

Administrators: a change of ultimate control not a 'stop-gap' measure

Reconstruction & insolvency

The recent decision of the Court of Appeal of the Victorian Supreme Court in *Burbank Trading v Allmere* has changed the general understanding of the effect that the appointment of an administrator has on the control of a company.

In its judgment, the Court of Appeal unanimously held that the appointment of administrators to Allmere Pty Ltd was a 'change in ultimate control' of Allmere, which triggered pre-emptive rights created by a shareholders' agreement to which Allmere was a party. As a consequence and subject to the statutory moratorium given to administrators, the appointment of an administrator to a company will also trigger contractual termination rights that arise upon the change in the ultimate control of the company.

This decision raises significant issues for administrators and receivers and consequently for other stakeholders (such as the lenders and shareholders of a company) where third party rights are triggered by the appointment.

Background

Allmere was a member of the Feltex group. In 2006, administrators were appointed to Allmere and to the other companies in the Feltex group.

Burbank and Allmere were equal shareholders of Carpet Call. Their shareholdings were governed by a shareholders' agreement providing that if either shareholder wishes to sell its Carpet Call shares or was to undergo a change in ultimate control, the other shareholder would be entitled to exercise pre-emptive rights over the Carpet Call shares held by the affected shareholder.

The central issue considered on appeal was whether the appointment of administrators to Allmere amounted to a 'change in ultimate control' of Allmere.

Appointment of administrators was a change in ultimate control

The Court of Appeal unanimously held that the appointment of administrators to Allmere constituted a change in the ultimate control of Allmere. In particular, the Court of Appeal found that:

- (a) 'ultimate control' is the supreme or most authoritative decision making power and a 'change in ultimate control' signifies a change in the identity of the supreme decision-maker;
- (b) a 'change in ultimate control' need not be long-term or permanent (but had to be more than the temporary inability of an existing controller to act due to illness or similar incapacity); and
- (c) the appointment of voluntary administrators effects a radical and sweeping change in the powers of ultimate decision-making in a corporation that cannot be viewed as a typically short-term displacement of existing controllers and a brief suspension of the status quo.

Implications of this decision generally

Before dealing with a company's property, administrators will need to examine carefully each shareholders' agreement and other contracts to which a member of the relevant group is a party, so as to ensure that no pre-emptive or termination rights have been triggered by virtue of their appointment. Such rights would, of course, arise if the relevant contract confers them expressly on the happening of an insolvency event. (In this case, the pre-emptive rights were expressly triggered by a change in the ultimate control of Allmere, but not by the occurrence of an insolvency event.)

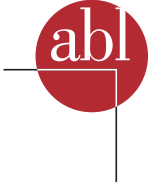
As a result of this decision, rights conferred as a consequence of a change in ultimate control are also triggered by the appointment of an administrator, thereby extending the range of circumstances that have the potential to result in the loss of a key asset as a consequence of the appointment.

Implications for short-term or 'pre-packaged' administrations

As a change in ultimate control need not be long-term or permanent, entering into a deed of company arrangement or a resolution that the administration end will have no effect as the pre-emptive or termination rights will already have been triggered by the appointment. (In fact, in relevant circumstances, the ending of an administration over a company may give rise to a second change in the ultimate control of the company.)

One of the key objects of the administration regime is to maximise the chances of the company, or as much as possible of its business, continuing in existence. The use of a short-term or 'pre-packaged' administration to restructure the affairs of a failing company is precisely what the creation of the administration regime was designed to achieve. A company and its lenders will need to think very carefully about undertaking a short-term or 'pre-packaged' administration if the appointment of the administrator will trigger pre-emptive or termination rights in respect of a key asset or contract.

In some circumstances, provisions such as section 440C of the *Corporations Act* may be used by an administrator to protect property used by a company. However, this provision only applies to protect property that is owned by a third party, including property leased to the company. More critically, this provision only operates 'during the administration' and would therefore not serve to prevent the exercise of rights that have been triggered by the appointment of the administrators even if their appointment only lasted for a short-term.



Implications for receiverships

The Court of Appeal did not consider whether the appointment of receivers amounted to a change in ultimate control. Adopting the Court of Appeal's reasoning, such an appointment would result in a change in ultimate control. This means that receivers (and those appointing them) must also be aware that pre-emptive and termination rights may be triggered as a result of the appointment of receivers. In a receivership, the situation may be even worse as protective provisions such as the statutory moratorium afforded by section 440C are not available to protect property used by a company that has gone into receivership.

Implications for subsidiaries in a corporate group

The Court of Appeal noted that it was common ground that normally, but not inevitably, the ultimate holding company of a group will be the holder of the ultimate decision making power of each of its subsidiaries. The Court of Appeal was not required to consider the effect on the subsidiaries of a change in ultimate control of the holding company of the group. However, based on the Court of Appeal's reasoning, in relevant circumstances, the appointment of an administrator to the holding company may well amount to a change in the ultimate control of each of its subsidiaries. This would be the case even if administrators were not appointed to the subsidiary, such as where the administrators replaced the majority of the directors of the subsidiary or where the directors of the subsidiary agreed to act in accordance with the wishes of the administrators of the ultimate holding company.

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