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Inside:

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Stocktake of insolvency laws

The recently tabled report of the Parliamentary Joint Committee on Corporations and Financial Services – *Corporate Insolvency Laws: A Stocktake* – addresses a wide range of issues and may bring substantial changes to Australia's insolvency laws. Senior Associate Kim Reid and Lawyer Tim James review the report and its recommendations.

Background

In November 2002 the Parliamentary Joint Committee on Corporations and Financial Services (the **Committee**), decided to inquire into the operation of Australia's insolvency and voluntary administration laws.

The inquiry was prompted by concerns that there had been no major review of the Australian insolvency regime since 1988 (the Hamer Report) and it has also been suggested that it was motivated by the spate of recent high profile corporate collapses such as Ansett and Pan Pharmaceuticals.

The Committee, chaired by Liberal Senator Grant Chapman, comprises ten members (five Government members, four ALP and one Democrat).

The Committee's terms of reference were to consider:

- the appointment, removal and functions of administrators and liquidators;
- the duties of directors;
- the rights of creditors;
- the cost of external administrations;
- the treatment of employee entitlements;
- the reporting and consequences of suspected breaches of the *Corporations Act 2001* (the **Act**);

- compliance with, and effectiveness of, deeds of company arrangement; and
- whether special provisions should be made regarding the use of phoenix companies.

Following submissions in late 2002 and early 2003, the Committee released an Issues Paper in May 2003, which is reviewed in the *AAR Annual Review of Insolvency and Restructuring Law 2003* (Go to: www.aar.com.au/pubs/pdf/arir/2003/arirmain.pdf).

The report

The Committee tabled its report, entitled *Corporate Insolvency Laws: A Stocktake (the Report)*, in both Houses of Parliament on 30 June 2004. It is available online at http://www.aph.gov.au/senate/committee/corporations_ctte/ail/report/ail.pdf

The inquiry was prompted by concerns that there had been no major review of the Australian insolvency regime since 1988 and it has also been suggested that it was motivated by the spate of recent high profile corporate collapses.

The 277-page report is a comprehensive document incorporating views and issues raised by 58 submissions, oral evidence, certain previous reviews and inquiries and, also contains the minority report of the Labor members of the Committee (the *Minority Report*).

According to the Committee, the foremost objective in the design of insolvency law is 'to promote and maximise trust and confidence in the operation of insolvency law on the part of the community in general and the business and corporate sector in particular'.

The Report addresses a wide range of contemporary insolvency related issues and, in addition to those issues raised in its terms of reference, it deals with:

- voluntary administration – success or failure;
- phoenix companies;
- cross-border insolvency; and
- other issues.

Based on those considerations the Committee has made 63 recommendations.

Key recommendations

Some of the key recommendations are:

Recommendation 1 – requiring administrators to provide a statement of independence before the first meeting of creditors.

Recommendation 2 – allowing creditors to appoint a different person as liquidator when either the administration or deed of company arrangement ends and the company proceeds into liquidation.

Recommendations 3 & 25 – prohibiting an administrator from using a casting vote in a resolution concerning his or her replacement or remuneration.

Recommendation 10 – permitting an administrator or liquidator to recover from directors who have failed to ensure company records are complete and up-to-date, the costs of reconstructing those financial records.

Recommendation 13 – removing insolvency as a prerequisite for the avoidance of uncommercial transactions that may be challenged by a liquidator.

Recommendation 14 – in relation to the threshold test to permit directors to make the initial appointment of an administrator, rewording the legislation from, if the company 'is or is likely to become insolvent at some future time' to 'is insolvent or may become insolvent'.

While the present wording in section 436A has been interpreted by some judges as being very flexible (for example in *Crimmins v Glenview Home Units Pty Ltd* [2001] NSWSC 599 (unreported 17 August 2001) as we discussed in *Turnaround Bright Eyes*, at www.aar.com.au/pubs/insol/cirdec03.htm), this recommendation is designed to alleviate perceptions that the voluntary administration procedure is only available to insolvent companies.

Recommendations 15 & 16 – amending the time periods in respect of creditors' meetings so that the first creditors' meeting is held within eight business days of the beginning of the administration (with five business days notice) and the period within which the second creditors' meeting must occur, is extended to 25 business days (with a convening period of 20 business days).

Recommendation 28 – that the Government consider establishing an 'assetless company' administration fund to finance investigations into breaches of directors' duties and fraudulent conduct.

Recommendation 31 – amending the power of the Australian Securities & Investments Commission (**ASIC**) to disqualify individuals from managing corporations under sections 206D and 206F by removing the requirement that a person must have managed two or more failed companies, by permitting ASIC or a court, to disqualify a director where a company has failed and the person is unfit to be concerned in the management of a company.

Recommendation 42 – not adopting the maximum priority proposal in respect of employee entitlements (under which employees would be placed before secure creditors) and instead to consider other reforms and measures.

Recommendation 48 – including superannuation contributions in the General Employee Entitlements and Redundancy Scheme.

As it is a Government-majority committee, it is likely that its recommendations will be largely acceptable to the Treasurer and form the basis of any legislative change.

Recommendation 54 – simplifying the creditors' voluntary liquidation procedure to enable directors to place a company in liquidation immediately.

Recommendation 55 – permitting administrators to apply to a court for an order that a party to a contract may not terminate the contract by virtue of entry into voluntary administration.

Recommendation 62 – examining further the problem of cross-border insolvency involving the misappropriation of company funds.

The Committee's entire recommendations are listed from page xxvii of the Report.

Next steps and reform

It is usual practice that a government respond to such a report within three months of its release. In the present political environment, however, and in the lead-up to an election, that may be an unlikely prospect.

Given the breadth of issues covered in the Report, the Treasurer will most likely be responsible for formulating the Government's response. As it is a Government-majority committee, it is likely that its recommendations will be largely acceptable to the Treasurer and form the basis of any legislative change.

If there is a change of government however, greater attention will need to be given to the Minority Report. According to the Minority Report, Labor members support many of the Committee's recommendations but there are certain areas where they consider additional or different recommendations are required. The key recommendations of the Minority Report include:

- a statutory code of conduct for administrators and liquidators;
- an ASIC-produced guide to fees and charges for insolvency practitioners;
- amending s206F to allow ASIC to disqualify a person who on only one occasion was an officer of a corporation wound up and the subject of a liquidator's report;
- a statutory obligation on directors to take appropriate action if a company is, or is likely to become, insolvent;
- a statutory presumption of insolvency for the purposes of the application of the voidable transaction provisions;
- an alternative model for the protection of employee entitlements in circumstances of corporate insolvencies;
- a requirement for a statement in annual reports that sufficient provision has been made for employee entitlements and contingent liabilities; and
- a provision to enable a liquidator, creditor or ASIC to apply to the court for an order that a related body corporate, in appropriate circumstances, pay the whole, or part of the amount, of a debt of an insolvent company.

It seems likely that some significant changes to Australia's insolvency laws will result from this report. We will continue to monitor the legislative process and report on any new issues of importance.



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