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Australian Credit Forum

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30 October 2003

Dr Kathleen Dermody
Committee Secretary
Parliamentary Joint Committee on
Corporations and Financial Services
Parliament House
CANBERRA ACT 2600

Dear Dr Dermody

INQUIRY INTO AUSTRALIA'S INSOLVENCY LAWS

I refer to the recent communications between Mr Frank Donnan, who is assisting the Committee, and David Francis, who is chairing the Sub-Committee of the Australian Credit Forum which has considered the Issues Paper issued by the Committee in May 2003.

The Forum's Submission is **attached**. If you have any questions in relation to the submission, please contact Mr David Francis on 0410 322 603.

Both the Forum's Vice-Chairman, Mr Barry Smith and Mr Francis will attend the Committee's Sydney hearings on 12 November 2003 to represent the Forum. Details of the hearing venue may be advised to Mr Francis by e-mail to DavidG.Francis@bigpond.com.

We look forward to hearing further from you.

Yours faithfully



Roger Bates
Chairman
Australian Credit Forum

ACF Submission on Corporations and Financial Services Inquiry into Australia's Insolvency Laws

The Appointment, Removal and Functions of Administrators and Liquidators

1.18 to 1.20 The appointment of Administrators and Liquidators

- The voluntary administrator should provide details of creditors with the first meeting notice
- The first meeting notice should be addressed to the "Credit Manager"
- The draft Deed of Company Arrangement should be provided to creditors with the notice of the 2nd meeting of creditors.
- The only Deed of Company Arrangement which can be executed is the draft as approved or amended at the second meeting of creditors.
- Administrators should post notices for committees of inspection and creditors to their website and communication via e-mail to committees of inspection and Creditors should be permitted (and encouraged).
- At the first meeting of creditors the voluntary administrator should supply an estimate of his or her fees for the periods 0-5 days and 6-28 days. These fees will only be able to be exceeded by a resolution of a majority in number of either the Committee of Inspection or the creditors generally.

1.18 Appointment of Liquidators

- Automatic transition into a creditors voluntary liquidation if the Report as to Affairs (RATA) is not lodged with ASIC within 7 business days from the first meeting of creditors.

1.21 & 1.23 Conflicting Administrations

- Companies should be prohibited from circumventing wind-up proceedings when there is an outstanding wind-up application
- Directors should also be prohibited from entering voluntary administration when the company is in Provisional Liquidation

1.25 *Removal of Administrators and Liquidators*

- The Committee of Inspection should have the right to call a general meeting of creditors for the purpose of replacing the administrator within 7 business days of the first meeting of creditors.

1.27 *Functions of Administrators & Liquidators*

- Details of any proposed Deed of Company Arrangement should be available with the notice of the 2nd meeting of creditors or available in electronic format as a download from the administrator's website
- Prohibition on "Related Parties" (using the public company definition in s228 for all companies) being members of the Committee of Inspection.

1.29 & 1.31 *Information Available to Creditors*

- See earlier comments

1.32 – 1.36 *Timing of Meetings*

- No change to timing. One of the benefits of the voluntary administration process is quick resolution.
- Support the suggestion that the Committee of Inspection has the right to call a meeting of creditors with the intention of replacing the administrator within 10 business days of the first meeting (refer comments Removal of Administrators).

1.37 *Other Aspects of the Role of Administrators / Liquidators*

- Support the need for administrators to put forward realistic deeds of company arrangement.

1.39 – 1.42 *Assetless Administrations*

- Support levies on companies on 1) incorporation and 2) on annual returns
- Support making Directors liable to reimburse the fund for the cost of initial investigations of their companies, where the company has gone into liquidation.
- Support ASIC commissioning Insolvency Practitioners to investigate Assetless Administrations where obvious breaches of Corporations Act are evident (similar to (S)305 of Bankruptcy Act), by submission to ASIC

1.44 – 1.48 The Duties of Directors

Insolvent Trading

- No comment

Voidable Transactions

- No change other than as set out below.
- **Abolition of the “peak indebtedness” rule in relation to running accounts.**
Under this Rule, the liquidator is entitled to choose any point during the relation back period, including the peak point of indebtedness, to show that subsequent to that time there was a preferential payment. This is contrary to the principle of equal treatment (*pari passu*) which underpins all avoidance provisions. It also undermines the principle affirmed by the High Court in *Civil Aviation Authority vs Ferrier* that it should be the ultimate effect of the series of transactions which determines whether there has been a preference. It also fails to take into account the wording of section 588FA which requires the transactions in the period of the running account to be treated as a single transaction.

Some examples should illustrate:

In all scenarios the creditor has given the debtor a \$10,000.00 credit limit, the transactions run for a full six months. The balance at the beginning of the six months is \$10,000 as is the balance at the end. On the last day of the 6 month period, the debtor company appoints a voluntary administrator.

Scenario 1 -- the debtor maintains the \$10,000 credit limit, that is, each month \$10,000 worth of product is supplied to the debtor who pays \$10,000 for it.

Scenario 2 -- at the end of the third month the debtor has gone \$20,000 over the credit limit to \$30,000. The creditor refuses further supply until the debtor brings his account back to the agreed credit limit. In the fourth month the debtor pays \$30,000 to get a further \$10,000 worth of product and bring the account back to the agreed credit limit. For the remaining months of the 6 month credit period \$10,000 worth of product is supplied to the debtor who pays \$10,000 for it.

Scenario 3 -- at the end of the fourth month the debtor has gone \$50,000 over the credit limit to \$60,000, by failing to pay for the previous month. The creditor refuses further supply until the debtor brings his account back to the agreed credit limit. In the fifth month the debtor pays \$60,000 to get a further \$10,000 worth of product and bring the account back to the agreed credit limit. For the remaining month of the 6 month credit period \$10,000 worth of product is supplied to the debtor who pays \$10,000 for it.

In each case the creditor has provided \$60,000 worth of product and been paid \$60,000. Using the ultimate effect doctrine no creditor has been preferred in fact. However, application of the peak indebtedness rule allows the liquidator to recover preferences of \$20,000 and \$50,000 in scenarios 2 and 3, respectively, notwithstanding

they have not been preferred in fact. This is manifestly unfair and should be changed as suggested.

1.52 – 1.54 General Duties of Directors

- No changes

1.55 – 1.57 Directors' Reports

- If Directors do not provide a Report As To Affairs (RATA) within 7 business days of from first meeting of creditors, the company goes directly into creditors voluntary Liquidation.

Rights of Creditors

1.62 – 1.66 Voting at Meetings

- No change

1.67-1.69 Statutory Demands

- No change

1.70 – 1.75 Merger of Corporate & Personal Insolvency Law

- Support leaving corporate & personal insolvency law separate

1.76 – 1.83 A New Form of Administration

- Do not support a US style "Chapter 11" as that process is believed to be too debtor driven, slow, costly, involves court time, and is generally not in the interests of creditors

1.85 – 1.88 Corporate Groups

- Support Liquidators pooling the unsecured assts and the liabilities of two or more group companies with the prior approval of all unsecured creditors

1.89 – 1.90 E-commerce & Insolvency Administration

- The use of technology and E-commerce is strongly supported in communicating with creditors and the committee of inspection to reduce the costs of external administrations and improve communications with creditors

1.91 – 1.94 Shareholders

- Support shareholders being invited to participate to fund action against directors and auditors

The Cost of External Administrations

1.98 IPAA Recommendations

- Support upper limits on practitioners fees which should be set at the first meeting of creditors

1.102 – 1.105 Rights of Review

- Propose estimates of fees be supplied by administrators to cover the 2 periods
0 – 5 days
6 – 28 days

1.104 – 1.106 Disclosure

- Administrators should only be permitted to seek fees in excess of agreed upper limits when the majority of creditors in number or of the committee agree

The Treatment of Employee Entitlements

1.107 – 1.115 The General Employee Entitlements Scheme

- No comment

1.116 – 1.124 Maximum Priority Form Employee Entitlements

- No comment

1.125 *Current Law Governing Employee Entitlements*

- No comment

1.126 – 1.128 *Superannuation*

- No comment

The Reporting & Consequences of Suspected Breaches of the Corporations Act 2001

- Support ASIC to control funds as suggested in clause 1.42 / 1.43

1.31 Compliance With, & Effectiveness of, Deeds of Company Arrangement

- The deed of company arrangement should be made available as suggested with comments at the second meeting of creditors in electronic format
- Creditors should be able to access via the administrator's firm website
- The deed has to be in the form approved by creditors at the 2nd creditors meeting.
- Any variations of "Terms of Payment" under the Deed may be extended to a maximum of 21 days from due date with the approval by the Deed Administrator in writing. After this period the Administrators or Creditors may apply for termination of the Deed.

1.133 – 1.138 *Contents of Deed of Company Arrangement*

- We do not support the ATO suggestion in 1.136

Whether Special Provision Should be Made Regarding the Use of Phoenix Companies

- We support the Cole Royal Commission proposals in total