Jones Condon

Our Ref: MGJ/16/030122 ASIC/JT:AB
Reply to: SYDNEY OFFICE

31 January 2003

The Secretary
Parliamentary Joint Committee on Corporation & Financial Services
Room SG.64 Parliament House
Canberra ACT 2600

Attention: Kathleen Dermody - Committee Secretary

Dear Ms Dermody,

Enclosed is our Submission to you regarding your Inquiry into Australia's Insolvency Laws.

The submission has been prepared and structured on the issues referred to in paragraphs (a) - (h) inclusive of your letter to us dated 29 November 2002.

In Summary, approximately 6 pages of our 9 pages Submission focuses on the appointment and removal of an Administrator of a company. For reasons referred to in our Submission, we are satisfied with the current provisions of the Corporations Act (*"the Act"*) and are against any form of amendment.

We have mainly focused on the appointment and removal of an Administrator because of our concerns that there is a movement for change to a system which we believe has worked exceptionally well since its inception in 1992 and which we also believe complies with the intentions of its author, Ron Harmer.

We are not saying that the current provisions are perfect. We have endeavoured to take a balanced view in discussing the advantages and disadvantages of the current provisions of the Act. However, we have come to the conclusion/s in our recommendations that, in spite of concerns raised by certain parties, the advantages of the current provisions far out weigh claimed disadvantages and accordingly should not be amended.

Should you have any enquiries regarding the Submission please do not hesitate to contact me at my Sydney office or Mr Schon Condon of the Parramatta office.

Yours faithfully,
Jones Condon
Chartered Accountants

MICHAEL G JONES
PARTNER

Helping you. Get things under control.

Jones Condon
ABN 44 325 998 654
Chartered Accountants
Insolvency Practitioners
www.jonescondon.com.au

Sydney
Level 12
185 Macquarie Street
Sydney NSW 2000
Tel 02 9223 5333
Fax 02 9223 5394
city@jonescondon.com.au

Parramatta
Level 1, 34 Charles Street
Parramatta NSW 2150
PO Box 1418
Parramatta NSW 2124
Tel 02 9893 9499
Fax 02 9891 1833
parra@jonescondon.com.au

Bankstown
Tel 02 9708 6622
Hornsby
Tel 02 9482 7391
Penrith
Tel 02 4722 9699

Partners
M G Jones BA, FCA
S G Condon RFD B.Bus, FCA
T Javorsky BA, CA
Associates
D G Shannon B.Bus, CA
J J Tanna LLB, B.Comm, CA
B Gleeson B.Comm, CA

Member of the Natsol Australia Group, Sydney, Melbourne, Canberra, Brisbane, Adelaide, Perth and affiliated firms overseas.
Liability limited by the Accountants Scheme, approved under the Professional Standards Act 1994 (NSW).

Jones Condon

Our Ref: MGJ/16/030122 ASIC/JT:AB
Reply to: SYDNEY OFFICE

31 January 2003

The Secretary
Parliamentary Joint Committee on Corporation & Financial Services
Room SG.64 Parliament House
CANBERRA ACT 2600

Attention: Kathleen Dermody – Committee Secretary

Dear Ms Dermody,

RE: SUBMISSION REGARDING INQUIRY INTO AUSTRALIA'S INSOLVENCY LAWS

a) THE APPOINTMENT, REMOVAL AND FUNCTIONS OF ADMINISTRATORS AND LIQUIDATORS

1. Appointment of Administrator by the Company

1.1. General Comments

The current method of appointment of an Administrator pursuant to the Company's Act (*"the Act"*) is relatively simple and practical. All that is required is the consent of a registered Liquidator.

The company director/s approach a registered Liquidator of their choosing (usually by referral by the company accountant or solicitors). In essence, it is the Board of Directors choice as to who will be appointed Administrator of the company.

1.2. Advantages of this method

The main advantages are:-

- The method of appointment is simple, practical inexpensive.
- Placing a company into administration and possible liquidation is obviously a major decision of the Board. The Board must have confidence in the person who will be appointed Administrator especially if the Board has a proposal and the success or otherwise of the company's future rests

with the competence of the Administrator and the Board's ability and willingness to cooperate (in particular, be enthusiastic and not resign) with the Administrator.

- We consider one of the implied main purposes of Voluntary Administrations (*"VA's"*) is to encourage directors to appoint an Administrator as soon as possible if there are concerns about potential insolvency. Apart from a director being concerned with committing offences such as insolvent trading, other major inducements for appointing an Administrator forthwith are the matters referred to above.
- If creditors are unhappy with the Board's choice, there are statutory avenues to replace the Administrator with a person of their choice (e.g. at the first meeting of creditors or by Court approval).

1.3. Disadvantages

We consider the only disadvantage is the claimed apprehension by creditors that the Administrator appointed by the directors will only act in the directors/company's interests.

1.4. Recommendation

It is our opinion that the abovementioned advantages far outweigh the alleged disadvantage referred to above. The current method of appointment should not be changed.

Administrators are registered Liquidators who have obtained and must comply with certain technical, commercial and ethical standards. Their duties and responsibilities are set out in the Corporations Act and the Australian Securities and Investment Commission (*"ASIC"*) and Insolvency Practitioners Association of Australia (*"IPAA"*) guidelines. The Institute of Chartered Accountants (*"ICAA"*) and Certified Practicing Accountants (*"CPA"*) have also issued certain standards and guidelines to be followed by Administrators and in particular those relating to conflicts of interest.

The Administrator must prepare a report to creditors in relation to any proposal submitted by the directors/company and this report must follow strict guidelines and address specific material matters (e.g. directors offences, voidable transactions, insolvent trading) as specified by ASIC. The Administrator's report is scrutinised by creditors who have various avenues open to them if they consider the report to be deficient in any way (e.g. complaints to ASIC; voting against the proposal at the meeting of creditors; application to Court to challenge the Deed; complaints to the disciplinary committees of the CPA and ICAA).

In most situations there is a bank security such as fixed and floating charge over the company's assets. The conduct of the Administrator is also scrutinised by the mortgagee/charge holder who has the power to appoint a Receiver and Manager over the company's assets within 10 business days after being notified of the Administrator's appointment.

Furthermore, the obvious dilemma is who will appoint an Administrator if this is not done by the Board of directors and the method of appointment.

Appointment by the Court is too cumbersome and will negate the advantages of a company appointed Administrator referred to above.

Appointment by creditors also has its problems because of possible conflicts among creditors as to who will be appointed. It could be argued that a major creditor has its own self interest in mind in the appointment of an Administrator of its choice and its interests are not necessarily the interests of creditors as a whole; there could be a conflict of interest by a creditor appointing an Administrator (e.g. investigation into the company's affairs could disclose significant preference payments made to that creditor).

2. Appointment of Administrator of a company where a proposal is unlikely

It is obvious that an Administrator should be appointed if a company is trading and there are reasonable grounds to suggest that a proposal will be made by the directors. This may also be the case even if the company is not trading for various reasons (e.g. stigma of liquidation) and the Board may wish to enter into a Deed of Arrangement with its creditors.

However, it has been argued that it is an *"abuse of process"* to appoint an Administrator when no proposal is likely and the appropriate form of appointment is a Creditors Voluntary Liquidation (*"CVL"*).

We are of the opinion that a company should still have a discretion of VA or CVL even if it is unlikely that a proposal will be submitted for the following reasons:-

2.1. The appointment of an Administrator is simple and efficient. All that is required is that there be a meeting of the Board of directors to approve the appointment of an Administrator who submits his/her consent. A CVL is more cumbersome in that there needs to be convened both a shareholders and creditors meeting and notices must be forwarded to all creditors not less than 7 days nor more than 14 days before the date fixed for holding the creditors meeting. In fact, it usually takes 14 days to hold the meeting after the directors have made their determination.

There may be problems regarding obtaining the appropriate consents for short notice of the shareholders meeting (21 days notice is required unless at least 95% of the vote that may be cast at the meeting agree beforehand). There may be difficulty locating certain shareholders. There may be a shareholders' dispute regarding not only whether a CVL is appropriate but entitlement to vote. Lawyers are usually involved to give advice regarding the Articles of Association if there is the hint of a potential dispute which adds to the cost and delay.

2.2. The appointment of an Administrator is in the interest of the company and its directors when time is of the essence and an appointment must be made immediately. For example, continued trading could result in the director being exposed to insolvent trading proceedings. Continuing to trade without incurring credit while waiting for a CVL meeting can create commercial nightmares.

Furthermore, the directors may have been served with a Section 222AOE notice by the Australian Taxation Office (*"ATO"*) requiring the company among other things, to wind up the company or appoint an administrator within a period of 14 days from the issuing of the

notice. In practice, by the time the directors receive the notice, understand its implications and obtain professional advice there is inadequate time to enter into a CVL.

2.3. The strict time frame referred to in an Administration regarding calling the first and second meetings and detailed report to creditors ensure that creditors are kept informed on a timely basis of the company's financial position, results of preliminary investigations and potential dividend. With a CVL, the Liquidator is obviously not in a position to make any informed comment about the company's financial affairs at the first meeting of creditors. Unfortunately, it is not too uncommon that creditors receive their first report from the Liquidator after a period which is significantly longer than that of a VA.

2.4. A VA is more cost efficient. The Administrator must conduct certain preliminary investigations to comply with the requirements set out by ASIC regarding a report to creditors. This must be done within a relatively short period of time and regarding specific issues which ensures cost efficiencies. Although a VA entails two meetings of creditors this is also usually is the case with a CVL. The agenda of the first meeting of creditors and knowledge of the company's affairs is restricted. Accordingly, it is usually the norm that a second meeting of creditors is called not only to discuss the result of the Liquidator's investigation but also for remuneration approval.

2.5. One of the object's of a VA as set out on Section 435A of the Act is for *"...a better return for the company's creditors and members than would result from an immediate winding up of the company"*. The convening of a CVL could take 7 to 14 days or even longer if there is a shareholders dispute or the requisite majority of 95% can't be obtained to convene a meeting of shareholders on short notice (less than the required 21 days).

Creditors are always concerned about the security and control of the assets immediately prior to the holding of the creditors and shareholders meetings.

The immediate appointment of a VA in lieu of CVL would result in the assets being secured and under the control of an Administrator to ensure that they are not dissipated by the directors. Are the assets insured? Are there Retention of Title (*"ROT"*) claims resulting in suppliers attending the premises to remove their stock without their claims first being assessed. Preserving and securing the assets as soon as possible is essential in ensuring that a better return is provided to creditors. This *"time limbo"* with a CVL is avoided by a VA.

Furthermore, from experience it is also likely that a secured creditor/bank will be gravely concerned about the security of its assets which results in the appointment of a Receiver and Manager which usually is not in the interests of ordinary unsecured creditors. Although the secured creditor has priority to claims of ordinary unsecured creditors, there is usually a dispute between the bank and the unsecured creditors regarding the most efficient and best method of sale which will affect the size of the surplus after payment of the bank's debt. Secured creditors/banks are now quite comfortable with the appointment of an Administrator and it is only in rare cases that a Receiver and Manager is appointed.

2.6. While there is life there is hope. When can you be certain that a proposal will not be made? Directors have changed their minds. This usually occurs when they realise that creditors are

not as hostile as first thought and are prepared to *"listen to a reasonable offer"* which could be less than the director anticipated. Although a liquidation can be converted to a VA, this can be costly (especially if Court approval is required for the current Liquidator to be Administrator) and accordingly a deterrent.

3. Removal of Administrator

3.1. General Comments

An Administrator can be removed at the first five day meeting by a resolution passed by creditors. An application can also be made to the Court if the creditors are dissatisfied with the Administrator appointed.

The company Administrator is to be the Administrator of the Deed unless the creditors by resolution appoint someone else.

3.2. Disadvantages of this method

The main disadvantages regarding the removal are:-

- Some creditors claim that they have insufficient time to canvas other creditors to consider the removal of the Administrator. The notice of the first meeting of creditors must be given at least two business days before the meeting and some creditors claim that this is inadequate.
- An Administrator can be removed by a resolution passed by creditors. The resolution is passed if there is a majority in number of those present and voting or, if a poll is called, a majority in number and value. Some creditors claim that if there is a stalemate in that their nominee can only achieve one of the required majority (i.e. majority in number but not value or vice versa) then the Administrator/Chairman should not have the casting vote which he/she may exercise in his/her favour.

3.3. Advantages

The main advantages are:-

- It is important for an Administrator, the company/directors and creditors to know as soon as possible whether the current Administrator will continue. If a company is trading on and a proposal is to be submitted by the directors, a number of significant decisions will need to be made and possible immediate significant costs incurred. Accordingly, it is imperative that the Board and the Administrator know his/her security of tenure as soon as possible.
- In the five business days leading up to the first meeting of creditors, the Administrator would have made significant inroads in relation to trading on, assessing the company's financial position and proposal, communications with all relevant parties including creditors, suppliers, landlords, secured creditors, employees and potential buyers of the business. Significant remuneration and expenses would have been incurred. In the circumstances, it is only fair and reasonable and in the best interests of the company and creditors as a whole that the onus is placed squarely on any concerned creditor to achieve the requisite majority vote. To re-invent the wheel and incur additional significant costs cannot be justified unless there are grave concerns regarding a potential conflict of interest. If there is a conflict of interest then the

Administrator should resign in any event and it is more than likely that the creditors at the meeting will vote against the current Administrator. Furthermore, there are avenues of complaint to ASIC and even the Court in such circumstances.

- We also refer to the abovementioned advantages regarding the appointment by the company of an Administrator. The Board of directors should have a degree of faith that their appointee will retain his/her position unless there are significant valid reasons for their appointee being replaced. To replace the current Administrator with another nominee merely because certain creditors prefer another Administrator cannot be justified for reasons of costs and the beforementioned advantages of having the current Administrator. Accordingly, the onus must be placed on those creditors to obtain the requisite majority in number and value which they normally do obtain if their reasons for appointing another Administrator are significant and have merit. It should not be obligatory for the Chairman to vote in any particular way.

3.4. Recommendation

We are of the opinion that the current method for removal of an Administrator should remain the same. We refer to the advantages of the current system mentionabove.

The Chairman/Administrator of the meeting when using his/her casting vote has certain guidelines as set out by the Court and the IPAA. One guideline is that the Chairman should follow the wishes of the majority in value, however as with any rule there are exceptions (e.g. a majority in value could be a related entity or the major creditor has not given any justifiable reasons as to why significant additional costs and time should be incurred by the appointment of another Administrator). Accordingly, this power should be discretionary and the Court has the power to review the Chairman's decision.

4. Liquidator's Powers

We consider it important that a Liquidator's powers be extended to allow him/her without the need for Court approval, to collect and secure an item/assets if the Liquidator is of the opinion it is owned by the company or sold for what the Liquidator believes to be under value to a director, relatives or friends. There should be more automatic provisions removing the need for a Liquidator to go to Court to recover such assets. For example, if a bus is sold at under value to a director or relative, then the Liquidator can serve a Notice on the recipient to immediately return the bus and the Liquidator has the right to enter the recipient's premises or where the bus is held to collect it. The onus is then on the recipient to go to Court and prove that the bus should be returned. The Liquidator is only liable where evidence was given to him/her prior to collection of the assets and he/she ignored it. After all an Official Liquidator is an officer of the Court and a Liquidator in a CVL should also have this power.

5. General Matters

5.1. A Liquidator to be able to appoint himself Administrator if Liquidator determines VA is a more suitable form of administration. This would mean no need to obtain Court approval or for Liquidator to appoint a partner of the firm.

5.2. Replace expensive advertising of appointments for all types of corporate appointments, meetings, dividends etc with a central web-site on which all insolvency notices are posted. This would mean that interested parties nation wide would only have to look at one site. If this service was free then more funds would be available for the benefit of creditors.

5.3. No personal liability for Administrators and Liquidators. Trading on an insolvent entity should be carried on as an agency agreement. All Administrators under UK laws contract with NO personal liability.

5.4. Ban Retention of Title (*"ROT"*) provisions on the appointment of an insolvency practitioner. This would save significant time and costs in dealing with ROT claims and potentially provide a greater return to creditors overall.

5.5. No security of costs orders against liquidators. When commencing legal actions, Liquidators are often asked to provide a security for costs. Defendants do this suspecting the Liquidator has no funds and as a result the legal action by the Liquidator may not be taken.

5.6. For Official Liquidations (*"OFL"*), abandon fee approvals for remuneration of up to $10,000. In an OFL there are times when asset realisations are only minimal such as $1,000. The costs of calling a creditors meeting to approve fees is often greater than the assets themselves.

This issue is addressed in the Bankruptcy Act. Section 162(4) and Regulation 8.08 of the Bankruptcy Act 1996 (with regulations) entitles a Trustee to remuneration of 85% of the former IPAA recommended scale of fees without the need of creditor approval.

5.7. Annual General Meetings (*"AGMs"*) are not required for OFLs. Accordingly, there is no reason why they should be required for CVLs as they add unnecessary costs to the administration. If AGMs are considered to be necessary, the law/regulations should be changed regarding the necessity to have a quorum. The meeting should lapse without the necessity for an adjourned meeting.

5.8. The Australian Taxation Office must within a certain specified time after receipt of a dividend for Superannuation Guarantee Charge forward same to the member's nominated superfund. Any unnecessary delay results in a financial loss to the member.

b) THE DUTIES OF DIRECTORS OF PRIVATE COMPANIES

- The Act should require directors to lodge accounts annually with the ASIC. This will mean that a liquidator would have some financial information.
- Directors should be personally responsible to do all tax returns, group certificates and BAS's up to the date of the external administrator's appointment.
- Directors should be responsible for getting all records up to date – Appropriate fine if they don't, ie $1,500 which will be enforced.

c) THE RIGHTS OF CREDITORS

- Allow communications, notices, reports etc to be distributed by electronic means ie e-mail websites etc.

d) THE COST OF EXTERNAL ADMINISTRATIONS

- The government should pay Liquidators a standard fee to do OFL's thereby avoiding massive cross-subsidisation from funding. This could be potentially funded by a *"bond"* imposed by ASIC when registering a new company. If a company goes into liquidation the bond is paid to the Liquidator. This would mean a Liquidator would get some funds if only minimal. If the company is deregistered with no liabilities then the bond is returned to shareholders.

e) THE TREATMENT OF EMPOYEE ENTITLEMENTS

- Priority for limited Directors employee entitlements should be abandoned. Directors to have no rights to claim any priority. Any director employee entitlement claim to be ordinary unsecured.
- Wages and superannuation should be split into separate categories of entitlements (section 556-1(e). ie have wages a separate higher priority than superannuation. If there is insufficient funds to pay all wages and super, we are sure employees would rather they receive any distribution as wages (which they can spend) rather than super (which is invested in fund until they are 65).

f) THE REPORTING AND CONSEQUENCES OF SUSPECTED BREACHES OF THE CORPORATIONS ACT

- Liquidators need funding to assist with at least rudimentary investigations.
- More funding for the ASIC to take action against rogue directors.

g) COMPLIANCE WITH AND EFFECTIVENESS OF DEEDS OF COMPANY ARRANGEMENT

*** no comment***

h) WHETHER SPECIAL PROVISION BE MADE REGARDING THE USE OF PHOENIX COMPANIES

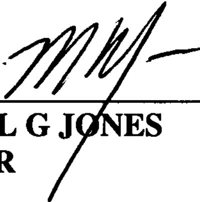
- Directors automatically banned for a period of 3 years from being a director or managing a company if they have had 3 or more failed companies. i.e. Not a discretion of ASIC.
- Directors with a history of corporate failures to pay a bond of $10,000 when a new company is created. This will at least pay the petitioning creditor legal costs and the liquidator in part if the company subsequently is wound up.
- Cancel trade or professional licences of directors who indulge in phoenix company activity. For example if a builder and they have a string of failed companies, cancel building licence.

- Make the directors personally liable for debts if they engage in phoenix activity. Ie directors personally liable for debts of a company if they have previously had 3 or more failed companies. Maybe a director should be forced to show cause to ASIC, why they are not personally liable for company debts after a series of failures.
- Restrict family members from incorporating companies that perform the same business. This would prevent family members being used as directors when the reality is that (which is difficult to prove) that the disqualified director is managing the company.

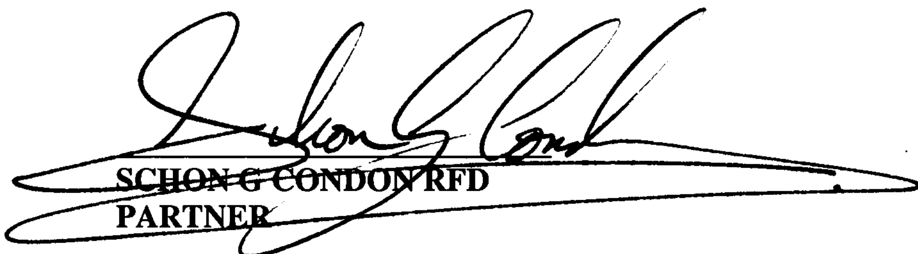
  or

  Banning a disqualified director from being involved in any way whatsoever (including as an employee, consultant) with a similar business owned by a related entity which commenced, say, less than 12 months before the failure of the director's company

Yours faithfully,
Jones Condon
Chartered Accountants



MICHAEL G JONES
PARTNER



SCHON G CONDON RFD
PARTNER