

# FOCUS

## INSOLVENCY



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## INSOLVENCY REFORM PACKAGE RELEASED

Draft legislation dubbed 'the first comprehensive package for insolvency law since the 1988 Harmer Review', has been released for public comment. Partner Michael Quinlan, Senior Associate Della Stanley and Lawyer Adrian Fisher look at the changes.

We look at the implications of an insolvency law reform package released for public comment

### HOW DOES IT AFFECT YOU?

- The Government intends to pass draft legislation amending existing insolvency laws next year.
- The amendments aim to streamline the processes involved in insolvent external administration by increasing their flexibility, removing unnecessary regulatory burdens and reflecting the practices which are already in use.
- While none of the changes are 'groundbreaking', they will impact on most insolvencies even if only in a minor way.
- The draft legislation is open for public comment until 23 February 2007.
- The full range of proposed changes and the exposure draft of the legislation can be viewed here.

### THE DRAFT LEGISLATION

The draft Corporations Amendment (Insolvency) Bill 2007 and Corporations and ASIC Amendment Regulations 2007 were released on 13 November 2006 by the Parliamentary Secretary to the Treasurer, the Honourable Chris Pearce MP, for public comment. The draft legislation embodies the reforms originally announced in October 2005 and addresses four main areas.

### IMPROVING OUTCOMES FOR CREDITORS

The reform package introduces some key changes to the current law relating to outcomes for creditors, including:



## PROTECTING EMPLOYEE ENTITLEMENTS

Under the law as it currently stands, a creditor may challenge in court a deed of company arrangement (a **DOCA**) on the basis that it is oppressive or unfairly prejudicial or discriminatory because it does not reflect the statutory priority requirements and results in a return which is worse than would be the case in a liquidation.

The draft legislation requires that a DOCA must adhere to the priority requirements of the *Corporations Act 2001* (Cth) unless a majority in value and number of creditors affected by any proposed changes to those requirements agree to such changes.

The court may approve a DOCA which does not preserve the statutory priority requirements if this would result in the same or better outcome for the affected creditors. The administrator, an affected creditor or another interested party may make an application to the court for such an order.

In effect, this amendment will place the burden on the administrator, rather than on the affected creditor, to bring an action to a DOCA which does not comply with the statutory requirements.

The draft legislation also improves the protection of employees' superannuation entitlements.

## INFORMING CREDITORS

Administrators must now provide a statement of independence, listing any potential conflicts of interest, to creditors at the time of giving notice of the first creditors' meeting. Although this practice has already been endorsed by the Insolvency Practitioners Association of Australia as best practice<sup>1</sup>, it will be enshrined in law if the draft legislation is enacted.

Regarding the remuneration of administrators, the draft legislation responds to the 2004 Federal Court decision in *Stockford*<sup>2</sup> which identified gaps in, and some practical difficulties with, the existing law, by:

1. IPAA Statements of Best Practice – *Independence on the Appointment of an Administrator* (1 July 2003) and *Calling and Conducting Creditors' Meetings* (1 July 2005).

2. *Korda in the Matter of Stockford Limited (Subject to Deed of Company Arrangement)* [2004] FCA 1682.

- giving ASIC power to seek a court review of an administrator's fees;
- outlining factors a court should consider in setting an administrator's fees;
- requiring an administrator to provide adequate information to creditors to enable them to assess whether the administrator's fees are reasonable; and
- allowing an administrator to apply to court to have its fees set in situations where creditors have not yet met.

## STREAMLINING EXTERNAL ADMINISTRATION

The draft legislation also includes provisions aimed at streamlining external administration, including provisions relating to:

- Advertising requirements. The requirement to publish notices is removed except where there are strong policy reasons for publication eg, the creditors and the public have not been informed about important facts.
- Electronic communication of notices of creditors' meetings. It will be permissible for notices to be sent by email, fax, or other electronic means such as an internet site, provided that the recipient of the notice has nominated a particular mode of communication and has provided their relevant contact details, such as an email address or fax number.
- Transfers of shares in a company during liquidation or administration. The amendments address the current inconsistency in the law by giving both liquidators and administrators the ability to consent to the transfer of shares if satisfied that such a transfer is in the best interests of the creditors.
- Changes to a company name in administration. For example, any company which changes its name during, or within six months prior to, administration, must disclose its former and current company name on any public documents, unless the court orders otherwise.

## POOLING

Although there is currently no legislation in place providing for 'pooling' in an administration context, it has always been possible for administrators to pool the administration of companies in the same group. This has been done by proposing DOCAs in each group company providing for pooling. Such DOCAs to date have been effective if approved, in the usual way, that is by a majority in value and number of creditors in each company to



be pooled. The draft legislation will make the preconditions for pooling during administrations of company groups and the procedures which should apply much clearer and protect the rights of objectors.

The draft legislation provides that during voluntary administration, a pooling decision may be made by the administrator with the *unanimous* consent of creditors. If *any* creditor objects, the administrator may approach the court to obtain approval for the pooling decision. The court may make a pooling order despite any objections from creditors. The model proposed by the draft legislation allows DOCAs to include pooling arrangements or to confer authority on the administrator to prepare a pooling proposal.

A pooling decision will have the effect of:

- making each company jointly and severally liable for the debts of all other companies in the pooled group; and
- extinguishing any debts between companies in the group.

The recent decisions in *Black Stump*<sup>3</sup> showed the present difficulties with pooling in liquidations<sup>4</sup>.

The draft legislation provides a method for pooling during liquidation which differs from the method during voluntary administration outlined above in that a pooling decision may be made either:

- by the liquidator with the unanimous consent of eligible unsecured creditors; or
- by the liquidator approaching the court for a pooling order without first seeking the creditors' consent (the court may make such an order despite any objections from creditors).

Only those companies in a group which have entered administration or liquidation may be pooled.

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3. *Tayeh; Re Black Stump Enterprises Ltd* [2005] NSWSC 475; *Re Blackstump Enterprises Ltd* [2005] NSWCA 480; *Re Blackstump Enterprises Ltd* (No 2) [2006] NSWCA 60; see also AAR paper dated 17 October 2006 that considers the Black Stump cases.

4. See also the recent decision in *Whittingham, Re; Hunter Valley Gravel Supplies Ltd* [2006] NSWSC 1070.

## DETERRING CORPORATE MISCONDUCT

The reforms include a number of provisions which are intended to punish and deter corporate misconduct, including:

- empowering ASIC to investigate liquidators' conduct generally;
- allowing applications to be made to a court where a court-ordered condition or alteration of a company scheme of compromise or arrangement is breached and loss or damage is suffered as a result;
- giving ASIC the power to apply for a court order preventing a company officer from avoiding liability by, for example, sending funds out of or leaving the jurisdiction;
- relating to arrest warrants;
- removing the privilege against exposure to penalty for certain ASIC investigations, such as investigations concerning disqualification, banning, suspension or cancellation orders. This amendment is stated to reverse the practical effect of the High Court's decision in *Rich v Australian Securities and Investments Commission*<sup>5</sup>; and
- imposing a time limit of six months for the lodgment of liquidators' reports relating to any possible offences committed by company officers or members.

In most cases, these reforms are designed to overcome limitations on and practical difficulties associated with powers and enforcement mechanisms already available to ASIC.

## IMPROVING REGULATION OF INSOLVENCY PRACTITIONERS

Insolvency practitioners in Australia are already heavily regulated. The reforms include a number of changes aimed at improving the regulatory systems already in place.

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5. [2004] HCA 42.

The Companies Auditors and Liquidators Disciplinary Board (the **CALDB**) has been given more power and flexibility in relation to disciplinary proceedings against insolvency practitioners. For example, the draft legislation gives the chairman of the CALDB the option to convene pre-hearing conferences in order to fix hearing dates or give directions concerning the timetable for the making of submissions or evidence. The CALDB may admonish or reprimand anyone who breaches such directions.

Other relevant changes covered in the draft legislation include that:

- liquidators must maintain adequate professional indemnity and fidelity insurance;
- liquidators must submit annual, rather than triennial, statements regarding their practice and any relevant offences; and
- ASIC, without reference to the CALDB, has the power to cancel the registration of a liquidator.

## FINETUNING VOLUNTARY ADMINISTRATION

Although it is generally acknowledged that the voluntary administration procedures currently in place are effective, the draft legislation includes amendments aimed at addressing several technical issues that have been identified, including:

- Narrowing the circumstances in which creditors will be entitled to terminate a DOCA. This will only be possible in situations where there has been an unrectified material breach of the deed.
- Slightly extending the timing for the holding of creditors' meetings. The first creditors' meeting which currently must be held within five business days of the commencement of the administration will instead need to be held within eight business days of the commencement of the administration. The period for the holding of the second creditors' meeting will be extended from 21 or 28 days (depending on whether or not the administration commenced in December or the month before Good Friday) to 20 or 25 business days. Five business days' notice must be given to creditors for both the first and second creditors' meetings.
- A company under a DOCA may seek a court order that it need not indicate on public documents that it is subject to a DOCA. It

has been acknowledged that there may be circumstances in which it may be appropriate for a court to make this kind of order where there is little risk to creditors, for example where a DOCA is still to be terminated due to an administrator's inability to pay creditors due to unresolved disputes over proofs of debt.

Certain provisions in the draft legislation are also aimed at streamlining the transitions from:

- liquidation to administration (for example, liquidators will be able to appoint themselves as administrators without obtaining the leave of the court as long as the appointment is supported by creditors); and
- administration to liquidation (for example, the definition of 'relation-back period' will be expanded so that the relation-back day is the date of the application for winding up where an administration preceded the liquidation).

The draft legislation also aims to improve the ability of companies in voluntary administration to borrow by including borrowings by administrators without the liabilities for which they are personally liable and entitled to from the assets of the company.

## AMENDMENTS NOT INCLUDED IN THE REFORM PACKAGE

### ADOPTION OF THE UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY

In the Federal Government's announcement of October 2005, it was indicated that the UNCITRAL Model Law on cross-border insolvency would be adopted. This decision has not been implemented in the current reform package, but the Parliamentary Secretary to the Treasurer has stated that it will occur through a separate Bill<sup>6</sup>. The Government is currently seeking any further comments from the public on the UNCITRAL Model Law.

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6. Pearce, C, Press Release, 'Pearce announces most substantial insolvency reforms in almost 20 years', <http://parlsec.treasurer.gov.au/cjp/content/pressreleases/2006/039.asp>, visited 14 November 2006.

