) appeared to relate to 'small company insolvencies' at the time of the appointment of voluntary administrators. Usually the 'small company' criteria were met simply on the basis of the s 45A revenue and asset thresholds stated above. The s 439A reports contained the best information to enable the application of the s 45A criteria. For the 20 or so DOCA companies for which s 439A reports were not able to be obtained, the unsecured (participating) debts threshold of $1.5 million was applied to assess the company as 'small' or 'large'.

Weighted average dividend returns from DOCAs

By reference to the final Forms 524 lodged in respect of the sampled DOCAs, a weighted average dividend return to ordinary unsecured creditors can be calculated. In respect of some DOCAs a degree of extrapolation was required due to either (i) the opaque manner in which the Form 524 was completed or (ii) the use of a creditors' trust for the ultimate distribution to creditors, in which case the dividends paid to creditors may not be disclosed in the Form 524 associated with the DOCA. One such final Form 524 for a 'creditors' trust DOCA' was excluded from the total sample of 72 due to its non-disclosure of ultimate dividend payments.

Across 71 sampled final Forms 524, aggregate dividend payments to ordinary unsecured creditors entitled to prove in the DOCAs totaled $15,155,664.[14] Total provable (participating) ordinary unsecured claims in the sampled deed administrations amounted to $258,439,932. This produced a weighted average dividend of 5.86 cents in the dollar across these 71 DOCAs.[15] However, five 'outliers' were identified among the Form 524 returns, namely:

- four DOCAs under each of which less than a cent in the dollar dividend was paid against total ordinary unsecured claims of $11.7 million, $18.7 million, $25 million and $40 million respectively (ie, instances of trivial or derisory dividends together with very large aggregate unsecured debts); and
- one DOCA under which a (very healthy) 35c dividend was paid to ordinary unsecured creditors whose claims totalled just over $10 million.

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[14] More often than not, the sampled DOCAs provided for the exclusion of related party creditors (eg, directors) sharing in the DOCA fund – ie, disentitling such creditors from proving for their claim and/or receiving a dividend. Accordingly, the weighted average dividend was calculated against a denominator of aggregate unsecured claims *excluding* such claims where the DOCA so provided. Thus, the denominator in the weighted average dividend calculation comprised (as best could be made out) the total or aggregate 'provable' (eligible or participating) claims according to the terms of the DOCAs.

[15] To be clear, twelve (12) DOCAs which returned no dividend at all to ordinary unsecured creditors were included in the calculation of the general weighted average dividend (ie, these 'nil dividend returns' were weighted according to the aggregate unsecured debts provable under the relevant DOCAs).

If the above five 'outliers' are excluded, the recalculated weighted average dividend was 7.55 cents in the dollar for ordinary unsecured creditors (ie, $11,546,118 of aggregate dividend payments against $152,958,600 of aggregate participating provable claims). The inclusion or exclusion of these 'outlier' DOCAs thus produced a difference of almost 2 cents in the dollar to the calculated weighted average dividend. Excluding a further ten DOCAs under which no dividend at all was paid to ordinary unsecured creditors, the weighted average dividend to ordinary unsecured creditors was 7.9 cents in the dollar.

Table 3: Weighted average (and median) dividend returns to ordinary unsecured creditors under 71 sampled DOCAs effectuated between 1 August 2012 and 31 July 2013

Weighted Average Dividend Including outliers	5.86 cents in the dollar (71 DOCAs)	
	Small Companies 9.7 c/$ (61 DOCAs)	**Large Companies** 4 c/$ (10 DOCAs)
Weighted Average Dividend Excluding outliers	7.55 cents in the dollar (66 DOCAs)	
	Small Companies 13.9 c/$ (60 DOCAs)	**Large Companies** 3.7 c/$ (6 DOCAs)
Weighted Average Dividend excluding outliers and nil dividend returns	7.9 cents in the dollar (56 DOCAs)	
Median Dividend (71 DOCAs)	$40,000 (Median dividend payments) $733,230 (Median total participating unsecured debts) = 5.4 c/$ median dividend return[16]	

[16] The median of all individual dividend rates observed across the 71 DOCAs was also 5.4 cents in the dollar. The median deed administration (according to its individual rate of dividend return) paid $65,000 against $1,199,926 provable (participating) unsecured debts – ie, 5.417 cents in the dollar.

Projected versus final dividend returns

The projected dividends notified to creditors in the sampled s 439A reports were analysed and compared against the final dividend returns reflected in the Forms 524.

Broadly, in around 73% of cases, the DOCA could be said to have generated the sort of final return which creditors could have reasonably expected on the faith of the projected dividend stated in the s 439A report (remembering of course that s 439A reports provide good-faith projections and not guaranteed outcomes).

Forty-four (44) s 439A reports were identified as recommending a DOCA and providing a projected return to unsecured creditors under that proposed DOCA. (In a few cases the s 439A report recommended liquidation in the absence of a DOCA proposal at the time of convening the second meeting but a subsequent proposal and DOCA still came to pass.) In 32 DOCAs the final dividend return exceeded, met, or only just (negligibly) fell short of, the projected dividend return set out in the preceding s 439A report. 12 DOCAs produced a final dividend return which could be said to be significantly less than that which was projected in the s 439A report.

Of the 44 s 439A reports which projected a DOCA dividend return in comparison with the alternative liquidation scenario, 34 reports (77%) projected a nil return (or the possibility of a nil return) to ordinary unsecured creditors in the event of a liquidation.

Costs of voluntary administrations and DOCAs

In light of the above observations of the typical total arms-length unsecured debts owed by the sampled companies, it is instructive to note the costs borne by the Part 5.3A process - ie, both the average and typical cost of the relevant voluntary administrations (from the date of appointment of administrators until execution of the DOCA) as well as the cost of the administrations of the DOCAs themselves.

The costs of the voluntary administrations which preceded the DOCAs were extracted in respect of 'small' companies only, as the issue of cost is more acute for the operation and effectiveness of Part 5.3A in SME insolvencies. For the deed administrations, costs and expenses were more broadly extracted for 70 sampled DOCAs.

Voluntary Administration Costs

The costs of the voluntary administrations of the small companies were extracted from the remuneration reports contained in the s 439A reports sent to creditors prior to their second meetings at which the relevant DOCAs were approved. Across 41 s 439A reports the *average* remuneration of the administrators - for the period from their appointment to the execution of the subsequent DOCA – was $54,670. The *median* remuneration for these 41 voluntary administrations was $31,500, which may be a more reliable indicator of the level of fees typically charged in a small company voluntary administration.

Deed Administration Costs

The total remuneration and disbursements for the respective deed administrations are contained in the final Forms 524 which were either obtained from practitioners or purchased from ASIC. Across 70 Forms 524 the *average* remuneration of the deed administrators was $97,141. The *median* remuneration for the deed administrations was $28,772, which may be a more reliable indicator of the level of fees customarily (or typically) charged for the

administration of a DOCA. (Average and median expenses for the deed administrations – also reflected in the final Forms 524 - were $12,404 and $2,329 respectively.)

Lifespans of DOCAs and post-DOCA company status

The *median* duration of the 72 DOCAs which were sampled - ie, the period between their execution and effectuation - was 11.25 months. (The median duration would probably reflect the more typical lifespan of a DOCA.) The *average* duration of the sampled DOCAs was 18.2 months. At the respective ends (or extremes) of the results in terms of the duration of DOCAs were:

- 12 long-term DOCAs which ran for a period of 3 years or more; and
- 4 short-term DOCAs which were 'rolled into' creditors' trusts, meaning that the relevant DOCA was effectuated in a matter of a day or a week. (10 DOCAs were effectuated in a period of 2 months or less).

Fate (status) of the 72 sampled DOCA companies (as at 16 May 2014)

As can be seen in the table below, most of the companies which entered into the sampled DOCAs remain registered with only 21 companies (out of the 72 sampled) either deregistered or currently subject to a process of impending deregistration.

Table 4 : Post-DOCA Status of Sampled DOCA Companies (as at 16 May 2014)

Status	No.	%
Registered	46	64%
Deregistered	20	28%
Strike-off in progress	1	1%
External Administration	5	7%
Total	**72**	**100%**

Types of DOCAs: What they provide and achieve

Prevalent 'types' of DOCAs: genuine rescues and workouts or pragmatic compromises and compositions?

While typical dividend returns are noteworthy, the observations of the data in terms of the *substance* of the DOCAs – ie, their main goals or purposes, terms and conditions – are equally significant facets of the sample review which was undertaken.

In short, instances of the preservation or rescue of companies or their businesses - in a trading sense – were in a clear minority (though not negligible). Of the 68 DOCAs substantively reviewed, only 19 appeared to involve substantial trading of the business through or under the DOCA. Indeed, in only 8 of those instances did the terms of the DOCA appear to provide for or contemplate a contribution from the trading profits of the business.

Of the 49 DOCAs which did not entail any substantive trading-on of the business under the auspices of the deed administration, the most prevalent form of DOCA was invariably a 'quasi-liquidation' composition,[17] comprising the following essential features or terms:

- Full release of unsecured creditor claims in exchange for the right of those creditors to prove for a dividend in a fund established by the DOCA ('the DOCA fund'); and
- Enhancement or improvement of the ultimate return (dividend) to unsecured creditors by reason of either one or both of:
    - the establishment of the DOCA fund through third party contributions (usually directors or related parties) which would not otherwise be forthcoming in a winding up;[18] and/or

[17] In insolvency law parlance, a 'composition' is usually understood to be an agreement by creditors to formally accept a payment which is less than their full claim or debt (accepting the certainty of a specific 'cents in the dollar' return in exchange for a release of their claim or debt against the debtor).

[18] 47 of the 68 sampled (reviewed) deeds (ie, 69%) provided for third party contributions. Of the 21 DOCAs which did not, some still left open the possibility of such a contribution by providing for a director's guarantee of the company's contribution obligations under the DOCA.

- the exclusion of related party creditors from participating in a dividend from the DOCA fund (which would not otherwise transpire in a liquidation).[19]

Of these 49 DOCAs, two deeds established creditors' trusts, an ilk of DOCA which is addressed further below.

'Glorified liquidations' and 'settlement DOCAs' (mere compromises to avoid winding up an assetless shell)

Of the 49 'quasi-liquidation' composition DOCAs (excluding the two creditors' trusts), it was noteworthy how many of these provided for a DOCA fund in circumstances where there were little company assets or property available for creditors in a liquidation scenario. In 36 (73%) of these 'quasi-liquidation' DOCAs there appeared to be negligible company assets which would (or could) generate any substantial return for unsecured creditors (let alone sustain trading). In such cases, invariably the proposed distribution to creditors was effected through a DOCA fund established largely by third party contributions. Indeed, across the entire sample of 48 s 439A reports which were able to be obtained, in 35 instances (73% of cases) the s 439A report projected a 'nil return' to unsecured creditors (or a significant possibility thereof) in the event of a winding up. (The s 439A report projection is of course provided to creditors for comparative purposes when considering how to exercise their vote for or against any DOCA proposal as an alternative to liquidation.) In two further instances the relevant s 439A report projected a dividend in a winding up of less than 1 cent in the dollar.

'Creative alternative' DOCAs (trading-on compositions, genuine workouts and business rescues)

The 19 DOCAs under which companies did continue to substantially trade-on appeared to achieve what might be characterised as the optimal Part 5.3A result – ie, a rescue or at least a continuation of the business in some shape or form (post-DOCA) for the benefit of both

[19] 59 out of the 68 DOCAs reviewed provided for the exclusion of related parties from participating in the distribution of the DOCA fund (or associated creditors' trust or deed administration property).

creditors and other stakeholders in the business such as directors, equity holders and/or employees. The manner of company/business rescue or workout varied among these 19 DOCAs. There were some instances (again) of simple 'upfront' compositions to promptly and expediently release the company's unsecured debt and facilitate a new equity investor or purchaser of a restructured business. (In such cases the DOCA fund would be established by the investment contribution made by the new purchaser or equity provider.)

Alternatively, some of the trading DOCAs were essentially compromise workouts designed to improve cash flow and returns to unsecured creditors while the company and its business enjoyed the moratorium or 'standstill arrangement' established by the DOCA. Sometimes the end result or goal appeared to be a 'clean slate' or 'fresh start' for the company and its business in its present form, in which case the required contributions from trading to establish the DOCA fund would usually be guaranteed by the directors, and related parties would be ineligible to participate in the DOCA fund (presumably to 'sweeten the deal' for creditors). In other instances, the DOCA was intended to also facilitate the exploration of options in the way of a restructure, merger or amalgamation, while still allowing the company to trade on for a limited period for the benefit of creditors.

Perhaps unsurprisingly, these 'creative alternative DOCAs' appeared typically to yield a higher ultimate return for ordinary unsecured creditors. The weighted average dividend for 18 of the 19 'creative alternative DOCAs' was 16.7 cents in the dollar. (One DOCA was subject to a creditors' trust and so the final dividend return to creditors was not available on the face of the Form 524.) After excluding the very successful 'outlier' DOCA mentioned above[20] the weighted average for 17 of the 'creative DOCAs' was still 11.1 cents in the dollar. By comparison, the weighted average dividend for ordinary unsecured creditors of the 49 'quasi-liquidation DOCAs' was 3.6 cents in the dollar. It is perhaps self-evident that where a company still has some semblance of a trading business to speak of when it enters voluntary administration, the administrator and stakeholders have more to work with in procuring a favourable outcome.

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[20] Only one of the five outliers was a 'creative alternative DOCA'.

Of course (without stating a firm opinion on the matter) where a business is rescued and continuity of employment is achieved for workers, the ultimate return to unsecured creditors may not necessarily be the sole criterion against which to assess the 'success' or otherwise of a given DOCA. The broader economic and social implications of corporate or business rescue - as to which there are competing views - are relevant considerations, but beyond the scope of this particular research.

The profile of the objectives, outcomes and 'types' of the 68 DOCAs substantively reviewed is summarised in **Chart 2** on p 23.

Noteworthy (prevalent) terms and conditions of the sampled DOCAs

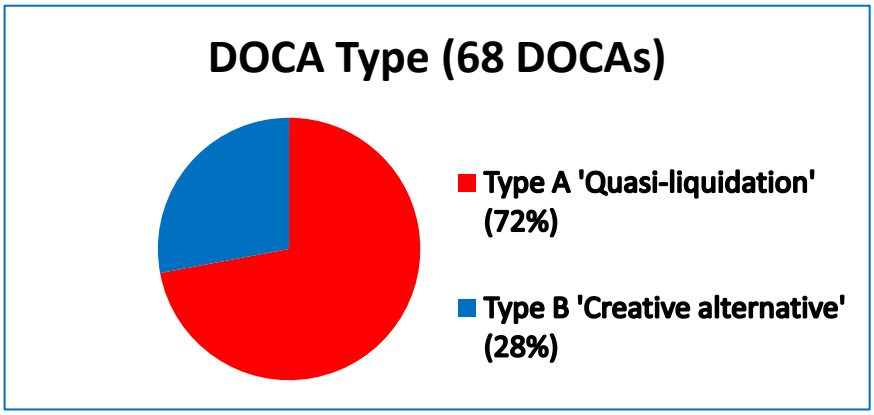
Some other observations and results extracted from the global sample are worthy of specific mention:

- In 59 out of the 68 DOCAs reviewed (ie, in 87% of cases) related parties were excluded from participating in the distribution of the DOCA fund, associated creditors' trust or deed administration property;
- All but one of the DOCAs provided for a full release of creditors' claims upon effectuation of the deed (the one exception was a holding deed which ultimately saw the business preserved/rescued and all unsecured creditors paid 100 cents in the dollar);
- Excluding 3 extremely 'short-term DOCAs', forty-nine (49) of the sampled DOCAs (or 75% of 65 relevant deeds) provided for the management/control of the company to revert to the directors upon execution of the DOCA.

Companies remaining registered post-DOCA

As reported above on p 18, a good number of companies remain registered after the effectuation of DOCAs (even in the cases of 'quasi-liquidation' DOCAs). This matter may warrant further investigation and research, but the author understands that this phenomenon may be attributable to the perceived tax effectiveness of a residual corporate shell (including any related party debts which may not have been released or extinguished by a DOCA).

Chart 2: Summary of sampled DOCA 'types' (objectives/outcomes)



TYPE A

'Quasi-liquidation' DOCA

49 DOCAs (incl 2 creditors' trusts)

- Composition by way of compromise;
- Business usually not traded on through/under DOCA (or only very limited, 'wind-down' trading);
- Returns from asset/property realisations improved, enhanced or augmented by 3rd party contributions and/or exclusion of related party claims (not otherwise forthcoming in liquidation);
- Liquidation averted (in exchange for improved or more certain return under DOCA);
- No business rescue;
- Company may still remain registered;
- 3.6 cents to 6.6 cents in the dollar weighted average dividend return (depending on outliers).

TYPE B

'Creative alternative' DOCA

19 DOCAs (incl 5 creditors' trusts)

- Trading-on composition;
- White-knight investor, purchaser or directors make (or guarantee) contribution to DOCA fund (or creditors' trust) from which dividend is paid for release of unsecured claims (facilitating either purchase/restructure or clean slate for directors);
- Alternatively (or in combination), some sort of workout for benefit of creditors, sometimes DOCA expressly providing for contributions to DOCA fund from trading profits);
- Exclusion of related-party claims in DOCA fund usually agreed to enhance outcome for unsecured creditors;
- 11.1 to 16.7 cents in the dollar weighted average dividend return (depending on outliers).

Use of DOCAs to establish creditors' trusts

DOCAs were observed to interface with a creditors' trust in seven instances, or about 10% of the DOCAs sampled. Two cases involved the use of the DOCA to facilitate a classic 'back-door listing', that is:

- using the DOCA to effect a release of creditors' claims against the company in exchange for the establishment of a creditors' trust fund in which creditors are entitled to receive a dividend share by way of distribution (in effect the creditors' rights against the company and its property are replaced with rights to prove for their claim against a trust fund instead of the usual DOCA fund); and
- enabling value to be made of the residual corporate shell (now free of debt courtesy of the DOCA release) by means of a recapitalisation and/or back-door ASX listing.

In four other instances of a DOCA being used to establish a creditors' trust, the primary rationale was to enhance the trading prospects of the company – that is, having the company escape or avoid the 'stigma' of external administration while seeking support from external suppliers/supporters to trade or continue its operations. At least two of these cases involved a 'white knight' equity investor or purchaser whose investment effectively comprised the contribution which established the DOCA fund (and which was immediately 'rolled into' the creditors' trust according to the terms of the DOCA).

Two of the DOCAs interfacing with creditors' trusts were effectuated immediately upon execution (ie, 'same day' execution and effectuation) while three other DOCAs were effectuated one week, six weeks and two months post-execution, respectively. One of the DOCAs which facilitated a back-door listing via a creditors' trust was effectuated 18 months after execution. One other instance involved a rather curious final transfer of a DOCA fund to a creditors' trust to achieve the final effectuation of the deed almost 3 years after its execution. (The original DOCA made no mention of the use of a creditors' trust though creditors may well have approved a DOCA variation which the author did not sight.)

Analysis, Conclusions and Recommendations

Better data means better evidence-based policy: Expand the final Form 524 to make it a more informative 'Final Report'

While ASIC's revamped Form 5047 (lodged after a DOCA is executed) is an improvement in terms of the data and information requested, much of the significant information it captures consists of front-end estimates and projections (expectations) as to the anticipated operation and effect of the DOCA. It is self-evident that the best assessment of the outcomes and effectiveness of Part 5.3A requires information and data in terms of 'actual' outcomes – ie, the sort of information which can only be captured at the 'back end' of the deed administration process. Serious consideration might be given to revising the final Form 524 for a DOCA so that it captures much of the same information required in the new Form 5047 – ie, not only final dividend returns but other information such as:

- A summary of the basic outcome for the company and its business through the effectuation of the DOCA (eg, whether the company's business is continuing to trade after effectuation of the DOCA);
- Confirmation of company asset realisations, third or related party contributions and the size of the ultimate DOCA distribution fund (before and after costs); and
- Details (or a basic statement) of the final position of the company upon effectuation of the DOCA including the quantum of any related party or other debts which might not have been released by the DOCA.

Such a 'final report' or expanded Form 524 would provide more (and better) 'hard data' as to the *actual* outcomes of deed administrations. The actual outcomes of DOCAs may of course vary from the estimates or expectations reported around the time the DOCA is executed, which could well be up to a year or more prior to its ultimate effectuation. Section 509 of the Act is a possible reference point (in the creditors' voluntary winding up context) for the sort of final report which might be mandated for DOCAs.

One other point which might be made is that future empirical researchers will be better served if insolvency practitioners and their staff make every endeavor to complete the prescribed returns correctly (and with consideration for the plight of any person who may later wish to review the document to divine the outcome of the relevant deed administration).

Part 5.3A: A Modest Success?

There has been a deal of recent (healthy) debate devoted to the question of the 'success or failure' of the Part 5.3A voluntary administration regime. It is contended that looking merely at the raw numbers of 'rescued' businesses and companies against the numbers of companies entering external administration is a somewhat simplistic perspective. As the Harmer Report alluded to, no corporate rescue regime can resuscitate every company in financial distress (nor should such a regime aim to do so). In the author's view, we should not be aspiring to a threshold or quota of corporate or business rescues according to some centrally-planned economic policy. (In any event, how is a desirable level of successful corporate rescues in a free market economy determined?) Above all else, Part 5.3A was designed to provide more *alternatives* – ie, a new path or means to better insolvency outcomes which might not have been available had the law remained as it stood prior to Part 5.3A's commencement.

The results and outcomes of DOCAs, as they are currently being used – at least according to the modest sample the subject of this report – appear to support the conclusion that alternatives more favourable than liquidation *are* indeed being achieved, as was the stated intention of the Harmer Report's recommended voluntary administration procedure. Most of the DOCAs sampled improved the ultimate return to unsecured creditors compared with what was likely to eventuate in the liquidation scenario. In a minority, but still significant number (28%) of cases, a DOCA was instrumental to not only improving the bottom line result for creditors, but also supporting ongoing trading and the preservation or rescue of the company's business in some shape or form. The weighted average dividend return to unsecured creditors of the sampled DOCAs (around 5.86 to 7.55 cents in the dollar) is modest to be sure, but liquidations which yield no return at all for unsecured creditors are legion. Success is always in the eye of beholder, but one can legitimately conclude that the goals of the Harmer Report have been

(and are still being) achieved through Part 5.3A and DOCAs. Whether the voluntary administration regime can be further *improved* is an altogether different question.

The realities of the situations reflected in the s 439A reports which preceded the sampled DOCAs suggest that in the case of small companies there is often little left in the way of trading or an income-producing business to accommodate any sort of outcome for creditors, other than a simple composition dividend which 'beats' the likely projected dividend in a liquidation scenario (often zero). Far from being the problem, Part 5.3A and the DOCAs appear to salvage something for creditors in those scenarios, presumably because directors either see some value in avoiding a liquidation or wish to ensure some return to creditors as a matter of commercial morality, goodwill or 'saving face'.[21] To this extent, Part 5.3A and DOCAs may be facilitating a degree of director or corporate accountability which should not be overlooked.

The 'one-size fits all' nature of Part 5.3A: Is a streamlined SME regime worth considering?

That said, the modest weighted average return achieved from the sampled DOCAs begs the question as to what price creditors pay for the Part 5.3A process (ie, through practitioner remuneration and costs). Are all the features and safeguards of the Part 5.3A process worthwhile in light of the size of the companies which appear to commonly utilise a DOCA? This is a point not directed towards the charging practices of insolvency practitioners (important a matter though that is) but rather the 'bells and whistles' Australian approach of the appointment of external administrators who are required to have little involvement with the companies or businesses of which they and their staff must assume control. The cost of process and independent control may be a significant one in the context of a small company – do the modest returns generated by DOCAs justify a rethink of whether a 'debtor in possession' or more streamlined model might better serve Australian small company insolvencies?

[21] Of course, general contentions as to the underlying motivations for DOCA proposals are a matter of speculation.

The idea of a small company, quasi-debtor-in-possession moratorium regime was legislated in the UK[22] but was not embraced in practice, arguably because of the advent of pre-packaged administrations. UK directors of SME companies who are able to purchase their business back from an administrator on the first day of a voluntary administration have little incentive to explore the prospect of negotiating a 'workout' deed (company voluntary arrangement) with creditors via the small company statutory moratorium.[23] Australia, with its innate resistance to pre-packaged administrations, might be more receptive to a 'small companies' procedure or regime.

Australia may have a unique opportunity to strike the right balance and consider the merits of a separate legislative regime for a small company moratorium with a view to the execution of a DOCA. Of course, the challenge is in ensuring that there is still a degree of balance in preserving the nominee insolvency practitioner's role as an 'honest broker', lest a streamlined regime becomes a tool for tawdry DOCA proposals which short-change creditors.

Would a streamlined small company process really produce markedly better outcomes?

However, the typical small company voluntary administrator appears to charge around $30,000 in remuneration for the period between appointment and the execution of the DOCA. One might query what real value would be gained in the way of practitioner-related cost savings in light of the scale of arms-length, participating debts typically addressed by small company DOCAs. Typical administrator remuneration for the voluntary administration period equates to around 3 cents in the dollar in dividend terms if participating claims were around $1 million

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[22] Schedule A1 to the Insolvency Act 1986 (UK). See Keay & Walton, "Insolvency Law: Corporate and Personal" (3rd ed) 2012, Bristol, Jordan Publishing, 157 for an outline of the Schedule A1 small company moratorium procedure.

[23] See Walters A and Frisby S, 'Preliminary Report to the Insolvency Service into Outcomes in Company Voluntary Arrangements'(23 March 2011), 17 who speculated that 'well-advised directors may find themselves with alternative strategies from which to choose, the obvious one being a pre-pack administration under which they themselves acquire the business and assets of the company free of its debts. At n 40 of their report, Walters and Frisby note that for some directors '[t]he choice would therefore seem to be between an immediate outlay to purchase the business and assets and a period of deprivation from participation in its profits.' In the author's view, the prevalence of pre-packs in the UK has arguably also seen a lamentable lapse in practitioner independence standards and creditor participation in UK voluntary administrations, but that is the subject of a separate debate currently playing out in the UK and Australia.

(assuming that all other things such as third party contributions were to remain constant). Will a streamlined small company administration or moratorium regime really provide a marked benefit in the way of improved returns? The gains from modest cost savings would need to be carefully considered and balanced against any potential for the abuse of a new, streamlined SME procedure.

Promoting early intervention by SME directors: The holy grail of turnaround management?

Burges, a business reconstruction and insolvency practitioner, recently articulated the importance of directors of distressed SMEs avoiding procrastination, contending that 'all too often, the operators of SMEs, particularly SMEs under pressure, are too "busy" to recognise the warning signals before them, or to spend sufficient time pausing to consider the meaning of the signals.'[24] Burges stressed the 'benefits of early intervention' – ie, that 'the earlier intervention is sought, the greater range of alternatives available' - but also noted that it was 'not uncommon' for SME directors to seek assistance at a time when 'there are no choices to be made'.[25] This sample review observed that in 50% of all cases there were very limited assets on hand by the time an administration was in train, reinforcing the point that the consequences of procrastination by SME directors are just as influential upon outcomes as are the nuances of the voluntary administration procedure. No rescue regime can realistically be expected to resuscitate corporate patients already deprived of their vital organs.

Closing Comment

Empirical research is a time-consuming but necessary process in order to properly observe and reflect upon the actual outcomes and operation of our insolvency laws. It is the author's hope that this report of a modest sample review of DOCAs plays a role in providing but one perspective - among many others - on the outcomes and effectiveness of Part 5.3A of the Act, thereby making a legitimate contribution to the ongoing debate as to the calibration of Australia's corporate rescue laws.

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[24] Burges P, 'A stitch in time: early intervention in a corporate context' (2012) 26(3) *Commercial Law Quarterly* 10.
[25] Ibid, 14.

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Appendix A

Template 'Record of Data (DOCA) Review'

RECORD OF DATA (DOCA) REVIEW

Company Data

Company Name (***confidential***)	
ACN (***confidential***)	
Small Company? (Y/N)	
Industry type	
Trustee corporation?	

DOCA Data

Date of DOCA (commencement)	
Effectuation Date	
Duration of DOCA/timeframe for effectuation	
Goal/purpose/aim of DOCA (summary)	
Post-DOCA fate of company	
Creditors Trust?	
Company's business or assets sold?	
Pre-appointment sale contract?	
Business trading on through/under DOCA?	
Control of company revert to directors?	
Related parties excluded from dividend?	
3rd party contributions?	
Quantity of 3rd party contributions	
Contributions from trading profits?	
Displacement/variation of priority entitlements?	
Release of all unsecured creditor claims?	
Schedule 8A terms displaced/excl'd/modified?	

Final Form 524 (Presentation of Accounts and Statement) Data

Total payments to priority creditors	
Total payments to secured creditors	
Total payments to unsecured creditors	
Cents in dollar return to priority creditors	
Cents in dollar return to unsecured creditors	

Section 439A Report estimated dividend for unsecured creditors (DOCA vs Liq): _____

Form 5056 (how deed effectuated): _____