The Sovereign Voluntary Administrator

Position of the Voluntary Administrator vis a` vis the company stakeholders.

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Introduction

The purpose of voluntary administration laws is to provide an efficient decision-making process to deal with insolvent companies. Two key elements in this process are:

1. Who has the ultimate control of the insolvent company and
2. In whose interests should that control be exercised?

The importance of answering both of these questions is their positive and normative implications for corporate insolvency laws. Positive, in the sense of best explaining the provisions of Part 5.3A in the Corporations Act 2001 (Cth) and normative in determining

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4 The importance of control as an aspect of insolvency is discussed by Westbrook J in The Control of Wealth in Bankruptcy (2004) 84 Texas Law Review 795. Westbrook argues at 798 that “Control of the debtor’s assets in the recovery process following general default has an important impact on both maximization and distribution.”

5 Conventional wisdom suggest that the interests of the creditors are paramount when the firm is insolvent: Kinsela v Russell Kinsela Pty Ltd (1986) 4 NSWLR 722. In Korda, in the matter of Stockford Limited (Subject to Deed of Company Arrangement) [2004] FCA 1682 Finklestein J at [50] stated plainly that “An insolvency practitioner stands in a fiduciary relationship with the creditors.” Whilst it is not clear whether the fiduciary duty may exist in relation to the company rather than individual stakeholders such as creditors, it emphasizes the importance of the creditors as a group in the insolvency context. This is not to say that other interested stakeholders may also be relevant. In ASIC v Edge [2007] VSC 170 Dodds-Streeton J at [44] said in relation to a liquidator stated that “The extensive powers vested exclusively in the liquidator entail a corresponding vulnerability in the creditors, members and the public. The liquidator is a fiduciary on whom high standards of honesty, impartiality and probity are imposed both by the Act and the general law.” There are also arguments that a broader group should be considered as having a recognisable interest in insolvency procedures: for example Warren, E., “Bankruptcy Policy” (1987) 54 University of Chicago Law Review 775; Gross, K., Failure and Forgiveness 1997

6 All future legislative references will be to the Corporations Act 2001 (Cth) unless specifically advised.
the role that company stakeholders, the voluntary administrator and the courts should play in the insolvency process.

**Position of Voluntary Administrator vis à vis the Company Stakeholders**

A voluntary administrator can be appointed by the company if its board of directors resolve:

(i) that in the directors’ opinion the company is insolvent or likely to become insolvent and that

(ii) an administrator should be appointed to the company.\(^7\)

Once appointed the administrator stands in the shoes of the company’s board of directors\(^8\) as he or she is vested with broad powers of responsibility and control, including control of the company’s business, property and affairs; the ability to carry on the business or dispose of all or part of it and exercise any power that the company or its officers could perform prior to administration.\(^9\) During administration, the powers of the directors and other company officers are suspended unless written approval is granted by the administrator.\(^10\) During such suspension, the company officers are not removed from their offices per se but,\(^11\) the administrator can remove and appoint directors if he or she desires.\(^12\)

The administrator’s appointment is relatively shortlived, existing only for generally 28-35 days, long enough so as to investigate the company’s affairs, and to form an opinion whether it would be in the creditors’ interests for the company to:

1. Execute a Deed of Company Arrangement or
2. End the administration or
3. Liquidate the company.\(^13\)

The administrator’s statement of opinion, with reasons and accompanying report of the company’s business, property, affairs and financial circumstances and proposed deed of company arrangement, if applicable is then given to the creditors at a meeting convened

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7 S436A(1) **Corporations Act 2001** (Cth). It is also possible for a holder of a charge over the whole or substantive whole of company’s property s436C(1) **Corporations Act 2001** (Cth) or the liquidator/provisional liquidator to appoint an administrator s436B(1). Where the liquidator/provisional liquidator does so appoint neither the directors nor the charge holder can resolve to so appoint. S436A(2).

8 S437C(1).

9 S437A(1)(a)-(d) **Corporations Act 2001** (Cth).

10 S437C(1) & (1A) **Corporations Act 2001** (Cth).

11 S437C(2) **Corporations Act 2001** (Cth).

12 S442A(a) **Corporations Act 2001** (Cth).

13 S438A **Corporations Act 2001** (Cth).
under s439A at which the creditors resolve which of the three abovementioned courses of action to take.  

The administrator is central to the administration process. While the company creditors would appear to have the ultimate authority to determine the company’s future course of action, the voluntary administrator has a paramount position. The administrator has control of the company during the period of the administration with extraordinary powers to control the company’s business and affairs. It is the administrator’s investigative report and his or her recommendations which largely motivate the creditors in their decision-making. Further in promoting the outcomes of the voluntary administration, it is the administrator who places before the creditors a proposed deed of company arrangement. It is the administrator who chairs the meeting of the creditors under s 439A and who has considerable influence over the constituency of the creditors’ meeting through the admission of creditors’ proof of debts. In the event of a deadlock between creditors the administrator has the casting vote.

Given these wide powers, questions arise as to whose interests, of the various company stakeholders does the administrator consider when preparing his investigative report and recommendations? To whom, if anyone, does the administrator owe a duty of care or other statutory/fiduciary duty in the preparation of his report and recommendations. To determine then the position of the administrator vis a vis the company stakeholders, it is useful to firstly, consider who are the company stakeholders. Secondly, various corporate theories which explain the position of the company director vis a vis the company stakeholders can be explored and applied to the voluntary administrator to clarify the position of the administrator.

To this end, Part I will discuss briefly who falls within the definition of company stakeholders, as well as two theories of corporate governance, namely Director Primacy and Team Production Theory.

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14 S439C Corporations Act 2001 (Cth).

15 See generally Div 3 and 4 of Part 5.3A especially s 437A, s442A and Brash Holdings Pty Ltd v Katile Pty Ltd [1996] 1 VR 24; 13 ACSR 504; Brash Holdings Ltd v Shafir (1994) 14 ACSR 192; Re Ansett Australia Ltd and Korda (2002) 40 ACSR 433; Carter v Global Food Equipment Pty Ltd [2007] NSWSC 901.

16 S438A(a) Corporations Act 2001 (Cth).

17 S438A(b) & s439A(4) Corporations Act 2001 (Cth).

18 See s 439A (4) and s 444A.

19 Regulation 5.6.23 and Selim v McGrath (2003) 47 ACSR 537.

20 Regulation 5.6.21(4) Corporations Act 2001 (Cth)

The administrator’s position vis-à-vis the company’s various stakeholders can be analyzed in the way that the director is viewed under Stephen Bainbridge’s Director Primacy model, that is, one of sovereignty. Discussion of the administrator’s position is confined to the administration period rather than all of the insolvency procedures. Whilst we can speculate that much of what is argued in relation to sovereignty may apply to liquidation and possibly an administrator under a deed of company arrangement, this paper is restricted to the relatively short period of administration. Support for this contention will be discussed in Part II by considering:

1. Failure of case law to recognize that the administrator owes a fiduciary duty directly to either the creditors or shareholders of the company under administration.

2. The inclusion of provisions within Part 5.3A which while providing adequate protection of creditors’ interests and to a much lesser extent, shareholders’ interests, do not lessen the administrator’s sovereignty.

3. The importance placed upon the independence of the administrator.

Part III will then conclude with the ramifications for company stakeholders of the sovereign position of the administrator.

PART 1

Who are the Company’s Stakeholders?

Stakeholders in the corporate context have been defined as follows:

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Bainbridge ‘Responses Director Primacy and Shareholder Disempowerment’ Harvard Law Review 2006 Vol 119 1735-1758


The stakeholders in a corporation are the individuals and constituencies that contribute, either voluntarily or involuntarily to its wealth-creating capability and activities, and that are therefore its potential beneficiaries and/or risk bearers.24

This definition can be further refined by classifying such stakeholders as internal or external to the company. Internal stakeholders include employees, managers and owners. External stakeholders are creditors, customers, suppliers, competitors, governments and local communities, including special interest groups.25 Within the context of an insolvent company recognition should also be given to the widely divergent interests among creditors, who may range from employees wishing to secure continued future employment, unsecured creditors wanting to maximize their payment quickly, and government authorities content to secure payment over the longer term. Such diversity of interests may preclude collective decision-making on the part of creditors26, so that there is a need for a body or person to maintain control of the corporate insolvency process. That person in the voluntary administration process is the administrator. The greater diversity of creditors’ interests, in comparison to shareholder interests, 27 leads to the administrator being in a more sovereign position than that of company directors who can usually be removed by the shareholder constituency themselves. Colin, should we include this point as creditors do have the power to appoint another administrator eg in lieu of director appointed administrator.

Two Theories of Corporate Governance

Various theories of the firm have been developed over the years to explain ‘the separation of ownership – control, the institutional governance structures following their separation, and the legal rules responsive to their separation.’28 A useful classification of these competing theories has been provided by Bainbridge who classifies various theories along an X-axis known as “Control” which varies from shareholder primacy to managerialism. Shareholder

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26 Hu H. and Westbrook J., “Abolition of the Corporate Duty to Creditors” (2007) 107 Columbia Law Review 1321 at 1353 where the authors state that “Unlike shareholders, who face similar risks and returns from a common interest in the share price, creditors face far different risks and returns. Creditor attitudes toward corporate investment risk taking and other issues will vary accordingly.”.

27 Shareholder interests can mostly be identified in terms of the value of their shares and they can generally exit the company where dissatisfied.

primacy considers shareholders own the corporation and that directors and officers are mere stewards of shareholders’ interest. The other end of the control spectrum, managerialism, considers the corporation to be a ‘bureaucratic hierarchy dominated by professional managers’.

Control is vested in neither directors nor shareholders but managers who are free to pursue the interests of their choosing. Various theories have been put forward over time that fit somewhere along this continuum.

The ‘Y-axis’ or wealth axis denotes the interests of those whom the corporation serves. At one end of the spectrum are the theories that consider the corporation should be run to maximize shareholder wealth only, while at the opposite end are the theories that consider the interests of all company stakeholders should be considered.

(1) Bainbridge’s Theory of Director Primacy

Bainbridge’s own model varies from this classification. While Bainbridge’s theory can be plotted upon the wealth axis (as Director Primacy claims that shareholders are the appropriate beneficiaries of director’s fiduciary duties) he considers the control axis to be incorrect. Bainbridge considers boards of directors rather than shareholders or managers control corporations.

Bainbridge offers his Director Primacy Model to describe the internal governance of a corporation. Grounded in contractarian theory of the corporation, Bainbridge argues that

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in saying that the firm is a nexus of contracts it means that the Board of Directors as a sui generis body hires the various factors of production (including shareholders) using the corporation as the vehicle to do so.  

The Board of Directors derives its powers therefore not only from the shareholders but from the complete set of contracts constituting the firm. The Board does not act as agent of the shareholders as the shareholders do not own, or control, the corporation. The Board of Directors controls the corporation. However a ‘contractual obligation to maximize the value of the shareholders’ residual claim’ exists such that directors still owe fiduciary duties to the company’s shareholders. Under Bainbridge’s framework the ‘means of corporate governance’ is by board of directors’ control and the ‘ends of corporate governance’ is shareholder wealth maximisation.

Bainbridge bases his theory on the statutory decision making structure of the United States public corporation relying on the provisions of the US Delaware Code which provides that the corporation’s business and affairs “shall be managed by or under the direction of a board of directors” Bainbridge regards shareholders as essentially having ‘no power to initiate corporate action and moreover ... entitled to approve or disapprove only a limited set of board actions’. To this extent Bainbridge’s theory contradicts the ‘shareholder primacy’ theories which regard the directors as ‘mere stewards of the shareholders’ interests’. Bainbridge

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31 For a brief summary of the multitude of corporate governance theories see Thomas Clarke, ‘Introduction: Theories of Governance – Reconceptualising Corporate Governance Theory after Enron Experience in Thomas Clarke (ed) Theories of Corporate Governance (2004). These theories can be classified generally into managerial or shareholder primacy theories, based upon whom within the corporation own and/or control it.

32 Contractarian theorists such as Brian Cheffins, Company Law Theory Structure and Operation (1st ed’n 1997) 32 and Stephen Bainbridge Corporation Law and Economics (2002) 201, believe that a ‘company is a network of explicit and implicit bargains, or a nexus of contracts’ involving the various factors of production which make up the firm, namely, shareholders, employees, managers, creditors, each of whom is endeavouring to maximise his or her position. Accepting the view of Adam Smith, The Wealth of Nations 1910 that free markets are the most effective wealth creation system, neo-classical economists see companies as an efficient means for a number of parties to contract within the market.


draws a distinction however between “shareholder primacy” and “shareholder wealth maximization” considering the latter to be ‘a bargained for right of the shareholders’.

(2) Team Production Theory

In comparison, in their seminal paper, Margaret Blair and Lynn Stout consider that a public corporation is a team production requiring the combined investment of specialized inputs and coordinated effort of shareholders, executives, employees, creditors, and the local community. Each team member with the goal of profit-making provides their own firm-specific investments, albeit financial capital or firm-specific human capital, to the enterprise, a legal entity created by the act of incorporation, which results in non-separable team output. Blair and Stout argue that public corporation law provides a solution to the inevitable problems of how the economic surpluses generated by the team – the rents- are to be divided. Team Production Theory postulates that a public corporation’s Board of Directors exists not ‘to protect shareholders per se, but to protect the enterprise-specific investments of all the members of the corporate “team” including shareholders, managers, rank and file employees and possibly other groups such as creditors’. Specifically their team production model explains the essential function performed by the board of directors who sits at the pinnacle of the public corporation’s internal hierarchy. Blair and Stout consider the Board of Directors to have the ultimate responsibility ‘to co-ordinate the activities of the team members, allocate the resulting production and mediate disputes among team members over that allocation’.


40 Blair & Stout as above, note 29,249. Blair & Stout identify two problems arising from the adoption of alternative methods of division, either ex ante sharing rules which invite shirking which they define as ‘when individuals fail to make optimum efforts to ensure a joint project’s success, instead free-riding on others’ efforts’, or ex-post division which creates incentives for opportunistic rent-seeking which encompasses ‘where individuals expend time, money and other resources competing for a fixed amount of wealth, in effect squabbling with each other over the size of their individual pieces of a fixed group pie., which leads to reduced total wealth available for distribution.’.

41 Blair & Stout, as above note 29, 247.

42 Blair & Stout, as above, note 29, 253.

43 Blair & Stout, as above note 29, 251.
Blair and Stout limit the application of their team production theory to public corporations. Their rationale being that within a private corporation the Board of Directors does not experience the same freedom from direct control of the various team members, especially shareholders, executives and employees. A second theory postulated by the same authors but applicable to both public and private corporations alike is that these same team members co-operate with each other ‘not because of external constraints’ (such as legal or market sanctions) ‘but because of internalized trust and trustworthiness’.

The essential difference between Bainbridge and Blair/Stout theories is in the position of the Board of Directors. Blair and Stout argue that directors are ‘mediating hierarchs’ who ‘work for team members (including employees) who hire them to control shirking and rent-seeking among team members’. Thus under the Blair & Stout model the board of directors’ fiduciary obligation to the corporation entails a consideration of the interests of all team members albeit shareholders, creditors or employees. Bainbridge however considers the Board of Directors to be a sovereign body invested with ultimate decision-making power of the corporation. The Board’s fiduciary obligation to the corporation is satisfied by the board’s obligation to maximize the value of the shareholders’ residual claim, although the Board is not constrained to consider any of the specific interests of team members.

Bainbridge’s theory rests on the importance of control in terms of corporate decision-making efficiency and to ensure such efficiency is maintained the Board of Directors decision-making authority cannot be usurped by either shareholders or the courts. Bainbridge’s theory recognizes the need for directors to be accountable given their degree of control, but points out that ‘ultimately authority and accountability cannot be reconciled. At some point, greater accountability necessarily makes the decision-making process less

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44 Blair & Stout as above note 29, 249.
45 Blair & Stout above note 29, 281.
48 Bainbridge as above note 18, 199.
efficient, while highly efficient decision-making structures necessarily entail non-reviewable discretion.\textsuperscript{49}

Whilst it may be debateable as to how well these theories reflect the reality of the corporate governance structures under the \textit{Corporations Act},\textsuperscript{50} such theories do provide a means of explaining the role of the administrator under Part 5.3A. In particular, Bainbridge’s theory can be applied to the position of the administrator given the legislative rights and duties that are placed upon the administrator in a voluntary administration.

\textbf{Question: Which, if either, of the above theories best reflects the position of the voluntary administrator vis à vis the company stakeholders?}

Adapting from Diagram 1, Bainbridge’s X and Y axis to reflect the position of the Voluntary Administrator within the insolvent company the following models are possible.

\footnotesize{\textsuperscript{49} Bainbridge as above note 18, 199. Bainbridge cites the sole power of shareholders to elect directors, countered by the diffuse nature of US stock ownership and the regulatory impediments to investor activism as insulating directors from shareholder pressure such that the Board of Directors are virtually free and unfettered when making decisions.}

\footnotesize{\textsuperscript{50} For a very interesting review of that issue see Hill J. The Shifting Balance of Power between Shareholders and the Board: News Corp’s Exodus to Delaware and Other Antipodean Tales, \textit{The University of Sydney Law School Legal Studies Research paper 08/20 January 2008}. available at \url{http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1086477#PaperDownload}}
In terms of control\textsuperscript{51} our model, an adaption of Bainbridge’s Director Primacy model considers the voluntary administrator to be of paramount importance. The sovereignty of the voluntary administrator’s position is evident not only by the vesting in him or her of broad powers of responsibility and control, superseding the previous control exercised by the company directors, but also by the moratorium of creditors claims during the administration period. \textsuperscript{52} This is despite the fact that the creditors do have a voice as they will usually be voting in the second meeting. For reasons outlined above in relation to the casting vote, the information provided and effectively controlling any deed proposal, we argue that control rests more with the administrator.

In relation to the wealth axis, under the Director Primacy model the Board’s fiduciary obligation to the corporation is satisfied by the board’s obligation to maximize the value of the shareholders’ residual claim, although the Board is not constrained to consider any of the specific interests of members. With respect to the voluntary administrator his or her role by way of the objectives of the Part, is to:

\section*{Notes}
\begin{itemize}
    \item \textsuperscript{51} That is the x axis.
    \item \textsuperscript{52} Excluding certain secured creditors interests s441A-C Corporations Act 2001 (Cth) and the interests of certain owners/lessors of property used /occupied or in the possession of the company s441E and S441G Corporations Act 2001 (Cth).
\end{itemize}
(1) maximize the chances of the company or a restructured form of the company’s business continuing to exist or failing that

(2) obtain a better return for the company’s creditors and members than would result from an immediate winding up. 53 (emphasis added)

Priority is given to the possibility of the company continuing, even if in a restructured form, as the obtaining of a better return for both creditors and members on the company’s liquidation is only considered if that possibility does not arise. Thus the administrator stands in a position of seeking better returns for creditors (and possibly members) under the second objective. However, even in relation to the goal of trying to have the business continue, it is clear in a practical sense that the business will only continue where that is more likely to give creditors (or at least some of them) a better return than liquidation. Hence it is argued that the administrator will be looking to the creditors’ interests rather than a general group of stakeholders in performing his or her tasks. In Bainbridge’s approach to the position of directors, he postulates that the directors adopt shareholder wealth maximisation because it is necessary to attract capital and because of the reputational effect. With respect to voluntary administration, it is not so much the contractual rights of creditors but the statutory provisions54 that will create the incentive for the administrator to effectively give them paramount consideration. There may be some reputational effect as well in that an administrator that is effective in gaining good returns for large numbers of creditors or those who are frequent users of the insolvency practitioners’ services55 is likely to gain further appointments.

Bainbridge’s theory can be adapted in this way despite the limitations on that authority under the legislation. For Bainbridge the recognition of the sovereignty of the board exists despite the fact that the directors are constrained by aspects of corporate law. It is possible to identify several constraints upon the administrator’s position as well. In looking at each of these below we conclude that they do not alter the administrator’s fundamental position of power. One initial difference between the position of a board of directors and the insolvency

53 S 435A Corporations Act 2001 (Cth) being the objects of Part 5.3A.

54 Such as s 439A and those provisions that enable creditors to seek redress from the court.

55 Such as banks and the ATO.
practitioner appointed as an administrator is that the administrator is required to be registered: s448B. This requirement however, does not reduce the administrator’s powers once appointed to the company. In fact it is the basis for allowing such wide powers to be granted to the administrator. Registration enables sovereignty rather than reduces it. Whilst the registering authority\(^{56}\) may take action \textit{ex ante} to sanction the particular behaviour of a particular administrator, the powers as appointed are identifiable in the legislation and discussed below.

Another limitation on the administrator’s sovereignty is found in the creditors’ right of replacement. Replacement can occur at two stages: when the first meeting of creditors is held and when the second meeting decides to enter into a deed of company arrangement or liquidation. In the first case there is little restraint on the administrator as a result of the first meeting. In practice the meeting is held so early in the administration that it is rare for the creditors to be in a position to seek a replacement.\(^{57}\) Further the position of directors is probably less secure in that the shareholders as a group do have powers to seek removal by way of a vote at a general meeting. See earlier comment Secondly, it is common for the administrator who can succeed in getting support for his or her recommendation to also gain support for continuing in their position as well. Lastly, the administrator is in a strong position to be retained even if there is a move against him or her because of their casting vote.

The final limitation of the administrator’s powers is a significant one and that is the power of a secured creditor with a charge over the whole or substantially the whole of the company’s assets to enforce their charge during the decision period.\(^{13}\) look up if there is a limit on this power. This power residing in the secured creditor is one that is possibly not reflected in the directors’ situation as described by Bainbridge. Of course it only exists where such a charge is in evidence with respect to the company. Where that happens though it will impact on the behaviour of the administrator as he or she is likely to need to act so as to protect the chargee’s interest.

\textbf{Part II}

\(^{56}\) Namely ASIC as per s1279 and 1282

\(^{57}\) This is supported by comments in the CAMAC and PJC Reports where there were serious proposals to remove the requirement for such a meeting.
It is appropriate to think of the administrator in terms of sovereignty in the sense used by Bainbridge, rather than by Blair and Stout. The emphasis given to the aspect of control exercised by the Board of Directors under Bainbridge’s theory is more reflective of the control exercised by the Voluntary Administrator during the short period of administration. Adapting Bainbridge’s Director Primacy Model provides a clearer view of the role that administrators play in the Part 5.3A procedure. Support for this contention can be gained from a consideration of a number of factors:

1. Failure of case law to recognize that the administrator owes a fiduciary duty directly to either the creditors or shareholders of the company under administration.

2. The inclusion of provisions within Part 5.3A which while providing adequate protection of creditors’ interests and to a much lesser extent, shareholders’ interests, do not lessen the administrator’s sovereignty.

3. The importance placed upon the independence of the administrator.

**Fiduciary Duty of the Administrator**

There seems little doubt that the administrator will be classed as a fiduciary because he or she is in a position of control of the company’s assets. Although this is readily identifiable it is much more difficult to find in either the case law or the academic literature discussion of its significance. There is a considerable question to be asked in such circumstances as to what being a fiduciary means in terms of obligations on the administrator. Certainly where an administrator favours themselves at the expense of the company in a blatant breach it may be a useful categorisation. However the more usual situations are often examples of more subtle conflicts. It has been suggested that the voluntary administrator will inevitably fail

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58 Reference to the administrator as fiduciary is found in *Wood v Laser holdings Ltd* (1996) 19 ACSR 245 at 266; *Hill v David Hill Electrical Discounts Pty Ltd* (2001) 37 ACSR 617 at 621; *Cresvale Far East v Cresvale Securities (No.2)* [2001] NSWSC 791 at [21-22]; *Lombe v Wagga Leagues Club Ltd* [2006] NSWSC 3 at [65]


in terms of their fiduciary duty to the company having regard to the interests of both creditors and members because of the structure of Part 5.3A. Both Glover & Duns and Austin & Brown, rely upon a direct analogy between the position of a company director and an administrator who replaces the director during the course of administration. Further, Austin & Brown rely on there being nothing in the Corporations Act inconsistent with such a proposition. We object to both arguments. Firstly, while supporting the director/voluntary administrator analogy, such an analogy does not extend to the administrator owing fiduciary duties directly to creditors. A director’s fiduciary duty is owed to the company in accordance with the equitable principle laid down by Mason J. in Hospital Products Ltd v US Surgical Corporation as the ‘fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense.’ The Corporations Act makes clear that the administrator acts as the company’s agent.

A company director’s fiduciary duty does not extend to the company’s creditors as made apparent in Spies v R. Similarly, a voluntary administrator’s fiduciary duty does not extend to the company’s creditors. Austin and Brown, along with Duns & Glover seek to extend the duty owed by the administrator to creditors relying upon the statutory role allocated to creditors, but this is a tenuous link given that the fiduciary duty is one arising under non-

61 ‘.. the question to be resolved is whether the risk [of breach of duty] is so real and endemic that the scheme of voluntary administration in Pt 5.3A is fatally flawed’ Justice Robert Austin and Robert Brown ‘Voluntary Administrators as Fiduciaries’ in Ian Ramsay (editor) Key Developments in Corporate Law and Trusts Law: Essays in Honour of Professor Harold Ford 2002, 179- 201, 200; and ‘There is, perhaps, a design problem with Pt 5.3A of the Corporations Act in relation to the possibility of fraud. It is too mechanistic…Equitable learning on the characterisation of improper purpose has been ignored.’ John Glover and John Duns Insolvency Administrations at General Law: Fiduciary Obligations of Company Receivers, Voluntary Administrators and Liquidators Insolvency Law Journal Vol 9 September 2001, 141.

62 [1984] HCA 64 at [67 –[87]; (1984) 156 CLR 41

63 [1984] HCA 64 at [67] –[87]; (1984) 156 CLR 41

64 S437B Corporations Act 2001 (Cth)


statutory principles. As has been pointed out “Fiduciary relations are of different types, carrying different obligations”\textsuperscript{67} and that “[t]he categories of fiduciary relationships are infinitely varied and the duties of the fiduciary vary with the circumstances which generate the relationship”\textsuperscript{68}. The duty of the administrator must remain one to the company in order for it to have any practical meaning. If it were owed to creditors individually it would be impossible to deal with the conflicting interests held by the various creditor groups such as secured creditors and non-secured creditors, employee and other unsecured creditors and so on. Of course even having the duty owed to the company does not eliminate issues of difficulty as the immediate question is who the company is at this stage. In resolving this it is likely that the creditors’ interest is paramount but it cannot be said that they are the only stakeholders in companies that are potentially salvageable.

The fiduciary duty helps to eliminate some of the possible agency conflicts arising between the pursuit of the director’s personal interests and those of the company. Thus fiduciary duties provide an alternative source of protection against opportunism.\textsuperscript{69} The identification of the administrator as a fiduciary does not however take matters very far and we argue that there is a need to provide other ways to protect stakeholder interests in the situation of insolvency and administration in particular. The notion that a greater identification of the administrator as a fiduciary would somehow assist in these situation we believe is misguided. Under Bainbridge’s director primacy theory shareholders are the beneficiaries of corporate fiduciary duties because the shareholder’s investment in the firm is a transaction-specific asset\textsuperscript{70} whereas non-shareholder constituencies (other internal or external stakeholders) are

\textsuperscript{67} Per Gibbs CJ in Hospital Products Ltd v US Surgical Corporation. [1984] HCA 64 at [30] ; (1984) 156 CLR 41

\textsuperscript{68} Per Mason J in Hospital Products Ltd v US Surgical Corporation. [1984] HCA 64 at [84] (1984) 156 CLR 41


\textsuperscript{70} Bainbridge relies upon Oliver Williamson’s transaction-cost economics model and the essential conditions of transaction specificity displayed by the shareholder’s investment: the investment is both at risk and turned over to someone else’s control. See Oliver Williamson, Corporate Governance 93 Yale Law Journal 1984, 1197, 1225.
not owed fiduciary duties as either do not invest in transaction-specific assets or are better able to protect those investments in other ways (emphasis added) 71.

Applying the principles of Bainbridge’s Director Primacy Theory to the position of the Voluntary Administrator there are sufficient provisions within Part 5.3A which provide better protection to creditors of their investments such that a fiduciary duty direct to creditors does not exist. Further by having specific provisions available to remedy default the broad duties owe to the company 72 do not assist in any practical meaningful way. This article will now consider some of the specific protections and their effect upon the sovereignty of the Voluntary Administrator.

Adequate Protection provided by Statutory Provisions while still maintaining the Voluntary Administrator’s Sovereignty

With respect to the possible misconduct by the Administrator a number of provisions in part 5.3A provide more than adequate protection to creditors, but limited protection to members such that it is not considered that fiduciary duties are owed by the administrator to non-shareholders.

These statutory protections have been discussed in Austin and Brown’s article 73, specifically s445D, s445G, s 447A, s447E, and s600A, s600B and s600C of the Corporations Act 2001 (Cth).

Essentially the ambit of these provisions is to protect the interests of the creditors, as a whole, although regard in some instances is given to the company’s member’s interests. This article will restrict its discussion to those provisions concerned with the relatively short voluntary administration process under Part 5.3A, rather than those provisions which alter or

71 Stephen Bainbridge ‘Director Primacy: The Means and Ends of Corporate Governance’ Northwestern University Law Review 2002-2003 547-606, 587. Bainbridge gives the example of employees who are sufficiently mobile so as to be defensible against opportunistic conduct of directors while recognising many employees invest in firm-specific human capital.

72 By the administrator as an officer of the company under Part 2D.1.

terminate a Deed of Company Arrangement if one exists. To that end, the article will consider only s447A, s447E, and s600B and s600C.

**S447A**

A broad spectrum of company stakeholders may bring an application under s447A for the Court to make an order regarding how Part 5.3A is to operate in relation to a particular company. 74

The court’s powers under s447A are supervisory in nature, and are generally concerned with regulating the procedures, rather than the outcomes of an administration, so as to minimize court involvement, thus reducing administration costs and maximizing funds available to creditors. Courts have utilised the s447A power to:

1. Grant orders to rectify Deeds of Company Arrangements so as to ensure their validity and operation 75 or
2. Vary Deeds of Company Arrangements 76
3. End the Voluntary Administration 77

Since the High court decision in *Australasian Memory* 78 all of the cases dealing with the section have considered the court’s powers to be wide. Earlier judgements also recognised the breadth of power – for example Justice Burchett in *Aloridge Pty Ltd v Christianos* 79 used words such as ‘broad discretionary powers’ 80 and ‘unfettered’ to describe the court’s powers under s447A. This seems to take matters too far though in the light of the later cases. However, although Finklistein J. suggested in obiter that the practice of appointing a special purpose liquidator could be extended to an administration by amending the deed of company

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74 S447A (4) Corporations Act 2001 (Cth) includes the company, its creditors, the administrator, ASIC or any other interested person such as a company member.

75 Reed Construction Australia v DM Fabrications Pty Ltd (2007) 25 ACLC 1463.

76 Re Pasminco Ltd (No2) [2004] FCA 656; 22 ACLC 744; 49 ACSR 470 22 ACLC 744.

77 S447A(2) Corporations Act 2001 (Cth).

78 Australasian Memory Pty Ltd v Brien (2000) 200 CLR 270.

79 1994 12 ACLC 237 at 238; see also Brash Holdings Ltd v Katile Pty Ltd (1994) 12 ACLC 472 .

80 Aloridge Pty Ltd v Christianos (1994) 12 ACLC 237 at 238 Justice Burchett described the Court’s jurisdiction as an important control over the ‘immense powers’ given to the administrators under Part 5.3A.
arrangement relying upon s447A 81 it was considered beyond the powers of s447A to authorize the appointment of an additional administrator to investigate the conduct of a deed administrator.82 Such a ruling is consistent with the views of Brennan CJ., McHugh, Gummow, Kirby and Hayne JJ.s in their joint judgement in *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* 83 where they stated:

> s447A of the Corporations Law empowers the court to make such orders as it thinks appropriate about how [Part 5.3A] is to operate in relation to a particular company. Assuming that the Federal Court could exercise that power it would not support an order taking away the discretionary powers of the administrators.

It is in this regard that the powers of the administrator are considered paramount. The High Court recognizes the importance of the voluntary administrator’s control in maintaining decision-making efficiency of the corporate insolvency process such that, his or her discretionary powers are not to be usurped by the courts.

**S447E**

Section 447E(1) gives consideration to not only the interests of some or all of the company’s creditors but also to some or all of the company’s members when determining to remove the administrator accused of managing the company’s business/property/affairs in a way prejudicial to such interests.

The procedure relies on s447E to supervise the administrator’s role, but again the court’s powers to do so are limited and the sovereignty of the administrator’s position in terms of managing the company and the process is apparent. It is a pre-requisite to the exercise of s447E that proof exists of the administrator having:

1. Managed or managing the company’s business, property or affairs in a manner that is prejudicial (not might be prejudicial) to the interests of some or all of the creditors or members 84 or

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2. has done or proposes to do an act or omission that is or will be prejudicial to such interests.

The need for such proof of prejudicial conduct towards the members of or creditors of the company under administration meant that a failure to perform an investigation of an administrator’s own conduct in the administration did not amount to relevant prejudicial management for the purposes of s447E. 85

S600B and S600C

The power of the administrator is further enhanced by his or her ability to exercise a casting vote at a creditors meeting under Part 5.3A where there is a disagreement between creditors by number and creditors by value. 86

The courts ability to set aside, pass or vary such a resolution rests upon:

1. The application to the court by a person or their agent who voted against the resolution (if it was passed s600B(2)) or by a person or their agent who voted for the resolution ( if it was lost because of the casting vote or failure to exercise a casting vote s600C(2)) of the administrator presiding at the meeting.

2. Whether the administrator has properly exercised the casting vote in the interests of creditors as a whole. 87

As to the latter requirement this duty will be satisfied if exercised honestly and in accordance with what the administrator believes to be in the best interests of those affected by the vote. 88 No other fiduciary duty exists to exercise a casting vote in any particular way other than this general duty. 89 The court is permitted to review all the material available to the administrator when exercising his or her casting vote. 90 However, there remains doubt as to whether the review extends to the court revisiting the commercial reasons for the manner of

86 Regulation 5.6.21 Corporations Act 2000(Cth).
87 Re Martco Engineering Pty Ltd (1999) 32 ACSR 487.
90 Hodgson, JA. In Young v Sherman & Anor (Accenture) 2002 20 ACLC 1559, 1576.
exercise of the casting vote or whether the review is limited to intervention if some serious error is detected. 91

No general rule exists that the administrator should exercise the casting vote in preference to the view of the majority in value creditor over the majority in number creditor, but the court will take into account any such large disproportion. 92 There is authority for the administrator maintaining his position by lodging the casting vote even though contrary to the view of the majority value creditor. As stated by Justice Giles,

_It may be unusual for an administrator to remain in office contrary to the wishes of the significantly major creditor. But it can be so (see Network Exchange Pty Ltd v MIG International Communications Pty Ltd (1994) 12 ACLC 594), and it must depend on the circumstances. The administrator has responsibilities to the minor creditors as well as to the major creditor and would not act correctly in complying with the wishes of the major creditor simply because it was the major creditor._ 93

The voluntary administrator is vested with wide discretionary powers to administer the business, property and affairs of an insolvent company to achieve the stated objectives of Part 5.3A. He or she may be appointed, a report made to creditors and a deed of company arrangement executed with creditor approval without the sanction of the court being required. The administrator is accountable to the court. However, where the court is asked to intervene as discussed above, its power is limited in that it cannot obviate the administrator’s discretionary powers, and may only set aside an exercise of such power where it is proven to be prejudicial to the interests of the creditor/s or members or set aside the making of a casting vote by the voluntary administrator where the vote is made dishonestly and not in the best interests of those affected. Given the significant time and cost saved by vesting discretionary powers in the administrator’s hands the courts do not lightly interfere with the administrator’s exercise of decision-making authority in the name of accountability. In this sense the administrator’s position is sovereign.

The sovereign power of the administrator when structuring a deed of company arrangement is no better illustrated than by the decision in the case of _Lam Soon Australia Pty Ltd v Molit_ 94

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91 Hodgson, JA. _In Young v Sherman & Anor (Accenture) 2002 20 ACLC 1559, 1576._


(No 55) Pty Ltd\textsuperscript{94} where the full court reversed the trial decision of Justice Branson.\textsuperscript{95} The Full Court did not set aside the Deed of Company arrangement whereby creditors were separated into different classes for payment, and paid varying amounts of their debts. Rather the voluntary administrator in making the Deed sought to satisfy the objectives of Part 5.3A, namely:

(i) maximise the chances of the subsidiary (in relation to its successful supermarket) continuing in existence and

(ii) obtain a better return for company creditors and members than would result from an immediate winding up (offered slightly more than 7.7% dividend to the lessor expected to receive 7.7% dividend in liquidation).

**The importance placed upon the independence of the administrator**

One of the themes of the Part 5.3A procedure is that the administrator comes to the company as an independent person. In \textit{Bovis Lend Lease Pty Ltd v Wily}\textsuperscript{96} Austin J described independence and impartiality as the ‘very marrow of the voluntary administration system’. The issue has featured strongly in the Parliamentary Joint Committee on Corporations and Financial Services Report \textit{Corporate Insolvency Laws: a Stocktake} in 2004.\textsuperscript{97} This was then reflected in the Corporations Amendment (Insolvency) Act 2007 which inserted provisions relating to declarations of relationships in an attempt to highlight the issue to creditors.\textsuperscript{98} However in looking at the issue of the independence of the administrator it needs to be asked what ‘independence’ means.

We consider the existence of the numerous provisions ensuring the independence of the administrator, as illustrative of the heavy reliance placed upon the discretionary power of the voluntary administrator to be free to exercise discretion unencumbered by any interference

\textsuperscript{94} (1996) 70 FCR 34.

\textsuperscript{95} \textit{Molit ( No 55) Pty Ltd v Lam Soon Australia Pty Ltd} (1994) 63 FCR 391.

\textsuperscript{96} (2003) 45 ACSR 612 at [133].


\textsuperscript{98} See now s 436DA.
from specific stakeholders. A dictionary\textsuperscript{99} definition of ‘independent’ suggests it requires \textit{not being subject to authority or control by any person or free to act as one pleases, autonomous}. The concept used by Bainbridge to describe the position of the board is that they are sovereign. We suggest that this is also an appropriate descriptor of the position of the administrator in terms of the administrator’s powers and discretions.

Much of the suspicion about the independence of the administrator\textsuperscript{100} comes from the appointment of the administrator by the directors. However this of itself ought not to be of so much concern where there is broad discretion given to the administrator so that when appointed there is no control by the appointor. We do not suggest that there are no situations of inappropriate connections between appointors and administrators, but we do argue that the administrator is, once appointed, in a position of sovereignty and that this is normatively the desirable position. The administrator must be able to act in order to achieve the objectives in s 435A without being limited by the interests of particular stakeholders. Whilst the goals set out in that section do favour the interests of creditors, it is not correct to say that the administrator is acting for them. In terms of the removal of an administrator for example the basis is whether the removal would result in a better conduct of the administration not whether most creditors wish to have him or her removed.\textsuperscript{101} The appointment is a statutory one and in order to achieve those statutory objectives the administrator is provided with that degree of independence from those who may benefit from the work undertaken.

We have noted above the areas of the legislation that provide the administrator with the discretion and power to demonstrate their sovereignty.\textsuperscript{102} The support for the proposition can be found in the case law though the issue seems to be rarely litigated. One of the strongest illustrations of the power of the administrator as an independent or sovereign operator of the

\textsuperscript{99} Oxford University Press \textit{Shorter Oxford Dictionary}.

\textsuperscript{100} And as a result the voluntary administration process itself –see Parliamentary Joint Committee on Corporations and Financial Services, Australian Parliament, \textit{Corporate Insolvency Laws: a Stocktake} , 3.12.

\textsuperscript{101} \textit{Network Exchange Pty Ltd v MIG International Communications Pty Ltd} (1994) 13 ACSR 544 at 549; see also \textit{Re Central Spring Works Australia Pty Ltd: Tubemakers of Australia Ltd v McLellan} (2000) 34 ACSR 169.

\textsuperscript{102} See generally Div 3 and 4 of Part 5.3A especially s 437A, s442A.
company’s affairs was in the *Patrick’s case* the joint judgement of the majority in that case stated

The orders made [at trial] fettered the discretion [of the administrator]. In particular, order 5 precluded the Administrators from deciding whether, if trading were resumed, it would be feasible to retain the whole workforce of the employer companies. Decisions of that kind are for the Administrators to make, not the Court.

The joint judgement went on to make the point that the courts below were in error in attempting to fetter the discretion reposed in the administrator by the legislation. Thus it was not possible for even the court to make the exercise of the administrator’s discretion, in areas such as who would continue to be employed, subject to court approval. As noted above this restriction extends to the power under s 447A as well. The courts will not entertain applications for advice from administrators so that where the administrator seeks to surrender this power the ‘courts have been particularly reluctant to accept’ it.

There are sound policy reasons why this discretion is granted to administrators. The emphasis in the process is on speed of dealing with the company’s insolvency with minimal expenses. Delay may mean lost opportunity to save the company and almost certainly will result in greater costs of administration. Accordingly it makes sense to empower the administrator and not have the courts second guess what the particular decision may have been. Whilst there needs to be redress available for stakeholders in particular situations and the creditors make a decision about the future of the company through the meeting in s 439A, the administrator remains sovereign to give effect to the statutory objectives in s 435A.

**Part III**

**Conclusions**

103 *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* [1998] HCA 30; 27 ACSR 535.

104 *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* [1998] HCA 30; 27 ACSR 535 at [61].

105 *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* [1998] HCA 30; 27 ACSR 535 at [62].

106 *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* [1998] HCA 30; 27 ACSR 535 at [63].

107 *Re Pasminco Ltd (No 2)* [2004] FCA 656; 22 ACLC 744; 49 ACSR 470 at [8].

108 As discussed above at p14-19.
This paper has argued that it is possible to view the administrator as sovereign in the sense used by Bainbridge. The reason for using the Bainbridge nomenclature is to clarify the position of administrator in the Part 5.3A procedure to assist in answering the two questions posed at the commencement, viz: Who has the ultimate control of the insolvent company? And in whose interests should that control be exercised?

In establishing that the control of the insolvent company rests in the hands of the administrator it has been shown how sovereignty is consistent with the aims of the process by allowing the procedure to be undertaken effectively with minimal costs. It also overcomes a potential difficulty associated with appointments being made by directors in that once appointed the administrator need not fear any attempt to control or influence their activity and he or she may concentrate on achieving the statutory objectives. Suggesting that the administrator is sovereign describes the nature and width of the discretion given to the administrator under the legislation. Whilst it is tempting to suggest that the creditors have the ultimate control of the voluntary administration given the voting power in s 439A, it is, we argue, more correct to state that the sovereignty rests with the administrator with the creditors confined to making one decision—albeit an important one—to take the company to the next procedure. Even in making that decision though, the creditors are constrained by the manner of voting, the recommendations the administrator makes along with the information able to be supplied and the ability of the administrator in certain circumstances to exercise a casting vote.

The second normative question of in whose interests is the control exercised is perhaps the more interesting in that it requires the consideration of stakeholder interest that is at the heart of insolvency law. The argument raised above is that the emphasis placed by some on the fiduciary duty of the administrator to the creditors is misplaced. This is so for two reasons. One is that fiduciary duty approaches in the context of insolvent corporations will tend to break down under considerations of the question to whom are the duties owed? The duties cannot be said to be owed directly to creditors but must be to the corporation. Even if the duty were said to be owed to the creditors, the diverse nature of their interests means that it will be often difficult to identify a course of action because some creditor interests may be harmed whilst others are enhanced. The second reason is that in a practical sense the establishment of fiduciary duties is not productive because the appointment of the administrator is a statutory one with statutory goals and it brings with it its own statutory remedies which provide adequate protection to those parties interested in the process. The
development of a statutory set of remedies does away with the need for a fiduciary type protection. The standard form of protection given under these protective provisions gives a much more direct basis for a claim against misbehaviour by the administrator. They create more certainty for participants in the process and hence assist in achieving the objectives of the Part.