

## **CORPORATE INSOLVENCY REFORM**

1. On 12 October 2005 the Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP, announced that the Government would be proceeding with an integrated package of reforms to improve the operation of Australia's insolvency laws.

## **ASSETLESS ADMINISTRATIONS AND PHOENIX COMPANIES**

2. The corporate insolvency regime provides for an independent insolvency practitioner to investigate the conduct of the company and its officers in the period preceding external administration. This is an important deterrent to misconduct by company officers, which complements the general body of rules concerning corporate governance.
3. Concerns have been expressed that there is generally only a limited investigation of companies with few or no assets and that this regulatory gap may be contributing to misconduct by company officers. A particular concern is the 'phoenix company' phenomenon, where business operations are transferred from one company to another to avoid having to meet liabilities to unsecured creditors (particularly revenue authorities and employees).
4. This regulatory gap arises because the remuneration and expenses of liquidators are ordinarily funded from the assets of the company in liquidation. Liquidators are not under an obligation to incur any expense unless there is sufficient available property to fund it. As a result, where a company is left with few or no assets, the liquidator is likely to perform only a perfunctory investigation. The absence of rigorous investigation into assetless administrations not only allows misconduct in the lead-up to a formal insolvency, more importantly it undermines the set of incentives and sanctions that would otherwise guide the behaviour of directors during the life of the company. Addressing the regulatory gap would improve corporate conduct generally, improve returns for creditors, and reduce the scope for phoenix activity.
5. A package of reforms has been developed in response to this regulatory gap. The key proposal is the establishment of an assetless administration fund to finance an investigation by liquidators in cases where it appears to ASIC that further investigation and reporting may lead to enforcement action. This approach draws on the existing skills of private sector practitioners to ensure that ASIC is provided with adequate information to identify and pursue misconduct by company officers in the lead-up to a company failure.

6. In addition, ASIC will be provided with additional funding to establish an enforcement programme targeting misconduct by the officers of assetless companies. This programme will focus on disqualifying directors of assetless companies who are involved in repeat phoenix activity. It will address the perception that such conduct can be engaged in with impunity provided the amounts involved are low enough to 'fly below ASIC's radar'.
7. The total cost of the assetless administration fund and related ASIC enforcement programme will be \$23 million over four years. Implementation of the Assetless Administration Fund will commence immediately, with applications for funding by liquidators being accepted from early 2006 when the fund becomes operational.
8. To support the assetless administration fund, it is also proposed that the privilege against exposure to a penalty be abrogated in proceedings where ASIC is seeking disqualification or banning orders and no other penalty. This would restore the longstanding interpretation of the applicability of the privilege, which was overturned by the High Court of Australia in the 2004 Rich case (*Rich v Australian Securities and Investments Commission* (2004) 209 ALR 271). This will allow ASIC to move quickly to disqualify directors engaged in phoenix activity, to protect creditors and legitimate competitors.
9. In addition, administrators' reports will be required to include 'any other matter material to the creditors' decision'. This would assist in ensuring that creditors, when making their decision at the second meeting, are made aware of matters such as a right of recovery against the director/s of the company for insolvent trading.

## **ENHANCING REGULATION OF PRACTITIONERS**

10. The regime for the regulation of insolvency practitioners is fundamentally sound; however, there are some anomalies and areas where the regime has become out of date. In addition, there is scope for reforms to assist creditors to make informed judgments about key issues such as appointments and remuneration.

### **Independence**

11. To address concerns about independence, administrators will be required to provide creditors with a statement of independence prior to the first meeting. This will allow creditors to prevent the appointment by directors of a 'friendly' administrator. In addition, the prohibition on inducements for the referral of work will be extended to directors and other persons. Finally, creditors will be able to appoint a new person as liquidator if the company proceeds to liquidation after an administration or deed of administration ceases. This

will allow creditors to appoint a new practitioner to investigate the conduct of the previous directors and administrator, if they are concerned about the performance or independence of the administrator.

### **Remuneration**

12. To address concerns about the costs of external administrations, practitioners will be required to provide additional information about the basis of a remuneration proposal when seeking agreement from creditors or the court. This information should be sufficient to enable the approving party to assess the remuneration as reasonable in accordance with a range of specified factors. Finally, ASIC would be able to make an application to the court to review remuneration in a voluntary administration.
  
13. The Government will also introduce reforms to address practical obstacles for insolvency practitioners obtaining approval in relation to remuneration. The reforms will:
  - a. allow administrators to apply to seek approval from the court for remuneration if creditors have not met;
  - b. allow insolvency practitioners to vote special proxies in favour of a resolution to fix remuneration;
  - c. clarify that a deed administrator's remuneration must be fixed in a separate resolution (that is, a vote in favour of a deed should not automatically be taken as approval of remuneration);
  - d. allow creditors, a committee of creditors or the court increased flexibility to approve remuneration; and
  - e. allow a fixed amount of fees to be drawn down (limit of \$5,000) where an administrator has called a meeting but failed to obtain approval to draw remuneration because of a lack of quorum.

### **FINE-TUNING VOLUNTARY ADMINISTRATION**

14. Recent reviews have found that the voluntary administration (VA) procedure is fundamentally sound, and has been successful. The following reforms respond to technical issues that have been identified since the commencement of VA.

#### **Timeframes for creditors' meetings**

15. A slightly longer period of time will be provided for holding the first and second meetings of creditors. Specifically, the period for holding the first meeting of creditors will be extended to **eight business days** after the beginning of the administration, with a requirement for **five business days' notice** of the meeting to creditors. The period for holding the second meeting of creditors will be extended to 25 business days with a new convening period of 20 business days.

16. Additional reforms will introduce greater flexibility in relation to the timing of creditors' meetings and clarify certain requirements. Specifically:
  - a. the court will be granted an express power to extend the convening period on an application made after the convening period has ended;
  - b. the law will be clarified to confirm the power of administrators to adjourn a meeting for up to 60 days, or to a date which is notified within the 60-day period;
  - c. the convening period will be calculated from the day after the administration begins; and
  - d. the law will be clarified to state that creditors may only remove an administrator and appoint a replacement administrator at the first meeting through a single resolution.

#### **Electronic communication**

17. External administrators will be given a greater discretion to communicate electronically with creditors. It is in the interest of creditors for administrators to use the most inexpensive and efficient means to provide them with information or to conduct meetings.

#### **Voting at the creditors' meeting**

18. New rules will be introduced to address practical difficulties that arise where a group of investors own key assets used by a company, for example forestry or viticultural syndicates where investors own the land and/or produce. This will facilitate business rescue in these situations.

#### **Effect of appointment of administrator**

19. A number of technical issues have been identified with the current moratorium provisions, arising from the different nature of securities that may be held in company property. To address these concerns, the law will be clarified in relation to:
  - a. the rights of persons who hold property of a company under administration as security under a lien or pledge to retain possession of that property, but not to exercise any rights under the lien or pledge to sell that property during the course of a VA;
  - b. the right of the administrator to sell property subject to liens, pledges and reservations; and
  - c. the right of a creditor to recover their debt by selling property subject to a lien, pledge or reservation of title clause, with the agreement of the administrator.
20. In addition, the general moratorium will be amended to exempt bankers' liens and shares lodged as collateral with any recognised clearing house. These exceptions recognise commercial practice with respect to the payment system and trading on the derivatives market.

21. The court power to grant an injunction preventing enforcement of a charge over particular property will be clarified such that it specifically covers injunctions against threatened enforcement actions. In addition, the ability of a chargeholder to enforce their charge in certain circumstances during the administration period will be clarified, such that it applies to court enforcement as well as extra-curial action.

#### **Deeds of company arrangement**

22. A number of technical matters have arisen about what matters should be included in a deed of company arrangement (DCA), the effect of the DCA on the company and creditors, and the circumstances in which a DCA may be terminated. To address these concerns, the law will be clarified such that:
  - a. the court's power to bind secured creditors (or owners or lessors of real or personal property) to the terms of a DCA is only exercisable after the creditors have resolved that a DCA be executed;
  - b. a company may apply to the court for an order that the company need not include the words 'subject to DCA' on its public documents; and
  - c. a debt which is extinguished by entry into a DCA is deemed not to have been extinguished for the purpose of enforcing a related guarantee or indemnity.
23. In addition, the circumstances in which a DCA can be terminated will be tightened, to prevent situations where a relatively small group of creditors could terminate a DCA even where the company is complying with its terms. Under the proposed approach a DCA would only terminate by creditors' resolution following a material breach of the DCA that has not been rectified, in circumstances contemplated by the deed, or by court order. ASIC will be included as a party who can make an application to terminate a DCA.
24. Finally, a new provision will be introduced requiring a deed administrator to notify ASIC when a deed is wholly effectuated.

#### **Powers and duties of administrators and deed administrators**

25. The powers of administrators will be extended to include a power to consent to a transfer of shares in the company, or an alteration in the status of the company's members, if this is in the best interests of the creditors of the company. This will enable administrators to reorganise the share capital base of a company in administration rather than, say, selling its assets to a new company and having the company under administration put into liquidation. It will also align the powers of the administrator with the powers of the liquidator in a voluntary winding-up. The existing power of the court to consent to these transactions would be retained, but limited to considering appeals of a decision of an administrator not to consent.

26. The administrator's right of indemnity will be clarified, to address a concern that rights may be limited in respect of some tortious liabilities. The right of indemnity will cover any personal liabilities incurred by an administrator in the due performance of the administrator's duties, other than liabilities incurred in bad faith or negligently.
27. In addition, the law will be clarified to provide that deed administrators may not sell existing shares in the company, except with the prior approval of the holder of those shares or with the leave of the court. Under the proposed approach, members, creditors and ASIC would have standing to oppose a court application for leave.
28. Finally, the law will be amended to require administrators and deed administrators to lodge with ASIC accounts of receipts and payments in line with the requirements for other forms of insolvency administration. This will improve transparency and facilitate creditor monitoring.

#### **Winding-up proceedings prior to an administration**

29. The prohibition on directors appointing an administrator after winding-up proceedings are commenced will be clarified in two ways:
  - a. the prohibition will explicitly state that the directors may not appoint an administrator once a provisional liquidator has been appointed; and
  - b. to address a gap in the current provision, the prohibition will be extended to state that a chargee over all or substantially all of the property of a company may not appoint an administrator once a liquidator or provisional liquidator has been appointed.
30. To streamline the transition from liquidation to administration, creditors will be permitted to approve a liquidator's appointment as an administrator at a creditors' meeting.
31. The requirement for a liquidator to obtain court (or creditor) approval for appointment as an administrator will be extended to apply where a liquidator or provisional liquidator seeks to appoint their business partner, employee or employer as administrator of a company.
32. Where a liquidator or provisional liquidator has appointed an administrator to a company, and the creditors approve the DCA, the deed administrator will be given standing to apply to the court for an order terminating the winding-up. The court should grant such an order, unless satisfied it would be unjust to do so having regard to specified matters. These changes will further streamline the transition from liquidation to administration.
33. Finally, a liquidator or provisional liquidator who has put the company into administration will be given standing to apply to the court for an order to

replace an administrator. Liquidators and provisional liquidators may be in a good position to assess the performance of particular administrators.

#### **Liquidation following an administration**

34. To address concerns about abuse, the exemption from the voidable transaction provisions for transactions during an administration will be limited to transactions authorised by an administrator, or authorised under the deed. In addition, the relation-back period will commence from the date of the initial winding-up application provided the application has not been dismissed.
35. To address situations where there is a long period between the application for winding-up and the termination of a DCA, the timeframe for a liquidator to undo voidable transactions will be extended to allow the liquidator either three years from the date of the commencement of the relation-back period or one year from the termination of the DCA, whichever is later. This recognises the need to allow the liquidator a reasonable period to commence action.
36. The administrator or deed administrator in control of a company under administration (or under a deed of administration) will be required to lodge a section 439A report, and a further report on any additional matters or material changes which affect the financial position of the company that the person is aware of, with ASIC at the time the company goes into liquidation.
37. The law will be clarified to state specifically that post-deed creditors have no priority, except where the administrator is personally liable for the debt. Debts incurred by the administrator prior to the DCA would retain their priority. However, creditors voting at the major meeting will have the right to include in a DCA any other form of priority for post-deed creditors. Such a proposal should be approved by three-quarters by value and a simple majority by number of those pre-administration unsecured creditors who vote on the resolution.

#### **Fundraising in administration**

38. An exemption from the fundraising provisions will be introduced, for offers or invitations to creditors to exchange debt for equity under a DCA. The exemption would only apply where the offer does not require accepting creditors to contribute any further consideration. An administrator making an equity-for-debt offer will only be required to provide a statement setting out all relevant information that the administrator knows or ought reasonably to know (regardless of the size of the fair value of the debt involved). This statement should indicate that it is not a prospectus and therefore may contain less information than a prospectus. The amendments will also clarify that all affected creditors will be bound by an equity-for-debt swap in a deed.

**Other matters**

39. For consistency, all references to days in Part 5.3A of the Corporations Act will be expressed as 'business days'.
40. A corporation will be able to be a member of a committee of creditors.
41. The law will be clarified to protect the priority of the costs of making an application for a winding-up order, where the company is liquidated through the VA procedure.