EXPLANATORY STATEMENT

EXPOSURE DRAFT

CORPORATIONS AMENDMENT (INSOLVENCY) BILL 2007

NOVEMBER 2006

Table of Contents

INTRODUCTION 6

ABBREVIATIONS 8

REGULATION IMPACT STATEMENT 10

THE TREATMENT OF EMPLOYEE ENTITLEMENTS IN VOLUNTARY ADMINISTRATION 12

THE TREATMENT OF THE SUPERANNUATION GUARANTEE CHARGE IN EXTERNAL ADMINISTRATIONS 17

THE REGISTRATION OF INSOLVENCY PRACTITIONERS 19

IMPROVING OUTCOMES FOR CREDITORS 25

PART 1 — ENHANCING PROTECTION OF EMPLOYEE ENTITLEMENTS 25

Mandating the priority debt ranking in deeds of company arrangement 25

Treatment of the superannuation guarantee charge under the Corporations Act in external administration 26

Timing issues and priority for superannuation guarantee charge 27

Superannuation guarantee charge and excluded employees 28

Superannuation guarantee charge and double payments 29

Clarification of the rights of subrogated creditors: section 560 31

PART 2 — BETTER INFORMING CREDITOR DECISIONS 33

Administrators to make available a statement of independence 33

Creditors to have power to appoint different person as liquidator 34

ASIC's power to seek court review of remuneration 34

Factors for consideration by a court in setting remuneration 35

Information to be provided to creditors to allow reasonableness to be assessed 36

Allow administrators to apply to seek approval from a court for remuneration if creditors have not met 37

Clarify the requirements for approval of administrator's remuneration 37

Allow a fixed amount of fees to be drawn down where a creditors meeting lacks quorum 38

Annual meeting in a creditors voluntary winding up 38

PART 3 — STREAMLINING EXTERNAL ADMINISTRATION 40

Advertising requirements 40

Electronic communication 41

Gazettal requirements for controllerships 43

Limiting the requirement to maintain separate bank accounts to managing controllers 43

Reporting of misconduct 44

Power to consent to a transfer of shares of the company 44

Schemes of compromise or arrangement — court discretion to approve 45

Corporate membership of the committee of creditors and the committee of inspection 46

Creditors' voluntary winding up 47

Multiple liquidators 48

Change of company name in external administration 49

Exemption from the requirement to hold an annual general meeting 51

PART 4 — FACILITATING POOLING IN EXTERNAL ADMINISTRATION 52

Background 52

Pooling in voluntary administration 53

Pooling in liquidation 55

Exercise of powers or functions by liquidator or administrator 58

DETERRING CORPORATE MISCONDUCT **59**

Compulsory powers to investigate liquidators' conduct 59

Schemes of compromise or arrangement — right of recovery for breach of condition or alteration 60

Court orders preventing company officers and others from avoiding liability 60

Warrant to arrest a person 61

Removal of penalty privilege in relation to banning and disqualifications 62

Time limit for the lodgement of reports by liquidators 64

IMPROVING REGULATION OF INSOLVENCY PRACTITIONERS **66**

Extending the prohibition on inducements for the referral of work 66

Education criterion for registration as a liquidator 66

Experience criterion for registration as a liquidator 67

Triennial Statements to be replaced by annual statements 68

Cancellation of registration by ASIC 68

Transfer of books 69

Disciplinary proceedings — CALDB 69

FINETUNING VOLUNTARY ADMINISTRATION **71**

PART 1 — GENERAL 71

Court's power to bind secured creditors 71

Third party guarantees 72

Right to terminate a deed 72

Notification when deed wholly effectuated 73

Power to consent to a transfer of shares of the company 74

Administrator's right of indemnity 75

Deed administrator's ability to sell the company's shares 76

Lodgement of accounts with ASIC 77

Reporting to creditors 78

Fundraising in administration 79

Appointment of administrator by directors and chargees 80

Transition from liquidation to voluntary administration 81

Stay and termination of a liquidation 82

Application to replace administrator 83

Meetings 83

Conversion of 'days' to 'business days' 85

Role of administrator and administrator of deed 85

Notification that a company is subject to a deed 86

Resolutions for removing an administrator 87

PART 2 — RIGHTS TO PROPERTY DURING ADMINISTRATION 88

Right of a person to retain pledged property 88

Power of an administrator to sell property subject to a lien, pledge or retention of title clause 88

Right of a creditor to sell property subject to a lien or pledge 89

General moratorium for bankers' liens and collateral lodged with clearing and settlement facilities 90

Clarifying the injunction power allowing a court to prevent enforcement of a charge 90

Clarifying the powers of a court to allow the enforcement of a charge 91

PART 3 — LIQUIDATION FOLLOWING ADMINISTRATION 92

Relation-back period 92

Priority for debts incurred during a DOCA 93

Priority for borrowings during administration 93

Uncommercial transactions during voluntary administration and deed of company arrangement 94

Period for challenging voidable transactions 95

Report as to affairs 96

Priority for costs of making a winding up application 97

MISCELLANEOUS **99**

Priority of administrative expenses in voluntary liquidation 99

Correction of anomalies 99

Share capital reductions — partly-paid shares 99

1

INTRODUCTION

1.1 The exposure draft of the Corporations Amendment (Insolvency) Bill (the exposure draft) includes a range of measures intended to modernise Australia's insolvency laws. These measures were announced by the Hon Chris Pearce MP, Parliamentary Secretary to the Treasurer, on 12 October 2005.

1.2 The reforms have been developed having regard to the recommendations of a number of recent reviews into the corporate insolvency framework.[1] The issues arising out of these reviews fall into four broad themes.

1.3 The first theme relates to improving outcomes for creditors, through enhanced protections for employee entitlements, improved information to creditors, removal of unnecessary procedural requirements, and by introducing a statutory pooling process to facilitate the external administration of related companies.

1.4 The second theme relates to deterring misconduct by company officers, primarily through the establishment of an assetless administration fund to improve the quality of information forwarded to the Australian Securities and Investments Commission (ASIC) by insolvency practitioners, and a new ASIC enforcement programme targeted at phoenix company behaviour. In addition, reforms are proposed to restore the longstanding interpretation of the applicability of penalty privilege in proceedings for disqualification or banning orders.

1.5 The third theme relates to improving the regulation of insolvency practitioners, primarily through enhancements to the registration regime administered by ASIC, but also through the introduction of more flexible disciplinary procedures.

1.6 The fourth theme relates to fine-tuning voluntary administration, comprising a package of technical amendments to enhance the efficiency and cost effectiveness of that process. These amendments recognise market developments and opportunities for improvement that have been identified since the procedure was introduced in 1993.

1.7 In addition, the Government will adopt the United Nations Commission on International Trade Law (UNCITRAL) Model Law on cross-border insolvency. The Model Law will provide effective and efficient mechanisms for dealing with cases of cross-border insolvency. These reforms will be enacted through separate legislation, and will adopt the approach detailed in the CLERP 8 Discussion Paper.

1.8 Your views and comments on the exposure draft are sought by 23 February 2007. They should be sent to:

---

1 Specifically, the reforms are based on the findings of the following reviews and inquiries into the corporate insolvency framework: the 1997 *Review of the Regulation of Corporate Insolvency Practitioners*; the 1998 Corporations and Markets Advisory Committee (CAMAC) Report *Corporate Voluntary Administration*; the 2000 CAMAC Report *Corporate Groups*; the 2004 CAMAC Report *Rehabilitation of Large and Complex Enterprises*; the 2004 Parliamentary Joint Committee on Corporations and Financial Services (PJC) Report *Corporate Insolvency Laws: A Stocktake* and the 2004 Report of the James Hardie Special Commission of Inquiry.

Corporations Amendment (Insolvency) Bill 2007
Corporations and Financial Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

Telephone: 02 6263 3217

Fax: 02 6263 2770

Email: insolvency@treasury.gov.au

2

ABBREVIATIONS

ACN	Australian Company Number
AGM	Annual General Meeting
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
ATO	Australian Taxation Office
CALDB	Companies Auditors and Liquidators Disciplinary Board
CAMAC	Corporations and Markets Advisory Committee, previously the Corporations and Securities Advisory Committee
CAMAC Report (1998)	1998 Corporations and Markets Advisory Committee Report *Corporate Voluntary Administration*
CAMAC Report (2004)	2004 Corporations and Markets Advisory Committee Report *Rehabilitation of Large and Complex Enterprises*
CASAC	Corporations and Securities Advisory Committee
Corporations Act	*Corporations Act 2001*
DEWR	Department of Employment and Workplace Relations
DOCA	Deed of Company Arrangement
GEERS	General Employee Entitlements and Redundancy Scheme
ICAA	Institute of Chartered Accountants in Australia
IPAA	Insolvency Practitioners Association of Australia

James Hardie Report	2004 Report of the James Hardie Special Commission of Inquiry
OCH	Options Clearing House
PJC Report	2004 Parliamentary Joint Committee on Corporations and Financial Services (PJC) Report *Corporate Insolvency Laws: A Stocktake*
Review of Insolvency Practitioners	1997 *Review of the Regulation of Corporate Insolvency Practitioners*
ROT clause	Retention of Title Clause
SGAA	*Superannuation Guarantee (Administration) Act 1992*
SGC	Superannuation Guarantee Charge
UNCITRAL	United Nations Commission on International Trade Law

3

REGULATION IMPACT STATEMENT

BACKGROUND

3.1 The last major reform of Australia's corporate insolvency laws was undertaken following the 1988 review of those laws by the Australian Law Reform Commission (the 'Harmer Report'). Recommendations of this review were implemented in the *Corporate Law Reform Act 1992*.

3.2 Since then a number of inquiries into the system have been conducted. In 2004, the Parliamentary Joint Committee on Corporations and Financial Services tabled a report, entitled *Corporate Insolvency Laws: A Stocktake* (the PJC Report). The report contained 63 recommendations for changes to Australia's insolvency system. The Corporations and Markets Advisory Committee (CAMAC) published a report on Corporate Voluntary Administration in 1998 (containing 60 recommendations) and a report on the Rehabilitation of Large and Complex Enterprises in 2004 (containing 49 recommendations). A 1997 Working Party inquired into the regulation of insolvency practitioners and recommended improvements to the regulatory framework.

3.3 These reports generally endorsed the current insolvency system but at the same time proposed measures to strengthen creditor protections and improve the efficiency of insolvency processes.

CONSULTATION

3.4 Stakeholders from a wide spectrum of interests (insolvency practitioners, employee and business groups, the legal community, representatives of financial institutions, regulators, accounting bodies and members of the academic community) actively participated in these public inquiries and expressed support for reforms of insolvency laws.

3.5 On 22 March 2005 the Government announced that it would address corporate law issues raised by reviews of the insolvency framework in the context of developing an integrated set of proposals to improve the operation of Australia's insolvency laws. On 12 October 2005 the Government announced details of its package. The package has four key themes:

- improving outcomes for creditors, including through:
  - initiatives to enhance protections for employee entitlements in insolvency proceedings;
  - initiatives to facilitate informed decision making by creditors;
  - initiatives to streamline external administration and reduce associated costs; and
  - allowing for the administration of related companies to be conducted as a single process.
- deterring corporate misconduct, including through allowing ASIC a general power to investigate breaches of liquidators' duties and restoring the longstanding position that penalty privilege does not apply in disqualification proceedings (complementing the assetless administration initiative discussed below);

- improving the regulation of insolvency practitioners by updating the registration regime administered by ASIC and introducing greater flexibility in disciplinary proceedings; and

- finetuning the voluntary administration process, in recognition of market developments and experience with the process since its introduction.

3.6 Some of the proposals of the Government's insolvency package, notably an expansion of the range of the entitlements available to employees whose employment is terminated as a result of their employer's insolvency under the General Employee Entitlements and Redundancy Scheme (GEERS) and the introduction of an assetless administration fund, announced on 12 October 2005, are already in place.

3.7 An additional $62 million over four years was allocated for the introduction of four new GEERS enhancements:

- assistance for underpaid wages in the three month period prior to the date of employer insolvency;

- assistance that recognises a claimant's entitlement to notice of termination under their terms of employment;

- coverage for employees who resign or whose employment is terminated up to six months prior to the date of their employer's insolvency; and

- aligning the treatment of 'excluded employees' (directors and close relatives) with their treatment under the *Corporations Act 2001*.

3.8 These enhancements to GEERS are included in revised GEERS Operational Arrangements, and apply to insolvencies that occur on or after 1 November 2005.

3.9 On 22 August 2006, the Minister for Employment and Workplace Relations announced a further extension to GEERS. The amount of unpaid redundancy pay available under GEERS has been doubled from eight weeks to a maximum of 16 weeks. This change is applicable to all GEERS claims made as a result of liquidations or bankruptcies that occur on or after 22 August 2006. This extension of GEERS brings it into line with the community standard for redundancy provisions now available in awards and agreements.

3.10 The Government has also allocated $23 million over four years to establish an 'assetless administration' fund and complementary enforcement programme by the Australian Securities and Investments Commission (ASIC). The fund will finance preliminary investigations by expert liquidators of companies, selected by ASIC, that have been left insolvent with little or no assets. The fund addresses a regulatory gap through more rigorous investigation of insolvent businesses. It aims to improve corporate conduct generally, and reduce the scope for phoenix activity. The fund is now in operation. As at 31 October 2006, ASIC has approved 132 applications for funding.

3.11 The Assetless Administration Fund and the enhancements to GEERS are not the only measures that can assist employees whose employment is terminated as a result of their employer's insolvency. There is also scope to improve the operation of insolvency laws and processes for the benefit of employees of insolvent businesses and other creditors.

THE TREATMENT OF EMPLOYEE ENTITLEMENTS IN VOLUNTARY ADMINISTRATION

Background

3.12 The PJC Report noted that the protection of employee entitlements in the circumstances of employer insolvency is an important public policy and it is appropriate for governments to explore options for better protecting such entitlements. While it recommended that the maximum priority proposal not be adopted, it made a number of recommendations to improve the standing of employee entitlements in the event of employer insolvency.

3.13 Business failures can have widespread and long lasting effects on stakeholders, particularly employees who commonly do not receive their full entitlements on their employer's insolvency. Employee entitlements generally comprise wages, annual leave, long service leave, sick leave, redundancy, notice and superannuation. The Productivity Commission has estimated that each year between 55,000 and 65,000 businesses cease to operate. Direct job losses resulting from business cessations are likely to account for, at most, between 9-10 per cent of total annual job losses. The majority of cessations, estimated to be around 80 percent, are 'solvent' failures. That is, the businesses in question cease operations without owing any debts or owing outstanding employee entitlements.

3.14 Empirical data on the extent of employees' losses is limited. In 2003 the ACTU estimated that around 19,000 employees lose up to $500 million in unpaid entitlements each year. The General Employee Entitlements and Redundancy Scheme (GEERS) provides a limited safety net for employees whose employment has been terminated because of an employer's insolvency. In 2004-05 $66.7 million was paid to employees under GEERS. In 2005-06 the total paid amounted to $49.2 million. The number of insolvent businesses totalled 912. The total number of recipients was 7,790. GEERS is fully funded by taxpayers.

3.15 In 2005, 7,277 companies entered external administration. Of these, 2,636 companies — approximately 36 per cent — entered voluntary administration. Introduced in 1993, the voluntary administration procedure replaced earlier arrangements that were considered to offer too limited scope for companies to trade their way out of difficulties.

3.16 In a winding up the law confers a priority on employee entitlements. The treatment of employee entitlements in a voluntary administration differs from that in a winding up.

3.17 The primary purpose of the voluntary administration procedure, set out in Part 5.3A of the *Corporations Act 2001* (Corporations Act), is to provide a flexible and relatively inexpensive procedure that enables a company to suspend the payment of its debts, so that it can attempt a compromise or arrangement with its creditors aimed at saving the company or the business or, if that is not possible, maximising the return to creditors. If successful, the compromise or arrangement will be set out in a deed of company arrangement (DOCA), which binds the company and the creditors. If these attempts fail, the legislation facilitates the transition to winding up.

3.18 If the creditors decide to enter into a DOCA, the Corporations Act sets out what the deed must contain, although the requirements are flexible. The DOCA details the adjustment of the rights and obligations of creditors in relation to the company.

3.19 If a DOCA is recommended, the administrator must provide a statement setting out details of the deed. The DOCA must include some essential matters (such as the property to be available to pay creditors' claims, the duration of any moratorium period for which the deed provides, the extent to which the company is to be released from its debts, conditions for the deed to operate, the circumstances for termination of the deed, and the order of payment of creditors' claims).

3.20 In addition, the deed may include prescribed provisions (set out in Schedule 8A of the Corporations Regulations). One of the provisions is clause 4 of Schedule 8A, which provides that the administrator must apply the property of the company in the order of priority specified for a liquidation. It is not mandatory to include these provisions in every deed. The deed may make other provision including altering the priority that would apply in a liquidation. In practice, most deeds will apply the property of the company in the order specified for a winding up.

3.21 To address the possibility that some creditors may be unfairly treated by the meeting of creditors, or outmanoeuvred at the meeting, the law allows creditors who consider a particular deed oppressive or unfairly prejudicial or discriminatory to initiate proceedings in the Supreme Courts or in the Federal Court to have the deed overturned.

Problem identification

3.22 Insolvency law has long sought to protect employee entitlements in the event of the insolvency of the employer. It affords priority status to employee entitlements in liquidation and a receivership. Traditionally, the employee has been seen to be in a different bargaining position in comparison with other creditors and investors. The impact of an employer's insolvency is likely to be greater for employees as a group than for other creditors. Wages are likely to be the only source of income for employees, while other creditors have access to other sources of income. Employees are involuntary creditors. In negotiating the terms of their employment, they are rarely able to seek provision for protection against employer insolvency. In most circumstances tradespersons and independent contractors are able to write off bad debts and diversify their risk. Under the General Employee Entitlements and Redundancy Scheme (GEERS), employees are not entitled to benefits under the scheme if the DOCA does not include the priorities specified in the Corporations Act in relation to the entitlements to be paid to employees in a liquidation.

3.23 In its Report, the Parliamentary Joint Committee noted an instance where the priority had been altered in a DOCA to the disadvantage of employees and against the wishes of a substantial number resulting in ineligibility for GEERS entitlements. Though the incidence of such cases is small in comparison to the total number of companies entering voluntary administration, the consequences can be serious for affected employees. Employee creditors have rights of appeal but the cost of undertaking an appeal imposes a considerable burden on them, particularly where not all are in agreement or willing to contribute to the cost of proceedings.

Objective

3.24 The broad objective is to improve the operation and fairness of insolvency laws. In particular, the objective is to enhance the prospect of payment of employee entitlements in the event of employer insolvency and improve the standing of ordinary employees in voluntary administrations.

Identification of options

Option 1

3.25 An option is to leave the voluntary administration procedure unchanged in relation to the priority of employee entitlements.

Option 2

3.26 The PJC Report recommended that the Government amend the law to make it mandatory for a DOCA to preserve the priority available to creditors in a winding up, unless affected creditors agree to waive their priority. It recommended that creditors or the administrator should have the right to initiate court proceedings to have the deed upheld.

3.27 An option is to accept that recommendation. (The PJC Report made no comment on the size of any majority of affected creditors, whether it be 50 per cent, 75 per cent or unanimous, required to waive the priority.)

Impact analysis

Impact group identification

3.28 For practical purposes the creditors who stand to benefit from Option 2 are employees, as they are the only relevant class of creditors who are afforded priority status under the law. Affected parties include employee groups, other unsecured creditors, insolvency practitioners, other potential stakeholders in voluntary administrations and the Department of Employment and Workplace Relations (DEWR) (which has responsibility for the administration of GEERS).

Analysis of the impact of each option

Option 1

Benefits

3.29 Option 1 would preserve the flexibility of the voluntary administration procedure and allow insolvency practitioners the greatest flexibility in proposing DOCAs. Insolvency practitioners would prefer this option in order to maximise their opportunities to negotiate acceptable DOCAs with creditors and other potential stakeholders in insolvency administrations.

Costs

3.30 If the recommendation is not adopted in the form proposed (or in some other form), there will continue to be criticism of the law and the treatment of employee entitlements where DOCAs alter the priority of the entitlements of employees without their consent. It would place the onus on employees to challenge deeds where the priority was altered. There are legal costs for employees who choose to challenge a deed that displaces their priority.

Option 2

Benefits

3.31 The main argument in favour of Option 2 is that it would improve the standing of employees in the voluntary administration procedure. It would reduce the risk that employees' interests are not taken into account in negotiating a DOCA. A significant number of employees are potentially affected. Approximately 40 per cent of external administrations take the form of voluntary administrations.

3.32 Option 2 does not depart significantly from current practice (and other insolvency procedures which also recognise the priority of employee entitlements). It is a feature of the model DOCA set out in the Corporations Act. It is possible that the courts may take the view that the maintenance of the priority is an implicit feature of the voluntary administration procedure as it currently exists.

3.33 If a DOCA alters the priority of employee entitlements, the only option available to aggrieved employees is to initiate court action. This imposes a considerable burden on employees. The costs arising from court action would be borne by employees. There appears to be no decided case on the question on altering the priority of employee entitlements to the disadvantage of employees in a DOCA since the introduction of the voluntary administration scheme in 1993.

Costs

3.34 Increasing the protection of employee entitlements may be seen to reduce the flexibility of the voluntary administration procedure. It would be seen to limit the capacity of insolvency practitioners and/or stakeholders to conduct creditors' meetings and achieve a consensus as to the way forward — a DOCA or liquidation.

3.35 Under Option 2, employees may choose to waive their priority. It will thus still be possible for a DOCA to alter the priority if the circumstances warrant. It has been suggested that employees will never or very rarely choose to waive their priority. They will always prefer the company's liquidation (particularly given that GEERS assistance may only be available if the company is put into liquidation).

3.36 If the priority of employees is legislated for, employees as a group would never (or rarely) agree to waive their entitlements and would rather vote for liquidation. Employees are traditionally seen as the type of creditor who would be likely to prefer a DOCA to a liquidation, as it presents the prospect of some employees retaining their jobs.

3.37 Option 2 will not benefit other unsecured creditors. It will be possible for their rights to be modified to their disadvantage by a DOCA. It may have the effect of reducing the level of returns that may otherwise be available to unsecured creditors in a DOCA. It may be seen to further the inequitable treatment of unsecured creditors vis-à-vis employees in insolvency law.

3.38 Option 2 may impose a cost on companies entering voluntary administrations, in that it narrows the options open to companies and their administrators in negotiating solutions to their financial difficulties. To some extent, it may compromise the objective of the voluntary administration procedure, which is to provide an expeditious, uncomplicated, inexpensive and flexible procedure for addressing a company's financial difficulties. Company shareholders may be affected if strategies for resolving financial difficulties are restricted. However, it is creditor interests that are paramount in insolvency.

Consultation

3.39 The problem received close consideration in the PJC Report. The results of any further consultation would be predictable. Non-employee stakeholders in corporate insolvencies would be opposed to mandating the priority of employee entitlements in DOCAs.

Conclusion and recommended option

3.40 In assessing the different options there are competing public policies to balance: the protection of employee entitlements and the desirability of encouraging business rescues wherever possible. The proposal favours the former policy over the latter.

3.41 Option 2 — mandating the priority of employee entitlements — has the advantage that it does not represent a significant departure from current practice. Other insolvency stakeholders are not unduly affected. Its impact is therefore limited. It gives recognition to an important public policy — the protection of employee entitlements. The current law imposes a considerable burden on employees in that it is predicated on an assumption that they will initiate potentially expensive court proceedings to challenge a DOCA that treats them unfairly. The flexibility of the voluntary administration procedure and the policy of encouraging business rescues are not unduly compromised by the adoption of option 2.

3.42 The recommended option is for the law to recognise that the priority of employee entitlements should be safeguarded in DOCAs but not necessarily in the precise terms proposed by the PJC.

Implementation and review

3.43 The proposed approach is consistent with the manner in which creditors determine matters at creditors' meetings under the current law, providing flexibility for eligible employee creditors. An administrator will be able to propose a DOCA that does not observe the priority only if they first secure the agreement of a majority (by number and value) of affected creditors at a meeting of eligible employee creditors. Creditors as a whole would then conduct a vote on whether the deed should be executed at the section 439A meeting (the major meeting of creditors in a voluntary administration). The impact of the provision can be monitored by ASIC, which collects statistical data on external administrations, and Treasury in its oversight of the legislative scheme for corporate insolvency.

THE TREATMENT OF THE SUPERANNUATION GUARANTEE CHARGE IN EXTERNAL ADMINISTRATIONS

Problem identification

3.44 The PJC Report identified uncertainties about the interaction between the *Superannuation Guarantee (Administration) Act 1992* (SGAA) and the Corporations Act. There is a lack of clarity as to how the Superannuation Guarantee Scheme is intended to operate in relation to employers that are under different forms of external administration. These uncertainties may have the result that employees are not receiving their full entitlement.

3.45 Neither the Corporations Act nor SGAA deals with the priority of the superannuation guarantee charge (SGC) in a receivership or a voluntary administration. Under the current law the only insolvency procedure in which the SGC is afforded a priority is in a winding up. As a result SGC payable to ordinary employees is not afforded the priority that applies to superannuation contributions in a receivership resulting in situations where employees do not receive their superannuation in the form of SGC as a priority.

3.46 If the law is amended to recognise that the priority of employee entitlements should be safeguarded in deeds of company arrangement as proposed above, the priority of superannuation and the SGC would need to be considered.

3.47 Under the Corporations Act there is a limit ($2,000) on the amount that can be paid to excluded employees as a priority in respect of wages and superannuation. Excluded employees include directors, their spouses including de facto spouses and relatives. It has been a long standing policy of insolvency law that priority is not afforded to debts or claims in respect of directors over $2,000.

3.48 The SGAA provides that in the winding up of a company any superannuation guarantee charge payable by the company is, for the purposes of payment, to have a priority equal to that of a debt of the company of the kind referred to in the Corporations Act. The above limit on debts or claims in respect of directors that attracts priority status is arguably not recognised in the SGAA.

3.49 The PJC Report recommended that the Government clarify how the SGC is intended to operate in relation to employers in external administration.

Objectives

3.50 The objective of the proposal is to clarify the status and priority of the SGC in a liquidation, a receivership and a voluntary administration. It aims to improve the recovery of employee entitlements in the event of employer insolvency.

Identification of options

3.51 It is necessary to clarify how the SGC should be treated in a receivership and a voluntary administration. There are no other feasible options in this regard.

3.52 In relation to the cap on debts in respect of directors that attracts priority status in external administrations, an option is to include SGC amounts in that cap. This would deliver the objective of consistent treatment of superannuation entitlements and SGC amounts. It would improve the likelihood of non-excluded employees receiving their entitlements.

3.53 An alternative option is to exclude SGC amounts from the cap. From a retirement incomes policy perspective it may be preferred that the SGC be excluded from this limit for the following reasons.

- SG charge amounts do not necessarily relate to the period where the company became insolvent. Therefore, while the directors of a company have some control over how it operates, the SG charge may relate to periods where the company was solvent.

- SG amounts represent compulsory community standard minimum amounts. Compulsory employer superannuation contributions are already subject to a maximum contribution limit, defined in section 15 of the *Superannuation Guarantee (Administration) Act 1992*, which ensures that an employee's SG entitlement is not excessive.

- Unlike the cap in section 556(1A) of the *Corporations Act 2001* the maximum contribution limit is indexed to maintain its value over time. It is noted that the $2,000 cap in the Corporations Act has not changed in the last 15 years. This erosion of value over time could potentially significantly reduce the amount going towards a director's retirement savings in future years.

Analysis of the impact of each option

3.54 The primary argument in support of including SGC amounts in the $2,000 cap for excluded employees is that this would improve the recovery of employee entitlements in the event of employer insolvency.

3.55 In relation to the alternative option of excluding SGC amounts from the cap, it is noted that it has been a long standing policy of insolvency law that priority is not afforded to debts or claims in respect of directors (above $2,000). The balance of any debts payable to excluded employees falls for consideration as an ordinary unsecured debt in a liquidation. The arguments in favour of retirement incomes policy recede in importance in the circumstances of an insolvent administration in which there will be insufficient funds to pay the outstanding debts and a choice has to be made as to which debts are to be paid or paid in priority to other debts. The fact that the $2,000 cap which has not changed in the last 15 years can be addressed by increasing the cap from time to time. There have been no recommendations for an increase at this time.

Costs and expenses of mandating the priority

3.56 As SGC is a tax, excluding directors from the limit may reduce the amounts payable to the Commissioner of Taxation in external administrations. However, the great majority of these amounts are forwarded to employee's superannuation funds.

Consultation

3.57 The Insolvency Practitioners Association of Australia has requested these amendments. It is unlikely that any other stakeholders in external administrations (apart from directors) would oppose the amendments.

Conclusion

3.58 The option of clarifying the status and priority of the SGC in a liquidation, a receivership and a voluntary administration is the only real option available at this time. The option of including SGC amounts in the $2,000 cap for excluded employees would appear to outweigh the other options.

Implementation and review

3.59 The impact of the proposed amendments would be monitored by ASIC which collects statistical data on external administrations.

THE REGISTRATION OF INSOLVENCY PRACTITIONERS

Problem identification

3.60 The administration of corporate insolvencies is carried out by private sector practitioners. Insolvency practitioners may act as liquidators, provisional liquidators, receivers, receivers and managers, voluntary administrators, administrators of deeds of company arrangement or scheme managers. In 2005, 7,277 companies entered external administration. Insolvency appointments in 2005 totalled 11,758.

3.61 Under the law insolvency practitioners are required to be registered (as 'registered liquidators'). As at 4 October 2006 there were 743 registered liquidators in Australia. Not all registered liquidators are actively engaged in insolvency work. About 520 are actively engaged. There are two forms of liquidator registration. A person may be registered as an official liquidator or as a registered liquidator. Of the 743 registered liquidators, 448 were official liquidators. Creditors of insolvent companies are also affected as they indirectly bear the costs of increased levels of practitioner compliance. The Insolvency Practitioners Association of Australia (IPAA) has about 400 members. Not all registered liquidators are members of the IPAA - it is not a prerequisite to being a registered liquidator - but most active liquidators are. Registered liquidators are predominantly accountants and members of accounting bodies.

3.62 Insolvency practitioners are granted extensive powers over debtors and their assets and are subject to fiduciary duties in relation to the assets they control, including duties to act impartially, to avoid conflicts of interest and to act in good faith and for proper purposes. They must exercise the highest standards of honesty, competence, skill and diligence and ensure that the law is applied effectively and impartially. They must be appropriately qualified and have the knowledge, experience and personal qualities that will ensure insolvency proceedings are efficiently conducted and there is confidence in the process. They are supervised by ASIC and the Companies Auditors and Liquidators Disciplinary Board (CALDB).

3.63 The role of insolvency practitioners has been the subject of comment and suggestions for reform in a number of reports beginning with the Harmer Report (1988) and the Trade Practices Commission 'Study of the Professions' (1992). In 1997 a government Working Party issued a comprehensive report on the regulation of insolvency practitioners (Review of Insolvency Practitioners). More recently the Parliamentary Joint Committee on Corporations and Financial Services in its 2004 report 'Corporate Insolvency Laws: a Stocktake' (the PJC report) and the Corporations and Markets Advisory Committee (CAMAC) in its reports on 'Corporate Voluntary Administration' (1998) and the 'Rehabilitation of Large and Complex Enterprises' (2004) have examined the role of insolvency practitioners and recommended reforms.

3.64 The problem is that some insolvency practitioners are not independent and are not exercising the high standards of honesty, competence, skill and diligence required of them or performing their duties efficiently and impartially.

3.65 Some of the key issues that have been raised in the abovementioned reports (and in the media and in ministerial correspondence) in relation to insolvency practitioners include:

- the independence of practitioners;
- the selection of administrators;
- the remuneration of practitioners;
- criteria for initial registration; and

- ongoing criteria for registration.

Objective

3.66 The objective is to enhance the independence and competence of insolvency practitioners and ensure that insolvency practitioners maintain the capacity to adequately and properly perform the duties and functions of registered liquidators on an ongoing basis.

Identification of options

Option 1

3.67 One option is to leave the law unchanged.

Option 2

3.68 A second option is to remove altogether the requirement to register as a condition of practice as an insolvency practitioner.

Option 3

3.69 A third option is to retain the current registration system and adopt targeted amendments and enhancements of the current regime for insolvency practitioners to address specific concerns that have been identified. The operation of the system could be improved with the following amendments:

- improve the quality and reliability of information available to creditors in considering the appointment of insolvency practitioners;
- update the experience criteria for initial registration of practitioners;
- strengthen the ongoing requirements for registration;
- prohibit the offering of inducements to directors or other persons to obtain appointments;
- introduce more flexibility for creditors to replace administrators will promote independence.

3.70 The independence of practitioners could be enhanced by amendments that require the provision of a statement of independence and allowing creditors to appoint a different person as liquidator when the administration ends and the company proceeds into liquidation and when a deed of company arrangement ends and the company proceeds into liquidation.

3.71 Ongoing requirements for registration could be improved by amendments to make the requirement for insolvency practitioners to lodge a security for the due performance of duties more flexible by permitting other forms of insurance to be provided, to replace the triennial reporting requirement with an annual reporting requirement, to allow ASIC to cancel the registration of practitioners where matters do not require the consideration of the CALDB (where a practitioner dies, becomes disqualified by reason of bankruptcy or becomes disqualified from managing corporations) and to require practitioners to transfer files on suspension or cancellation of registration.

Option 4

3.72 A fourth option is to introduce a licensing regime in place of the current registration regime, such as the occupational licensing regime for providers of financial services. The United Kingdom

has a type of licensing regime for insolvency practitioners. Features of a licensing regime could include:

- Requiring the regular renewal of licenses, to facilitate regular monitoring of matters such as compliance with continuous education standards and maintenance of practice capabilities;
- Providing for the cancellation of licenses at an administrative level (without seeking the approval of CALDB);
- Provide for the conditional issuing of licenses;
- More active monitoring of insolvency practitioners by ASIC; and
- Ongoing obligations to perform adequately and properly the duties of a registered liquidator, to remain a fit and proper person, to comply with conditions of registration prescribed by the regulations or ASIC, to maintain professional skills, to maintain adequate practice capacities, to notify ASIC if practitioners become disqualified from registration, to lodge annual statements and to maintain arrangements for compensation for loss.

Impact analysis

Impact Group Identification

3.73 Affected persons are:

- registered liquidators;
- stakeholders who have an interest in the outcomes of external administrations, including creditors, directors and shareholders.

Analysis of the impact of each option

Option 1

Benefits

3.74 Leaving the law unchanged would not result in any additional costs for practitioners or require additional resources for the regulator. The current law provides an adequate supervisory framework. While the focus of the current regime is on initial registration, a practitioner's status as a registered liquidator may be suspended or cancelled by the CALDB on the application of ASIC if it considers that a practitioner has failed to carry out their duties or is otherwise not a fit and proper person to remain registered. ASIC has recently reviewed these requirements, and issued draft guidance explaining that it will more actively monitor this provision in the future.

Costs

3.75 In the longer term a failure to respond to some of the concerns about the regulation of insolvency practitioners may erode public confidence in the insolvency process. Concerns about the professionalism and the lack of independence of practitioners are commonly expressed by stakeholders in corporate insolvencies in submissions to the public inquiries and in the media. Criticisms include:

- the increasing popularity of the voluntary administration process (which may be conducted by registered liquidators) and the resultant decline in the number of court liquidations (which

may only be carried out by official court appointed liquidators) has brought about an 'ambulance chasing mentality' on the part of some insolvency practitioners;

- the appointment as an administrator under the voluntary administration procedure does not ensure independent administrators in every case. Conflicts of interest tend to arise by reason of the appointment of the administrator by incumbent management;

- the existence of improper relationships between administrators and other parties;

- the 'partial' exercise of casting votes by administrators.

3.76 Concerns have also been expressed about the lack of on-going requirements for registration. The law does not require practitioners to meet ongoing obligations to retain their registration such as an obligation to maintain professional skills or continuing education. Practitioners retain their registration notwithstanding that they may not have taken up insolvency appointments for some years or have maintained professional skills or education. However, ASIC is able to address a failing by a registered liquidator by making a formal application to the CALDB.

Option 2

Benefits

3.77 In some jurisdictions there is no registration or licensing system for insolvency practitioners. In New Zealand and Hong Kong any natural person (with some exceptions regarding bankruptcy, insanity and relationship to the company) may act as a liquidator. In the United States, in reorganisation cases (including out-of-court restructurings and Chapter 11 bankruptcy cases) the company's existing management generally administers a restructuring with the assistance of insolvency counsel and financial advisers. There is no regulatory body which oversees the qualification of these restructuring professionals, however there are voluntary certification mechanisms.

3.78 Removing the registration requirement in Australia (as in New Zealand or Hong Kong) or relying on voluntary certification only (as for restructuring professionals in the United States) could increase competition in the industry, resulting in a reduction in administration costs. This approach would rely on market perceptions and reputation to test the qualification and experience of practitioners, providing stronger incentives for improved performance and reduced cost. Practitioners would not be subject to registration costs, the costs of maintaining their practices to a sufficient standard to meet statutory obligations for continuing registration and the costs of maintaining security for the performance of their duties.

Costs

3.79 If registration requirements are repealed and any person allowed to carry out external administrations, some creditors may have difficulty in deciding who to select as an external administrator. They may not be able to assess whether a person seeking to act as an external administrator possessed the qualifications, skills and/or experience needed to enable him/her to carry out that role. There is a risk that unqualified persons or creditors themselves might seek to undertake the functions of an external administrator without the knowledge or skills that are necessary for the discharge of such functions. The consequences of poor administrations may impact severely on creditors.

3.80 Creditors do not determine external administrators in every insolvency procedure. Methods for the appointment of external administrators differ depending on the procedure involved. In a voluntary administration an administrator may be appointed, and the procedure commenced, by the company itself (ie the board of directors), by its liquidator or provisional liquidator or by a creditor

who is entitled to enforce a charge on the whole, or substantially the whole of a company's property and the charge has become and remains enforceable. In other procedures such as a liquidation or a receivership a creditor or creditors may nominate the liquidator. A registration system provides a mechanism to improve confidence about the ability and integrity of practitioners.

Option 3

Benefits

3.81 There are concerns commonly expressed by stakeholders about some issues where the law has failed to move with market developments. In recent years creditors and other stakeholders in corporate insolvencies have expressed concerns about the lack of independence and impartiality on the part of insolvency practitioners. Concerns have been expressed about the mode of appointment of administrators, the disclosure of conflicts of interest, the offering of inducements for the referral of work, the registration requirements for external administrators, ongoing obligations to maintain professional skills or undertake continuing education, limitations on the ability of creditors to remove administrators or liquidators, and the desirability of a code of ethics for insolvency practitioners. The adoption of targeted amendments to address these concerns can respond appropriately to issues raised in recent reviews of the insolvency framework without introducing transitional costs or new compliance obligations and improve the efficiency and cost effectiveness of insolvency proceedings.

3.82 Targeted amendments which address concerns that have been identified in recent reviews would increase public confidence in the insolvency process and strengthen creditors' ability to select, and negotiate with, insolvency practitioners.

Costs

3.83 Targeted amendments that are proposed by this option (see above) would not give rise to any budgetary implications, unless the Government was to make a separate decision to increase ASIC's enforcement activities in this area.

Option 4

Benefits

3.84 A move to a licensing regime could lead to a better balance between initial registration requirements and ongoing requirements. Providing ASIC with greater resources to monitor practitioners could improve the speed and efficiency of enforcement actions. The shift to a licensing regime would facilitate regular monitoring of matters such as compliance with continuous education standards and maintenance of practice capabilities and enhance practitioner accountability. It would improve the efficiency and speed of the regime, and ensure CALDB's resources were directed at more serious conduct matters.

Costs

3.85 The costs of introducing a licensing model for some 450 active insolvency practitioners may outweigh its benefits. More active monitoring of insolvency practitioners by ASIC would impose costs on government to ensure that new requirements are enforced, with the extent of the implications determined by the features of the licensing model adopted. Practitioner compliance costs would increase and be passed on to creditors in the form of higher fees. This option would combine investigatory and decision-making functions in one body (ASIC) in relation to matters with potentially significant impacts on individual practitioners.

Consultation

3.86 Public inquiries that have examined the regulatory regime for insolvency practitioners include the 1997 Report of the Working Part on the Regulation of Insolvency Practitioners, the 1998 report of CAMAC on *Corporate Voluntary Administration* in 1998, the 2004 report of CAMAC on the *Rehabilitation of Large and Complex Enterprise* and the 2004 report of the Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: A Stocktake*. Insolvency practitioners and their representatives were consulted in the development of recommendations in these reports. Amendments to address this problem would be made available for public consultation, including consultation with practitioner representative bodies.

Conclusion and recommended option

3.87 A registration system provides a mechanism to improve confidence about the ability and integrity of practitioners. That system can be improved through targeted amendments. Option 3 is the preferred option. It addresses the concerns raised by stakeholders, imposes minimal new burdens on insolvency practitioners, enhances practitioner accountability, improves the supervisory framework administered by ASIC, enhances the capacity of creditors to choose independent administrators, and raises no new budgetary costs.

3.88 Option 1 fails to respond to the issues raised in the abovementioned reports that have been the subject of a number of recommendations (the independence of practitioners, the selection of administrators, the remuneration of practitioners, criteria for initial registration and ongoing criteria for registration.). Option 2 would pose risks for creditors. Registration has the benefit that it ensures insolvency practitioners are well qualified, experienced, are members of self regulatory associations (CPA Australia and ICAA) that impose professional standards of practice and have satisfied ASIC that they are capable of performing the duties of a liquidator and are otherwise fit and proper persons. Option 4 (a licensing model) would impose significant new burdens on practitioners and require increased resources on the part of the regulatory authority to supervise a licensing regime. The relatively lower costs associated with option 3, compared to the higher costs of a licensing model, make option 4 less attractive than option 3.

3.89 The current provisions of the law provide ASIC with flexibility to revise requirements regarding such matters as ongoing training and other capability requirements and do not need to be fundamentally altered. Policy Statement 186, released in September 2005, details how ASIC tailors its approach to the requirements for registration to reflect current insolvency practice, the nature of the work of registered liquidators, and its experience in administering the provisions. The legislative framework is complemented by self-regulatory oversight of the Insolvency Practitioners Association and professional bodies. The current law allows ASIC to initiate disciplinary proceedings before the CALDB where a registered liquidator has, among other things, failed to carry out or perform adequately and properly the duties of a liquidator or is otherwise not a fit and proper person to remain registered as a liquidator. Appropriate sanctions may be imposed.

Implementation

3.90 After taking effect as provided for by the amending legislation, the administration and enforcement of the new legislation will be conducted and evaluated by ASIC and the insolvency profession. No specific review is proposed.

4

IMPROVING OUTCOMES FOR CREDITORS

PART 1 — ENHANCING PROTECTION OF EMPLOYEE ENTITLEMENTS

Mandating the priority debt ranking in deeds of company arrangement

Background

4.1 It is implicit in the current law that the priority provided for in a liquidation under section 556 will generally be observed in a deed of company arrangement (DOCA). The law provides a model deed which expressly preserves, in a DOCA, the priority applicable in a winding up (Clause 4, Schedule 8A, Corporations Regulations 2001).

4.2 The provisions of the model deed may be displaced by the meeting of creditors. To address the possibility that some creditors may be unfairly treated at the meeting of creditors the law allows creditors who consider a particular deed is oppressive or unfairly prejudicial or discriminatory to initiate proceedings in the Supreme Court or the Federal Court to have the deed overturned.

4.3 To enhance the standing of employee creditors in voluntary administrations, the Government proposes to amend the law to make it mandatory for a DOCA to preserve the priority available to employee creditors in a winding up unless affected creditors agree to waive their priority. Interested persons, employee creditors or the administrator will have the right to initiate court proceedings to have the deed upheld if it does not afford priority to employee entitlements. This is consistent with recommendation 49 of the PJC report.

4.4 The effect of this change will be that the burden of challenging a DOCA that does not observe the priorities for employee entitlements will be borne by those best placed to bear the costs and assess the merits of any court action.[2]

Key changes

4.5 A provision will require all DOCAs to apply the priority afforded to unsecured debts under paragraph 556(1)(e), (g) or (h), section 560 and section 561 unless affected creditors (to be termed 'eligible employee creditors') agree to vary that priority. Other provisions of the model DOCA will continue to be able to be displaced.

4.6 If an administrator proposes to put to creditors a DOCA that does not observe the priority, the administrator will first need to seek the agreement of the affected creditors.

4.7 Specifically, the administrator will need to secure the agreement of a majority (by number and value) of affected creditors at a meeting of eligible employee creditors prior to proposing a formal DOCA and conducting a vote on whether the deed should be executed at the section 439A meeting (the major meeting of creditors in a voluntary administration).

4.8 If the consent to a modification of the employee priority is not obtained, administrators and other interested persons will have a right to seek an order from the Court to have the deed amended

---

2 This proposal is consistent with Recommendation 49 of the Parliamentary Joint Committee on Corporations and Financial Services report titled *Corporate Insolvency: A Stocktake* (the PJC Report).

to allow for such a modification. This is consistent with the current regime in relation to the amendment or alteration of DOCAs. The Court will be empowered to uphold the modified deed if, in the Court's view, it offers eligible employee creditors the same or a better outcome than they would receive in a winding up.

Notes on items

4.9 Item 1 of Schedule 1 will introduce a new term '*eligible employee creditor*', which defines those creditors who may agree to a variation in their priority by a deed. They are creditors whose debt or claim would, in a winding up of the company, be payable in priority to other unsecured debts and claims in accordance with paragraph 556(1)(e), (g) or (h) or section 560 or 561.

4.10 Item 4 will insert new section 444DB that will require all DOCAs to apply the priority set out in sections 556, 560 and 561, unless employee creditors agree to a variation to that priority or the Court makes an order approving non-application of the priority order.

4.11 New subsection 444DB(2) will provide that the rule requiring the DOCA to apply the priority set out in sections 556, 560 and 561 will not apply if, by resolution, eligible employee creditors consent to the non-inclusion of such a provision at a meeting which is held before the day of the meeting, or on the same day, or at the same time of the meeting. A resolution will be carried if a majority of eligible employee creditors by number and value vote in favour of the resolution. At a meeting of eligible employee creditors a casting vote will not be exercisable (new subregulation 5.6.21(4)(b)).

4.12 New subsection 444DB(3) will provide that the Court may approve an alteration of the statutory priorities in a deed, if the Court is satisfied the alteration is likely to result in the same or a better outcome for employee creditors than would result from an immediate winding up of the company. An application seeking an alteration of the statutory priorities may be made by the administrator of the deed, any eligible employee creditor or any interested person. The Court may make an order before or after the section 439A meeting.

4.13 Item 10 will amend paragraph 1364(2)(f) to allow the regulations to make provision for meetings of eligible employee creditors.

Treatment of the superannuation guarantee charge under the Corporations Act in external administration

Background

4.14 Section 52 of the *Superannuation Guarantee (Administration) Act 1992* (SGAA) determines the priority of the SG charge in a liquidation. It does not address the priority of the SG charge in a receivership, voluntary administration or a DOCA.

4.15 Section 52 of the SGAA provides that in a winding up of a company, any Superannuation Guarantee Charge (SGC) payable is to have a priority equal to that of a debt of the kind referred to in paragraph 556(1)(e) of the *Corporations Act 2001* (Corporations Act). Judicial consideration of this provision has determined that it does not confer the same priority status on the SGC as superannuation contributions enjoy under paragraph 556(1)(e) - section 52 merely directs observance of paragraph 556(1)(e).[3]

4.16 It has been held that superannuation contributions and the SGC amounts are separate and distinct debts for the purposes of section 556 of the Corporations Act.[4] This is because the two

3 *DP Excavation & Haulage Pty Limited v Commissioner of Taxation* [2005] NSWSC 533.
4 *Deputy Commissioner of Taxation v Rathner* [2004] VSC 352.

debts do not have the same character. Paragraph 556(1)(e) of the Corporations Act gives a priority to "superannuation contributions payable by the company in respect of services rendered to the company by employees before the relevant date". Subsection 556(2) defines 'superannuation contribution' as: "a contribution by the company to a fund for the purposes of making provision for, or obtaining superannuation benefits for an employee of the company…".

4.17 The SGC is a statutory tax liability owed to the Commonwealth. The SG charge is not paid in respect of services rendered or paid to a fund. It does not arise as a result of a contractual obligation. As a consequence it does not fall within the term 'superannuation contribution'.

4.18 The SG system is the means of ensuring compliance with superannuation obligations for the benefit of employees. Every sum paid or recovered as an SGC is referable to a failure by an employer to meet the criteria with respect to making superannuation contributions for the benefit of employees. From a policy perspective, it is important that the SG charge receive the same priority as superannuation contributions.

4.19 Recommendation 46 of the PJC Report stated that the Government should clarify how the SGC is intended to operate in relation to employers in external administration.

Key changes

4.20 The first step to clarifying the treatment of the SGC in external administrations is to remove the priority debt requirement in section 52 of the SGAA. This will avoid statutory duplication.

4.21 To ensure that 'superannuation contributions' and the 'superannuation guarantee charge' attract the same priority, section 556 of the Corporations Act will recognise the concept of an SG charge, and include the SGC in paragraph 556(1)(e) along with superannuation contributions.

4.22 This amendment will take effect on a winding up, but will also flow through to deeds of company arrangement as the section 556(e), (g) or (h) priority is to be mandated for DOCAs. Where a receivership precedes a liquidation, section 433(3) will ensure SGC are dealt with in the same manner as in a liquidation.

Notes on items

4.23 Item 11 of Schedule 1 will repeal section 52 of the SGAA. Item 14 is an application provision that provides for the effect of the repeal of section 52 of the SGAA.

4.24 Item 6 will ensure that the SG charge is treated in the same manner as other debts in paragraph 556(1)(e), ranking these debts equally with wages and superannuation contributions. Item 2 will provide that 'superannuation guarantee charge' has the same meaning as in the SGAA. Item 3 will provide that 'superannuation guarantee shortfall' has the same meaning as in the SGAA.

4.25 Item 7 will overcome the limiting effect of the wording of paragraph 556(1)(e) 'in respect of services rendered to the company by employees before the relevant date' by deeming the SGC to be a debt payable by the company in respect of services rendered in the quarter to which the corresponding shortfall relates (notwithstanding that the charge is payable to the Commonwealth).

Timing issues and priority for superannuation guarantee charge

Background

4.26 When a company fails to make the required superannuation contributions by the due date, an SG charge is incurred. If an SGC arises in respect of unpaid entitlements accruing after the date of appointment, there has been some uncertainty for practitioners as to whether the SGC should be afforded a priority in line with either:

- other employee entitlements under subparagraph 556(1)(e) of the Corporations Act; or
- other post-appointment debts, such as expenses of the administration which are afforded a higher priority) under subparagraph 556(1)(a).

4.27 Notwithstanding that the SGC is a new debt distinct from unpaid superannuation, the SGC represents the economic equivalent of the unpaid superannuation amount and is imposed to ensure it is ultimately remitted to the employee. The nominal interest component reflects the period of late payment and is intended to represent any possible gains the contribution would have made in that time, had the money been in the control of the complying superannuation fund. The administration component represents the cost of administering the SG Scheme, and is retained by the ATO.

Key changes

4.28 Amendments will address the situation where SGC amounts are attributable to periods wholly before or wholly after the relevant date or the relevant date divides a quarter (which begins on 1 January, 1 April, 1 July or 1 October). The amount of SGC attributable to the period occurring before the relevant date will be taken for the purposes of section 556 to be an amount referred to in paragraph 556(1)(e). The amount of SGC attributable to the period occurring after the relevant date will be treated as a cost of the winding up and taken for the purposes of section 556 to be an amount referred to in paragraph 556(1)(a).

4.29 This proposal is consistent with recommendation 46 of the PJC Report, which stated that the Government should clarify how the SGC is intended to operate in relation to employers in external administration.

Notes on items

4.30 Item 7 will include new subsections 556(1AB), 556(1AC) and 556(1AD) in section 556. New subsection 556(1AB) will address the situation where SGC amounts are attributable to a quarter that is wholly before the relevant date. New subsection 556(1AC) will address the situation where the relevant date divides the quarter. New subsection 556(1AD) will address the situation where the relevant date coincides with the first day of the quarter.

4.31 Where SGC amounts are attributable to a quarter which is wholly before the relevant date the SGC will be taken to be an amount within paragraph 556(1)(e): proposed subsection 556(1AB). Where the relevant date divides the quarter, for the purposes of section 556, the amount of SGC attributable to the period before the relevant date will be taken to be an amount referred to in paragraph 556(1)(e) and the amount of SGC attributable to the period after the relevant date will be taken to be an amount referred to in paragraph 556(1)(a): proposed subsection 556(1AC). Where the relevant date coincides with the first day of the quarter the amount of SGC attributable to the quarter will be taken to be an amount referred to in paragraph 556(1)(a): proposed subsection 556(1AD).

Superannuation guarantee charge and excluded employees

Background

4.32 Under subsection 556(1A) of the Corporations Act there is a $2,000 limit on the amount that can be paid to excluded employees as a priority in respect of wages and superannuation. Excluded employees include directors, their spouses including de facto spouses and relatives (subsection 556(2)).

4.33 It has been a long standing policy of insolvency law that priority is not afforded to debts or claims in respect of directors and their relatives. The balance of any debts payable to excluded employees falls for consideration as an ordinary unsecured debt in a liquidation.

4.34 The limitation applicable in the case of *excluded employees* does not apply in relation to outstanding SG charge amounts.[5] This has the potential to reduce the payments to ordinary employees as the amounts available to them as a priority debt may be reduced because of the inclusion of outstanding SGC amounts payable to directors.

4.35 An individual SG shortfall must be calculated as 9 per cent of an employee's salary or wages. The maximum amount of salary or wages which can be used in calculating an individual SG shortfall is equal to the maximum contribution base ($33,720 a quarter in 2005-06).

Key changes

4.36 As a result of the amendments in items 2, 6, 7 and 11, the SGC will be explicitly provided for in section 556 and aligned with the treatment of superannuation contributions under paragraph 556(1)(e). Subsection 556(1A) will apply the $2,000 limit to the SGC as well as to wages and superannuation contributions.

4.37 Section 64B of the SGAA sets out a formula which directs that any payment, including dividend payments, received must be allocated amongst all employees on a pro-rata basis. It does not permit the Commissioner to allocate shares to employees to take account of special circumstances such as the limit that applies in the case of excluded employees under subsection 556(1A) of the Corporations Act or paragraph 109(1)(e) of the Bankruptcy Act in respect of an employee. Item 15 is an application provision providing for the commencement of subsection 64B(3A) of the SGAA

4.38 This proposal is consistent with recommendation 46 of the PJC Report, which stated that the Government should clarify how the SGC is intended to operate in relation to employers in external administration.

Notes on items

4.39 Item 13 will amend section 64B of the SGAA to allow the Commissioner to vary an employee's proportion where the amount of the payment is affected by the application of section 556(1A) of the Corporations Act or paragraph 109(1)(e) of the Bankruptcy Act in respect of an employee. Item 12 will make a consequential amendment.

Superannuation guarantee charge and double payments

Background

4.40 Where an insolvent company has not made required superannuation contributions, or has done so but late, the ATO, affected creditors and complying superannuation funds may look to prove as creditors in any subsequent insolvent administration. This gives rise to the possibility that two proofs will be admitted in respect of what is (in a policy sense) the same debt.

4.41 This possibility is compounded because an SGC liability will still arise even if paid late. The SG charge liability will include the full amount of any shortfall, even if part or all of it is subsequently paid to the employee's fund by the employer. An SGC liability cannot be waived by the Commissioner, regardless of whether a contribution has been made to the superannuation fund after the due date.

4.42 Where the relevant employee's employment is ongoing, the late contribution can be used as an advance payment in respect of that employee for a future contribution period. Where the

---

5 *Deputy Commissioner of Taxation v Rathner* [2004] VSC 352.

employee is non-ongoing (often the case in liquidation and other forms of external administration), the employer will effectively make contributions twice for the relevant employee.

4.43 If an employee or a superannuation fund has a contractual entitlement to superannuation contributions, there are two types of double payment concerns in a liquidation context:

- Superannuation contributions are paid late giving rise to an SGC. Whilst the employees or superannuation fund have no unpaid debt to prove for, they will effectively receive a double payment if the SG charge is consequently paid to the ATO by the liquidator and the ATO remits monies to their complying fund.

- Superannuation contributions are unpaid and an SGC accrues. Both the ATO and the affected employees and superannuation funds prove for the outstanding SGC and unpaid superannuation respectively. As the debts are legally distinct, the rule against double proofs does not apply and a liquidator is obliged to admit all proofs.[6]

4.44 Amendments to the SGAA announced in the 2005-06 Budget and contained in the *Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005* will resolve the first issue:

- The SGAA now allows for the offsetting of a late payment of contributions against an employer's SGC.

- Under the offsetting rule, employers that make a late payment to a complying superannuation fund or retirement savings account within one month after the due date (which is 28 days from the end of the relevant quarter) can offset the late payment against the components of the SGC liability that relate to the employee's entitlements.

- Where such a late payment occurs, the SGC will arise but the components of the SGC which relate to employee entitlements are able to be offset to the extent of the amount of the late payment. The employee related entitlements of the SGC are the shortfall and nominal interest components.

4.45 In relation to the second scenario however, with the proposed amendments aligning the treatment of superannuation contributions with the SGC, the ATO, employees and superannuation funds will be entitled to participate in any available dividends payable in respect of their proofs.

Key changes

4.46 In order to resolve this anomaly, external administrators will have a discretion to reject a proof of debt when this scenario arises. It is preferable that the ATO's proof for the SGC be accepted rather than the affected employees' or superannuation fund's proof because the SGC includes the interest component and will ultimately give affected employees a greater benefit.

4.47 Section 553 provides for the admission to proof of debts and claims in a winding up. It will be amended to grant the liquidator a discretion to refuse a proof of debt for a superannuation contribution that results in a SGC.

4.48 In the case of a voluntary administration and a deed of company arrangement proofs of debt are required to determine creditors' eligibility to vote at the meetings of creditors. Administrators are guided by regulations 5.6.23 and 5.6.26 in this respect.

---

6 *Deputy Commissioner of Taxation v Rathner* [2004] VSC 352.

4.49 This proposal is consistent with recommendation 46 of the PJC Report, which stated that the Government should clarify how the SGC is intended to operate in relation to employers in external administration.

Notes on items

4.50 Item 5 will insert new section 553AB into the Corporations Act. Proposed section 553AB will give the liquidator a specific discretion to reject the whole, or a specified part of, a debt by way of a superannuation contribution where an SGC is attributable to the whole or part of that debt.

4.51 Item 4 will insert new section 444DC which will confer this discretion on deed administrators by prescribing it as a matter to be specified in a deed.

Clarification of the rights of subrogated creditors: section 560

Overview

4.52 A 'subrogated creditor' is a person who is entitled to be substituted for another creditor in a liquidation because they have advanced funds to meet a particular creditor's debt. As a general rule, a subrogated creditor is treated as a substitute for the original creditor, retaining all their rights.

4.53 An example is the right of the Commonwealth to stand in the shoes of employee creditors after the Commonwealth has paid out the entitlements of those employee creditors under the General Employee Entitlements and Redundancy Scheme (GEERS). Banks may also advance funds to enable the payment of particular debts.

4.54 Under section 560 of the Corporations Act, where the company has paid wages, salary, superannuation contributions, money due for the various types of leave or a retrenchment payments using money *advanced for that purpose* by some other person, that creditor is entitled to the same priority in respect of that money as the recipient would have been entitled to if the payment had not been made.

Background

4.55 It is unclear whether section 560 can apply to advances made after the relevant date. This issue has been recently highlighted as a consequence of the Commonwealth advancing funds through GEERS after a winding up begins or is taken to have begun. External administrators in practice have accepted advances from the Commonwealth under GEERS after the relevant date as advances for the purpose of section 560.

4.56 It is unclear whether a subrogated creditor in a receivership or a voluntary administration retains their rights as a creditor when that administration moves into liquidation.

4.57 The effect of this is that whilst the subrogated creditor enjoys the same priority as the creditor to whom it has advanced funds, they may not have the standing of that creditor, or enjoy the same rights. Subrogated creditors enjoy rights as an 'interested person' in some cases.

4.58 These concerns have been highlighted in the context of the administration of GEERS, where the Commonwealth's right to 'stand in the shoes' of employee creditors after those employees have had their entitlements paid out under the GEERS scheme is critical for the operation of the scheme.

4.59 The rights of subrogated creditors should be consistent across the different forms of external administration. Subrogated creditors should retain the rights of the original creditors.

4.60 As currently worded, section 560 may permit voting rights associated with a single debt to be split among two or more persons.

4.61 It is proposed that it be mandatory for a deed of company arrangement (DOCA) to preserve the priority available to eligible employee creditors in a winding up under section 556 unless eligible employee creditors agree to waive their priority. In relation to subrogated creditors, a Court has ruled that a DOCA that imports the section 556 system of ranking will not without more import the statutory right conferred by section 560 on persons who advance money for the payment of priority claimants.[7]

4.62 It is necessary to address an issue highlighted in the decision in *Capt'n Snooze Management Pty Ltd v McLellan [2002] VSC 432*, in particular the inclusion of the words 'out of' in section 560. In *Capt'n Snooze*, Hansen J interpreted the requirement that a payment must be made "out of" monies advanced such that where the account from which the payments are made is in debit, or where the amounts advanced are "mingled" with other monies, the operation of section 560 would not be attracted.

4.63 The decision in *Capt'n Snooze* poses a risk to a subrogated creditor's right of repayment of advances under section 560. It would be open to require liquidators to establish a separate account, and use that separate account for the receipt and distribution of section 560 advances. However, the opening of separate accounts, and their administration, imposes an expense on liquidators. To avoid this expense, an amendment to section 560 will overcome the problem that has arisen from the decision in *Capt'n Snooze*. Specifically, section 560 will be amended to avoid the need for making an advance into a separate bank account.

Key changes

4.64 Amendments to section 560 will clarify that section 560 may apply to advances that are made before, on or after the relevant date. The law will be amended to ensure subrogated creditors have the same rights the original creditors would have had under Chapter 5 if the advance had not been made. Persons making advances may not split voting rights associated with a single debt among two or more persons. The law will be amended to ensure that a DOCA mandating the priority available to eligible employee creditors also extends to the statutory rights under section 560.

Notes on items

4.65 Item 9 will clarify that section 560 applies to advances that are made before, on or after the relevant date: proposed subsection 560(b). It will amend section 560 to make it clear that the person by whom the money was advanced has the same rights under Chapter 5 as a creditor of the company. The reference in section 560 to "a payment made out of money advanced by a person" will be replaced in proposed subsection 560(b) with "the payment was made as a result of an advance of money by a person". Item 4 will add new proposed subsection 444DB(1) to ensure a deed of company arrangement that preserves the priority of section 556 for employee creditors also preserves statutory rights under sections 560 and 561.

---

7 *Re ACN 050 541 047 Ltd* [2002] NSWSC 586.

PART 2 — BETTER INFORMING CREDITOR DECISIONS

Administrators to make available a statement of independence

Background

4.66 Section 448C of the Corporations Act identifies a number of circumstances in which a person must not seek or consent to appointment as an administrator. Notwithstanding this provision, concerns have been raised that the appointment processes for administrators may leave them exposed to conflicts of interests in some circumstances.

4.67 For example, there may be a perception of a lack of independence where the administrator earlier acted as an adviser to the appointing director, particularly where the administrator is subsequently required to consider the possibility of offences, negligence or breaches of duty or trust by the current and former directors.

4.68 This proposal is consistent with recommendation 1 of the PJC Report and recommendation 36 of the CAMAC Report (1998).

Key changes

4.69 It is proposed to address the concerns about the independence of administrators by requiring administrators to declare any 'relevant relationships' and declare any indemnities that have been provided. These declarations will allow creditors to make a more informed decision about who to appoint as an administrator. The declarations will be provided to creditors with the notice of the first meeting of creditors. The categories of relationship that an administrator is required to declare are set out in a proposed amendment to section 9 of the Corporations Act defining 'declaration of relevant relationships'. To maximise the usefulness of the declarations to creditors (including creditors who may be unfamiliar with insolvency proceedings) the declarations should be expressed in simple language. They should be no more than two pages in length.

4.70 There will also be a requirement to update the declarations when an administrator becomes aware of additional relationships that must be disclosed.

4.71 Including a relationship in a declaration will in no way 'cure' any conflict of interest or conflict of duties that may arise out of that relationship, even if creditors approve the appointment after the declaration is made.

Notes on items

4.72 Item 16 will add a definition of 'administrator's firm' to section 9 of the Corporations Act.

4.73 Item 17 will add a definition of a 'declaration of indemnities' to section 9 of the Corporations Act.

4.74 Item 18 will add a definition of a 'declaration of relevant relationships' to section 9 of the Corporations Act.

4.75 Item 20 will provide for a declaration of indemnities and relevant relationships to be supplied by an administrator with the notice of meeting for the first meeting of creditors. The declaration must list any relationships falling within the definition for a 'declaration of relevant relationships' and must state why any of these relationships do not result in the administrator having a conflict of interest or duty.

4.76 Item 22 will provide for a declaration of indemnities and relevant relationships to be supplied by a replacement administrator, appointed under section 449C of the Corporations Act, at the next meeting of the company's creditors.

Creditors to have power to appoint different person as liquidator

Background

4.77 Section 446A of the Corporations Act provides for an administrator or deed administrator to become the liquidator of a company in a broad range of situations. In some instances creditors may consider that it is desirable to have a different person act as liquidator, notwithstanding that this could introduce new costs (which indirectly will be borne by creditors). One reason for such a decision could be a desire to have the conduct of the administration, or the pre-commencement conduct of the company, reviewed by a different practitioner.

Key changes

4.78 It is proposed to allow creditors to appoint a different person as liquidator when a company proceeds from administration into liquidation or from a deed of company arrangement into liquidation. (This is consistent with a proposal to allow creditors to replace the administrator at the first meeting of creditors, see Schedule 4, Part 1).

4.79 This proposal is consistent with recommendation 2 of the PJC Report.

Notes on items

4.80 Item 21 will amend subsection 446A(4) of the Corporations Act to allow creditors to appoint a different person as liquidator if they choose to do so. The amendment retains the automatic appointment of the administrator or deed administrator as liquidator where creditors do not act to appoint a different person as liquidator.

ASIC's power to seek court review of remuneration

Background

4.81 The remuneration of administrators and deed administrators is typically fixed by creditors of a company pursuant to section 449E(1)(a) of the Corporations Act. Section 449E(2) of the Corporations Act lists parties that may apply to the court for a review of remuneration. Included in the list are officers, members and creditors of the company. ASIC is not included in this list. In the case of *Korda in the Matter of Stockford Limited (Subject to Deed of Company Arrangement)* [2004] FCA 1682 (*Stockford*) [at para 4] the court commented that the lack of standing for ASIC to apply for review by the court 'is a surprising gap'. It is proposed to address this issue by giving ASIC standing to apply to a court for a review of remuneration.

Key changes

4.82 It is proposed to amend Section 449E(2) of the Corporations Act to include ASIC as a party who may apply to the court for a review of the remuneration of administrators and deed administrators.

4.83 This proposal is consistent with recommendation 23 of the PJC Report.

Notes on items

4.84 Item 25 will amend the Corporations Act to allow ASIC to apply to a court for a review of an administrator's remuneration.

Factors for consideration by a court in setting remuneration

Background

4.85 In *Stockford* [at para 2] the court called for 'closer judicial scrutiny [of administrators] fees'. In order to allow a more effective role for the court in reviewing and setting remuneration for insolvency practitioners, the Government has decided to provide greater guidance to the court by identifying relevant factors for consideration in setting remuneration.

Key changes

4.86 The Corporations Act will be amended to require a court to give consideration to a number of factors when setting or reviewing the remuneration of an insolvency practitioner.

4.87 Relevant factors that the court must consider in setting remuneration include:

- the extent to which the work performed, or likely to be performed, by the insolvency practitioner was reasonably necessary;
- the period during which the work was, or is or likely to be, performed by the insolvency practitioner;
- the quality of the work performed, or likely to be performed, by the insolvency practitioner;
- the complexity (or otherwise) of the work performed, or likely to be performed, by the insolvency practitioner;
- the extent (if any) to which the insolvency practitioner was, or is likely to be, required to deal with extraordinary issues;
- the extent (if any) to which the insolvency practitioner was, or is likely to be, required to accept a higher level of risk or responsibility than is usually the case;
- the value and nature of any property dealt with, or likely to be dealt with, by the insolvency practitioner;
- whether the insolvency practitioner was, or is likely to be, required to deal with one or more liquidators, receivers, or receivers and managers;
- the number, attributes and behaviour, or the likely number, attributes and behaviour, of the company's creditors;
- if the remuneration is ascertained, in whole or in part, on a time basis:
  - the time properly taken, or likely to be properly taken, by the insolvency practitioner in performing the work; and
  - market rates of remuneration; and
  - whether the total remuneration payable to the insolvency practitioner is capped;
- any other relevant matters.

Notes on items

4.88 Items 19, 26, 28 and 32 will amend sections 425, 449E, 473 and 504 of the Corporations Act to require a court to give consideration to the aforementioned factors when setting or reviewing the remuneration of an insolvency practitioner. Item 31 effects a minor consequential amendment.

Information to be provided to creditors to allow reasonableness to be assessed

Background

4.89 In *Stockford* [at para 15] it was noted that a report by a leading insolvency practitioner '…provided no information which would enable the creditors to determine the reasonableness or otherwise of the proposed rates.' There is currently no legal requirement for insolvency practitioners to provide information that would allow such an assessment to be made.

Key changes

4.90 The proposed amendment to the Corporations Act will provide that an external administrator must provide sufficient information to enable the approving party to assess remuneration as reasonable. This requirement will apply where the approving party is the court, a committee of creditors or a meeting of creditors. This requirement will apply where remuneration is being set under sections 449E and 473, 495 and 499.

4.91 The requirements are expressed in general terms, as the amount of detail required to appropriately inform creditors will vary with the size and nature of the proceeding and the amount of remuneration sought. This should provide practitioners with maximum flexibility and avoid the imposition of unwarranted costs (which ultimately are borne by creditors). To maximise the usefulness of the report to creditors (including creditors who may be unfamiliar with insolvency proceedings) the report should be expressed in simple language. It should be no more than two pages in length for routine matters.

Notes on items

4.92 Item 26 will insert new subsection 449E(5) into the Corporations Act to require an administrator to prepare a report that will enable a committee of creditors to assess remuneration as reasonable. Item 26 will also insert a new subsection 449E(6) into the Corporations Act to require an administrator to prepare a report that will enable a committee of inspection to assess remuneration as reasonable. Item 26 will also insert a new subsection 449E(7) into the Corporations Act to require an administrator to prepare a report that will enable creditors to assess remuneration as reasonable.

4.93 Item 28 will insert new subsections 473(11) and 473(12) into the Corporations Act to require a liquidator prepare a report that will enable a committee of inspection, or the company's creditors, respectively, to assess remuneration as reasonable.

4.94 Item 29 will insert new subsection 495(5) into the Corporations Act to require a liquidator in a members' voluntary winding-up to prepare a report that will enable members to assess remuneration as reasonable.

4.95 Item 30 will insert new subsections 499(6) and 499(7) into the Corporations Act to require a liquidator in a creditors' voluntary winding up to prepare a report that will enable a committee of creditors, or creditors, respectively, to assess remuneration as reasonable.

Allow administrators to apply to seek approval from a court for remuneration if creditors have not met

Background

4.96 Section 449E(1)(b) of the Corporations Act states that the remuneration of an administrator of a company under administration or of a deed of company arrangement can be fixed by the court upon application by the administrator.

4.97 It was noted by Finkelstein J in the *Stockford* case that it is unclear whether an administrator is able to approach the court to have remuneration fixed under this section prior to a meeting of creditors occurring. Clarification of the section is desirable to ensure that administrators are able to approach the court to have remuneration fixed when creditors have not met. This is desirable as it may be the case that creditors are disinterested (especially where there are no assets available for distribution) and it is not possible to obtain a quorum of creditors in meeting to approve remuneration.

Key changes

4.98 The proposed amendment to the Corporations Act will make it clear that it is possible for an administrator to apply to a court for remuneration to be fixed when creditors have not met. It is anticipated that this would generally only be considered where an attempt to convene a meeting of creditors had been made but had failed to attract a quorum, however flexibility is provided to allow the court to deal with other extraordinary circumstances that may arise.

Notes on items

4.99 Item 23 will insert a new section 449E(1C) into the Corporations Act to specifically provide for an administrator to apply to a court to have remuneration approved when creditors have not met.

Clarify the requirements for approval of administrator's remuneration

Background

4.100 Section 449E(1)(a) of the Corporations Act states that remuneration is fixed by a resolution of the company's creditors passed at a meeting convened under sections 439A or 445F.

4.101 Unlike other procedures, this does not anticipate approval of remuneration by a committee of creditors or a committee of inspection. Allowing for approval by a committee of creditors or a committee of inspection would streamline proceedings and reduce meeting costs, while still allowing creditors to monitor remuneration.

4.102 In the case of approving remuneration for an administrator under a DOCA, section 449E(1)(a) does not make it clear whether one vote can be sufficient to approve a DOCA and approve remuneration.

4.103 A vote in favour of a DOCA should not be sufficient to be taken as approval of remuneration. It should not be possible to have a combined resolution that approves a DOCA and approves an administrator's remuneration.

Key changes

4.104 The proposed amendment makes it clear that remuneration may be approved by a committee of inspection or a committee of creditors, and that a separate and distinct resolution of creditors is required to approve remuneration of an administrator when a company enters into a deed of company arrangement.

Notes on items

4.105 Item 23 will replace subsection 449E(1) with new subsections 449E(1) and 449E(1A) which will clarify that a committee of creditors and a committee of inspection, in the case of a deed administration, may determine the remuneration to be received by the administrator or deed administrator. Alternatively, an administrator may seek to have remuneration approved by the creditors of the company or by a court.

4.106 New subsection 449E(1B) will require a resolution dealing with remuneration to deal exclusively with that topic.

4.107 Item 24 is a consequential amendment to allow the Court to review the remuneration determined under subsection 449E(1) and (1A).

Allow a fixed amount of fees to be drawn down where a creditors meeting lacks quorum

Background

4.108 Liquidators in a court-ordered liquidation are sometimes unable to obtain approval for remuneration as a result of creditors' meetings failing to attract a quorum of creditors. While court approval for remuneration may be sought, this may be impractical where only limited funds are available. This may restrict the extent to which an investigation into the circumstances of the company is conducted.

Key changes

4.109 The proposed amendment will address this problem by allowing liquidators to draw down a maximum of $5,000 where a liquidator has called a meeting of creditors but failed to obtain approval for remuneration because of a lack of quorum. This will complement the $23 million assetless administration package, which is also intended to fund investigations in cases of assetless administrations.

Notes on items

4.110 Item 27 will insert new section 473(4A) into the Corporations Act to provide for a liquidator drawing down a maximum of $5,000 where a creditors meeting fails to approve remuneration due to a lack of quorum.

Annual meeting in a creditors voluntary winding up

Background

4.111 In a creditors' voluntary liquidation, a meeting of shareholders must be held annually under section 508 where the winding up continues for more than a year. This requirement has been criticised. It is said that the meetings are costly to hold. Creditors often do not attend. Sometimes a quorum is not reached and the meeting has to be adjourned. The meetings do not add value to the administration relative to the costs (e.g. advertising, meeting room hire, conduct of meeting, preparation and lodgement of minutes) of holding them.

4.112 It is important that those involved in the administration of insolvent companies be required to keep the creditors and members informed of the progress of the administration. Meetings are an important part of the system of corporate regulation. It is desirable that meetings be held, and documents laid before those meetings for consultation and debate by stakeholders. However, other means of informing stakeholders of the progress of administrations should also be available.

Key changes

4.113 It is proposed that a liquidator in a creditors' voluntary liquidation should have a choice of either calling an annual meeting of creditors or lodging with ASIC a report on the progress of the administration. Under this approach liquidators will not be required to incur the costs of convening a meeting which may fail due to a lack of quorum. They will retain the flexibility to hold a meeting if they consider it necessary (e.g. to seek to have the creditors fix their remuneration or to consider important issues affecting creditors). They will remain accountable to creditors in creditors' voluntary liquidations as creditors will be informed of the progress of the liquidation (where there are sufficient funds to hold the meeting or send the alternative report). Liquidators will have an incentive to complete liquidations in a timely manner.

Notes on items

4.114 Item 33 will give a liquidator in a creditors' voluntary winding up a choice of either convening a meeting of creditors as currently required or preparing and lodging with ASIC a report that complies with subsection 508(3). Item 35 will specify what the report must contain. It must set out an account of the liquidator's acts and dealings and the conduct of the winding up during the preceding year, the tasks remaining to be done in the liquidation and an estimate of when the liquidation is expected to be completed. This will be required to be done, as currently, within 3 months after the anniversary of the commencement of the winding up. A creditor will be able to request a copy of the report from the liquidator.

PART 3 — STREAMLINING EXTERNAL ADMINISTRATION

Advertising requirements

Background

4.115 The Corporations Act currently requires that various notices, documents and other forms of communication sent from an external administrator of a company to creditors of the company or ASIC must also be published in a national newspaper or in a newspaper that circulates in each State or Territory in which the company has an office or carries on business.

4.116 The publication requirement can impose a significant cost on an external administration, and as such should be limited to circumstances where that cost is warranted. For example, where a proceeding is in its late stages, and the creditors of the company have largely been identified, there may be little justification for requiring communications with creditors to also be published.

4.117 It is also noted that an alternate form of public notice is provided through the Company Alert system administered by ASIC. Credit managers can use Company Alerts to monitor their loan or credit portfolio, and respond to changes in the status of a company as they arise.

4.118 Recommendation 19 of the PJC Report stated that the Government should consider alternatives to the current advertising and gazettal requirements for external administrations.

Key changes

4.119 It is proposed to remove the requirement to publish notices, except where there is a strong policy rationale for such publication. For example, publication will be retained in circumstances where creditors and the public have not been alerted about important facts, such as the commencement of an insolvency proceeding, or where there is a need for notifying the broader community of an event.

Notes on items

4.120 Item 53 will remove the requirement in subsection 421A(3) for a managing controller to advertise that a report about a corporations affairs has been prepared and lodged with ASIC.

4.121 Item 64 will insert a new subsection 436E(3A) that will permit the notice of the first meeting of creditors in a voluntary administration required under subsection 436E(3) to be combined with notice of appointment of an administrator required under paragraph 450A(1)(b). Item 73 will insert a complementary provision 450A(1A).

4.122 Item 70 will remove the current requirement in paragraph 445F(2)(b), which provides that the notice of a meeting of creditors must be published in a national newspaper or in a daily newspaper that circulates in each State or Territory in which the company has a registered office or carries on business.

4.123 Item 71 will amend subsection 445F(3) to reflect the amendments in Item 70, omitting the reference to ‘paragraph (2)(a)’ and substituting reference to ‘subsection 2’.

4.124 Item 75 will repeal paragraph 450B(b) which requires that, as soon as practicable after a deed of company arrangement is executed, the deed’s administrator must publish a notice of execution of the deed in a national newspaper or in a daily newspaper that circulates in each State or Territory in which the company has a registered office or carries on business.

4.125 Item 77 will remove the requirement in paragraph 450C(b) for a deed administrator to publish a notice in the prescribed form that a company has failed to execute a deed of company arrangement within the required period.

4.126 Item 79 will repeal paragraph 450D(c) which requires that, where a deed of company arrangement terminates because of paragraph 445C(b), the deed's administrator must publish a notice of termination as prescribed. This will have the effect of removing the requirement in regulation 5.3A.09 to publish a notice of termination in a national newspaper or in a daily newspaper that circulates in each State or Territory in which the company has a registered office or carries on business.

4.127 Item 78 will delete 'and' from paragraph 450D(b) to reflect the amendment in item 79.

Electronic communication

Background

4.128 Subsection 249J of the Corporations Act facilitates electronic distribution of notices of meetings of members. However, there is no equivalent facility for electronic distributions of a number of notices that external administrators are required to send to creditors. An external administrator that wished to use electronic means to distribute notices would ordinarily need to seek the court's approval to do so.

4.129 Recommendation 20 of the PJC Report stated that the Government should consider making technology and e-commerce options more widely available to enhance communication with stakeholders in external administrations and reduce the costs of external administrations.

Key changes

4.130 It is proposed to introduce a facility similar to section 249J in order to allow external administrators to send notices electronically provided certain conditions are met.

4.131 A provision similar to section 249J, proposed section 600G, sets out the framework for electronic communication of various notices and documents in relation to external administration. Section 600G permits various modes of electronic communication:

- giving or sending the document to an electronic address or facsimile
  - this mode would allow, for example, sending a document by attaching it to an electronic mail message;
- giving or sending the document by other electronic means;
  - this mode would allow sending a document by some electronic means other than email; and
- rather than sending the document, notifying the recipient that it is available for access by some electronic means
  - this mode would allow, for example, the recipient to be notified by email that a document is available for viewing and/or download at an internet site.

4.132 Under all modes, it is a requirement that the recipient has advised the person sending the document (known as the 'notifier') has first expressly nominated that particular mode for the purposes of receiving such notices and provided the notifier with the relevant electronic address details. It is envisaged that, in most cases, external administrators seeking to utilise the facility would seek the nominations of creditors of a particular electronic communication mode early in the external administration procedure, so that after the nomination has been made, the external administration could communicate with the creditor through that electronic means throughout the remainder of the proceeding. A key reason why this option may be attractive for creditors is that

the speed of electronic communication will improve opportunities for creditor participation in the proceeding.

4.133 Section 600G lists the provisions of the Corporations Act to which the electronic communication facility will apply. Notes will be added to the relevant provisions to flag that the electronic communication facility is available. The amendments are not intended to limit the methods by which notices can be given, sent or lodged under other provisions of the Corporations Act.

Notes on items

4.134 Item 100 will insert a new section 600G that permits the sending of notices and other documents required or authorised under Chapter 5 of the Corporations Act to be sent through electronic means, provided certain conditions are met.

4.135 Subsection 600G(1) will identify the provisions to which it applies.

4.136 Subsection 600G(2) will allow notices or documents under the relevant provisions to be sent to an electronic address or facsimile number, if the recipient (as defined in subsection 600G(1)) has nominated such an electronic address or facsimile number for the purpose of receiving such notices or documents. It is expected that external administrators would seek the nomination in a form that could be substantiated later in the event a dispute were to occur about its content.

4.137 Subsection 600G(3) is similar in form to 600G(2) except it deals with electronic means other than one that would involve an 'electronic address'. This provision will allow for the take up of future technologies that may permit electronic communication without using an 'electronic address' (such as an electronic mail address).

4.138 Subsection 600G(4) will provide that if a recipient nominates an electronic 'notification means' and also an electronic 'access means', the notifier may give or send the notice or document to the recipient by notifying the recipient (using the nominated notification means) that the notice or document is available and how the recipient may use the nominated access means to access the notice or document. Under this facility, external administrators would be able to distribute a notice by, for example, sending a short electronic email to a member advising that a notice is available for viewing or download from the administrator's website. Recipients must first expressly nominate such a communication mode.

4.139 Subsections 600G(5) and (6) relates to the timing of the notices sent by electronic means and provides for a deemed giving or sending on the business day after it is either sent or the recipient is notified of its availability.

4.140 Subsection 600G(7) is intended to clarify that the electronic communication facilities under subsection (2), (3) and (4) do not limit any other modes of communication that may be available under the relevant provisions.

4.141 Items 63, 68, 69, 70, 72, 74, 76, 80, 84, 88, 92, 96, 98, and 99 will insert notes flagging the existence of the electronic communication facility in section 600G in the provisions to which it applies which are listed in subsection 600G(1).

4.142 Item 82 will remove from subsection 473(4) (one of the provisions to which section 600G applies) the requirement to 'attach' documents to a notice, because the concept of attachment may not be applicable if electronic communication is utilised. The documents formerly required to be attached to the notice must still accompany the notice.

4.143 Item 91 will remove from paragraph 497(2)(a) (one of the provisions to which section 600G applies) the requirement for the notice to be sent 'by post' to recognise the possibility of electronic communication under section 600G.

Gazettal requirements for controllerships

Background

4.144 The database maintained by ASIC provides the public with access to notices lodged in relation to controllerships. Section 427 of the Corporations Act requires the gazettal of certain matters related to controllerships in addition to notifying ASIC of the same matters. Gazettal is a significant expense for small controllerships.

4.145 The Review of Insolvency Practitioners recommended the repeal of provisions requiring gazettal of matters relating to controllerships. This would reduce the regulatory burden on controllers by limiting the notification requirements to lodgement of a notice with ASIC.

Key changes

4.146 It is proposed to repeal the requirement for gazettal of controllerships. The ASIC database will become the main source of information regarding controllerships.

Notes on items

4.147 Item 60 will repeal the subsections that require gazettal and notification of ASIC of matters related to controllerships and substitute provisions that require only the lodgement of notices with ASIC in relation to such matters.

4.148 Item 61 will repeal the subsection that requires gazettal and notification of ASIC when a person ceases to act as a controller of property of a corporation. The substitute provision will require a notice to be lodged with ASIC when such an event occurs.

Limiting the requirement to maintain separate bank accounts to managing controllers

Background

4.149 Section 421 of the Corporations Act requires all controllers to open and maintain a separate bank account for each controllership, and is designed to prevent the mingling of funds and make accounting for, and tracing of, the proceeds of the sale or profits from controllerships straight-forward and transparent. However, this requirement may be unduly onerous where a controllership is simple (for example, where a controller acquires rights over a single minor asset).

4.150 The Review of Insolvency Practitioners recommended that only managing controllers should be required to open a separate bank account when they receive money. The Review noted that 'the requirement to open a separate bank account is seen as burdensome and unnecessary' and indicated that the more complex controllerships are likely to be those where the controller is a managing controller.

Key changes

4.151 The proposed amendment to the Corporations Act will limit the requirement to maintain separate bank accounts to managing controllers. This change in no way inhibits the ability of a controller, who is not a managing controller, to maintain separate bank accounts should they wish to do so.

Notes on items

4.152 Items 48, 49, 50 and 51 will insert the word ‘managing’ before ‘controller’ wherever it occurs. The intended effect of these amendments is to limit the requirement to maintain separate bank accounts to managing controllers.

4.153 Item 52 will insert the word ‘managing’ before ‘controller’ such that the records kept by a managing controller under paragraph 421(1)(d) may be inspected by any director, creditor or member of a corporation.

Reporting of misconduct

Background

4.154 The Review of Insolvency Practitioners noted that managing controllers are arguably in as good a position as receivers to discover misconduct in the course of their work and, if they do, they should be obliged to report the possible misconduct.

Key changes

4.155 The requirement to report possible misconduct that is identified in the conduct of a proceeding will be extended to managing controllers.

Notes on items

4.156 The proposed amendments to section 422 will require a managing controller to prepare a report and lodge that report with ASIC should they apprehend that an officer, member or employee of the corporation may be guilty of an offence in relation to the corporation. The amendments also expand the power of a court to allow it to require a report from a managing controller where it appears to the court that a past or present officer, employee or member of the corporation has been guilty of an offence under the Corporations Act.

Power to consent to a transfer of shares of the company

Background

4.157 There is currently a lack of consistency across voluntary liquidation, court-ordered liquidation and voluntary administration, with respect to the practitioner’s power to consent to a transfer of shares or an alteration in the status of members of a company.

- A transfer of shares in a company, or an alteration in the status of the members of a company, that is made during the administration of a company is void, unless the Court orders otherwise (section 437F).
- By contrast, a transfer of shares in a voluntary winding up is permitted with the consent of the liquidator (subsection 493(2)).
- Section 468(1) has the effect of making void any transfer of shares in a court-ordered winding-up.

4.158 Recommendation 37 of the CAMAC Report (1998) supported improved consistency in this area of the law.

Key changes

4.159 A consistent approach will be adopted across the three procedures, with respect to authorising a transfer of shares or a change in the status of members of a company. The intent is to

provide maximum flexibility to practitioners in each of the types of proceeding, while retaining core shareholder protections.

4.160 Under the proposed approach, a liquidator will have the power to consent to a transfer of shares in a company in liquidation. The liquidator will need to be satisfied that it is in the best interests of creditors as a whole.

4.161 The ability to apply to the Court for an order authorising a transfer of shares will be retained, but will only be available where the liquidator's consent has been unsuccessfully sought first. This will ensure the 'least cost' option for approval is explored first. The court's power will be exercisable on application by the prospective transferor or transferee of shares, with the liquidator having standing to be heard on any application.

4.162 Liquidators will also be granted a power to consent to an alteration in the status of members of a company. Such an alteration may not be approved unless it complies with the rules for alteration of class rights in Part 2F.2 of the Corporations Act.

4.163 The amendments to effect similar changes for voluntary administration are found at item 7 of Part 1 of Schedule 4.

Notes on items

4.164 Item 81 will remove the provisions governing the transfer of shares, and an alteration in the status of members during a liquidation from subsection 468(1). Item 82 will replace these provisions with a new provision which will regulate transfers of shares (subsections 468A(1)-(7)) and alterations in the status of members during court-ordered liquidation (subsections 468A(8)-(15)).

4.165 In relation to a transfer of shares, new subsection 468A(1) will provide that a transfer is void unless the liquidator gives written consent to the transfer, or the Court makes an order authorising the transfer. New subsection 468A(2) will provide that the liquidator must be satisfied that it is in the best interests of creditors as a whole before granting his or her consent. New subsections 468A(3) and (5) will give the prospective transferor or transferee or a creditor standing to apply for a court order authorising the transfer if the liquidator refuses consent or a court order setting aside any conditions imposed by the liquidator. New subsections 468A(4) and (6) will empower the Court to authorise a transfer after a liquidator has refused consent to the transfer, or has approved the transfer subject to conditions that have not been met, where the Court is satisfied it is in the best interests of the creditors as a whole to do so.

4.166 New subsection 468A(8) will provide that an alteration to the status of members will be void unless the liquidator gives written consent to the alteration, or the Court makes an order authorising the alteration. The liquidator must be satisfied that the alteration is in the best interests of creditors as a whole before granting his or her consent and must refuse consent if the alteration would contravene the class rights provisions in Part 2F.2 (new subsection 468A(8)). Provision will be made for the Court to authorise alterations (but not if it contravenes the class rights provisions) or set aside conditions to which the liquidator's consent is subject.

4.167 Items 85, 86 and 87 will make similar amendments to the provisions regulating liquidator consent to a transfer of shares or an alteration in the status of members during a voluntary liquidation (new section 493A).

Schemes of compromise or arrangement — court discretion to approve

Background

4.168 Approval of a members' scheme requires a resolution to be passed by:

- a majority of members present and voting (sub-subparagraph 411(4)(a)(ii)(A)); and
- a special majority (75 per cent) according to the voting rights attaching to share capital (sub-subparagraph 411(4)(a)(ii)(B)).

4.169 The court has no discretion to approve a members' scheme if the resolution fails to attain both required majorities.

4.170 A members' scheme could be defeated by parties opposed to the scheme engaging in 'share splitting', which involves one or more members transferring small parcels of shares to a large number of other persons who are willing to attend the meeting and vote in accordance with the wishes of the transferor. By splitting shares to increase the number of members voting against the scheme, an individual or small group opposed to the scheme may cause the scheme to be defeated. This may occur even though a special majority is achieved in terms of voting rights attaching to share capital, and if the share split had not occurred, the majority of members were in favour of the scheme.

Key changes

4.171 It is proposed to amend Part 5.1 of the Corporations Act to confer a discretion on a court to approve a members' scheme where a resolution in favour of a compromise or arrangement:

- is passed under sub-subparagraph 411(4)(a)(ii)(B) (special majority pursuant to share capital voting rights); but
- is *not* passed under sub-subparagraph 411(4)(a)(ii)(A) (majority of members present).

Notes on items

4.172 Item 47 will amend sub-subparagraph 411(4)(a)(ii)(A) to give the court a discretion to make an order that the requirement for a majority of members present and voting may be dispensed with. It is intended that the court would only exercise the discretion to disregard the majority vote under sub-subparagraph 411(4)(a)(ii)(A) in circumstances where there is evidence that the result of the vote has been unfairly influenced by activities such as share splitting.

Corporate membership of the committee of creditors and the committee of inspection

Background

4.173 Section 436G of the *Corporations Act 2001* provides that a person can be a member of a committee of creditors of a company under administration if, and only if, he or she is a creditor of the company, the attorney of such a creditor because of a general power of attorney, or authorised in writing by such a creditor to be a member.

4.174 Paragraph 548(3)(a) provides that a person is not eligible to be appointed a member of a committee of inspection unless, in the case of an appointment by creditors of the company, the person is a creditor of the company, the attorney of a creditor of the company by virtue of a general power of attorney given by the creditor, or a person authorised in writing by a creditor of the company to be a member of the committee of inspection.

4.175 Paragraph 548(3)(b) provides that a person is not eligible to be appointed a member of a committee of inspection unless, in the case of an appointment by the contributories of the company, the person is a contributory of the company, the attorney of a contributory of the company by virtue of a general power of attorney given by the contributory, or a person authorised in writing by a contributory of the company to be a member of the committee of inspection.

4.176 Recommendation 34 of the CAMAC Report (2004) stated that the Corporations Act should be amended to make it clear that a corporation can be a member of a committee of creditors.

Key changes

4.177 Paragraph 22(1)(a) of the *Acts Interpretation Act 1901* provides that a person includes a body corporate and body politic as well as an individual. However, the reference to 'he or she' in section 436G suggests that membership of a committee of creditors may be limited to natural persons and, therefore, section 436G creates some uncertainty as to whether a corporation can be a member of a committee of creditors.

4.178 The amendments to section 436G and subsection 549(4) will confirm that corporate membership of a committee of creditors and a committee of inspection is possible, and that corporations may be represented at meetings by an officer or employee of the member or some other authorised person.

Notes on items

Items 65, 66 and 67: Section 436G

4.179 Item 65 will amend section 436G to insert '(1)' before 'A person'. Item 66 will amend section 436G to delete reference to 'he or she' and substitute 'the person', confirming that membership is not limited to natural persons. Item 67 will insert subsection 436G(2) to provide that if a member of a committee of creditors is a body corporate, the member may be represented at meetings of the committee by an officer or employee of the member.

Item 97: At the end of subsection 549

4.180 Item 97 inserts subsection 549(4) to provide that if a member of a committee of inspection is a body corporate, the member may be represented at meetings of the committee by an officer or employee of the member, or some other individual who is authorised in writing by the body corporate under the provision to represent it at committee meetings.

Creditors' voluntary winding up

Background

4.181 Directors of insolvent companies or companies in financial difficulty must carefully consider the options for external administration because they are under a legal obligation to cause an insolvent company to cease trading. If they fail to do so they may be held personally liable for the company's debts. One of the options available to directors of insolvent companies is to initiate a creditors' voluntary winding up. Part 5.5 of the Corporations Act sets out the procedure for a creditors' voluntary winding up. Following a resolution by directors, a meeting of members is called to place the company into liquidation. A meeting of creditors must also be held, and that must be on the same day or the day after, and the meetings of creditors may replace the liquidator. Section 497(1) provides that notices of meeting for the members' and creditors' meetings must be sent simultaneously.

4.182 Under subsection 497(2), creditors must be provided with seven days notice before the meeting of creditors. The combination of the notice and timing requirements for the creditors' meeting means that the meeting of members cannot be called to resolve that an insolvent company be placed in liquidation until nearly a week after the initial directors' resolution.

4.183 On the other hand, voluntary administration may be entered into directly from a directors' resolution. For that reason, it is often used as a route to a creditors' voluntary winding up, even when it is clear that a company has no option but to be wound up. That is because the longer timeframe for entering a creditors' voluntary winding up may expose directors to potential liability for insolvent trading and possible personal liability for taxation liabilities of the company.

4.184 Using the voluntary administration procedure in cases where there is clearly no option but to ultimately liquidate may result in unnecessary costs due to the investigative, reporting and meeting requirements of Part 5.3A.

Key changes

4.185 To introduce greater flexibility into the process for placing a company into liquidation through a creditors' voluntary liquidation, the requirement to hold the members' meeting and creditors' meeting on the same day will be relaxed. The required timing for the creditors meeting will be extended to 8 business days after the day of the members' meeting. The extension of this time period will mean that, in circumstances where a meeting of members can be called directly after the directors' meeting (by using the facility for members to consent to short notice under subsection 249H), an insolvent company may be placed into a creditors' voluntary winding up almost immediately. The proposed requirement to convene the creditors' meeting within 8 business days after the day of the meeting at which the resolution for voluntary wing up is proposed will align the timing of the creditors meeting in a creditors' voluntary liquidation with the first meeting in voluntary administration.

Notes on items

4.186 Item 89 will amend section 497 to require the creditors' meeting to be held within 8 business days following the meeting at which the resolution for voluntary winding up is to be proposed. The amendment will also remove the requirement for the notice of the creditors' meeting to be sent out simultaneously with the sending of the notices of the meeting of the company.

4.187 Item 90 will amend subsection 497(2) to clarify that the meeting referred to in the subsection is the same meeting of creditors referred to in subsection 497(1).

Multiple liquidators

Background

4.188 Paragraph 451A(2)(a) of the Corporations Act provides that where there are two or more administrators of a company, a function or power of an administrator of the company may be performed or exercised by any one of them, or by any two or more of them together, except so far as the instrument or resolution appointing them provides otherwise.

4.189 Paragraph 451B(2)(a) provides that where there are two or more administrators of a deed of company arrangement, a function or power of an administrator of the deed may be performed or exercised by any one of them, or by any two or more of them together, except so far as the deed, or the resolution or instrument appointing them provides otherwise.

4.190 Subsection 506(4) provides that when several liquidators are appointed, any power given by the Corporations Act may be exercised by such one or more of them as is determined at the time of their appointment, or in default of such determination, by any number not less than two.

4.191 Joint and several appointments of administrators of a company, under paragraph 451A(2)(a), and of administrators of a deed of company arrangement, under paragraph 451B(2)(a), are convenient and efficient, enabling multiple appointees to divide responsibilities in large and complex cases.

4.192 There is some uncertainty as to whether subsection 506(4) allows for joint and several appointments of liquidators. Under subsection 506(4), where the powers of multiple liquidators have not been determined at the time of their appointment, they may be appointed 'jointly' and not 'jointly and severally'.

4.193 The Corporations Act does not explicitly provide for joint and several appointments of receivers or receivers and managers.

4.194 Recommendation 57 of the PJC Report stated that consideration should be given to repealing subsection 506(4) and replacing it with a provision in similar terms to sections 451A and 451B. That is, where more than one liquidator is appointed, their functions or powers should be able to be exercised by any one of them, subject to the resolution or instrument appointing them providing otherwise. The Report also recommended that consideration be given to similar provisions being included in Parts 5.2 and 5.6 of the Corporations Act dealing with receiverships and windings-up generally.

Key changes

4.195 Amendments to sections 434D, 434E, 506(4), 530 and 530AA will provide for multiple 'joint' or 'joint and several' appointments in liquidations and receiverships, except where the instrument of resolution of appointment provides otherwise.

Notes on items

4.196 Item 62 will insert a new section 434D which provided that where there are two or more receivers of property of a corporation, a function or power of a receiver of property of the corporation may be performed or exercised by any one of them, or by any two or more of them together, except so far as the order or instrument appointing them provides otherwise. New section 434D will also provide that a reference in the Corporations Act to a receiver, or to a receiver of property of a corporation, is a reference to whichever one or more of those receivers as the case requires.

4.197 Item 62 will also insert new sections 434E, 434F and 434G which includes similar provisions with respect to multiple receivers and managers, controllers and managing controllers respectively. Item 93 will insert a new section 530 and 530AA, which include similar provisions with respect to liquidators and provisional liquidators respectively.

4.198 Item 93 will repeal subsection 506(4), because its subject matter will be dealt with by new section 530.

4.199 Items 36, 37, 38, 39, 40, 41, 42 and 43 will amend the definitions of 'controller', 'liquidator', 'managing controller', 'provisional liquidator' and 'receiver' in section 9 of the Corporations Act to recognise that there may be more than one appointee.

Change of company name in external administration

Background

4.200 When a company is under external administration, a number of issues relating to its name may arise.

4.201 The company name is an asset which may have some value as part of a business sale in external administration. As such, facilitating a change of name may maximise the value of an asset, improving outcomes for creditors. However, it is extremely difficult for a special resolution to be passed for a public company in external administration, particularly so considering the problems identified in relation to companies in external administration holding annual general meetings[8]. In

8 Generally, if a company wishes to change its name, it must pass a special resolution adopting the new name and lodge an application in the prescribed form with ASIC (section 157).

the case of external administration, the interests of creditors should be prioritised. As such, there is a case for allowing greater flexibility for practitioners to be able to change the name of a company.

4.202 On the other hand, it is important that creditors of externally administered companies have adequate opportunity to identify that a company is subject to external administration. Companies commonly change their name, often to their Australian Company Number (ACN) only, before appointing an administrator, to minimise the potentially damaging commercial effect of having their prior name associated with a voluntary administration. This practice may disadvantage creditors who may not associate the new name with the company with which they have been dealing. For instance, creditors may not recognise the new name in notices of creditors' meetings, in notices calling for proofs of debt and in general correspondence.

4.203 Recommendation 60 of the CAMAC Report (1998) stated that any company that changes its name during the course of, or in the six months before, a voluntary administration should be required to disclose its former, as well as its current, name on its public documents for the period of that administration or any subsequent liquidation.

Key changes

4.204 It is proposed to introduce a series of new rules relating to the names of company under external administration, to better balance the competing interests discussed above.

4.205 The law will permit liquidators, administrators and deed administrators to lodge an application to change a company's name without the need for a special resolution of members, where it is in the interests of creditors as a whole to do so.

4.206 The law will also provide that any company that changes its name during, or six months prior to, an external administration should be required to disclose its former, as well as its current, name on its public documents for the period of that administration or any subsequent liquidation. This will include public documents issued by an external administrator.

4.207 In relation to deeds of company arrangement, there may be limited circumstances where a deed is still yet to be terminated but there is little risk to creditors by the change of name. Accordingly, the law will provide an opportunity for the deed administrator to apply to the Court for an exemption of the requirements to disclose the company's former name as well as the new name in circumstances where the Court considers that there is little risk to creditors. (A similar ability to apply to the Court is proposed in relation to the requirement to disclose that a company is under a DOCA - see items 39 and 40 of Part 1, Schedule 4).

Notes on items

4.208 Item 44 will insert proposed section 157A which permits liquidators, administrators, deed administrators and managing controllers to lodge an application with the Court to change a company's name without the need for a special resolution of members, where it is in the interests of creditors as a whole to do so.

4.209 Item 45 will insert proposed section 161A in Division 2, Part 2B.6 which provides that a company that changes its name during, or six months prior to, an external administration should be required to disclose its former, as well as its current, name on its public documents for the period of that administration or any subsequent liquidation. New subsections 161A(3), (6) and (7) will provide that, in relation to a company subject to a DOCA, the deed administrator can seek leave of the Court for an exemption from the requirements of new section 161A.

4.210 Item 101 will amend the penalties schedule to provide a penalty for an offence against subsection 161A(2) or (3).

Exemption from the requirement to hold an annual general meeting

Background

4.211 Section 250N of the Corporations Act requires public companies to hold annual general meetings (AGMs) within 18 months of registration and at least once in each calendar year and within 5 months after the end of its financial year. Public companies can apply for an extension of the time for holding AGMs from ASIC under section 250P. However, ASIC currently cannot give an exemption from the requirement to hold an AGM.

4.212 The above sections continue to apply whilst a company is under external administration. Further, section 508 provides that if a creditors' or members' winding up continues for more than one year, the liquidator must convene an AGM within three months after the end of the first year from the commencement of the winding up and the end of each succeeding year. There is no requirement for an AGM in the case of a winding up by the Court.

4.213 The cost of holding an AGM, which in the case of companies in external administration is borne by creditors, may be considerable. In a large number of cases, these meetings have little value to an administration relative to the cost required to hold the meeting. It is understood to be rare that any business is conducted at these meetings. It has been observed that AGMs of members and creditors in a creditors' voluntary liquidation rarely attract a quorum and are generally considered to be an unnecessary drain on funds which may otherwise be distributed to creditors.

4.214 Proposed amendments to section 508 discussed above (item 33, Part 2 of Schedule 1) will allow liquidators in a creditors' voluntary administration the option of either calling an AGM or preparing a report on progress and lodging that report with ASIC. The intent of the amendment to section 508 is to better balance the need to keep creditors informed with the costs of holding a meeting.

Key changes

4.215 ASIC will be granted a discretion to grant an individual company an exemption from the requirement to hold an annual general meeting on application made by an external administrator.

Notes on items

4.216 Item 46 will insert proposed new section 250PAA in the Corporations Act giving ASIC a discretion to grant a company in a form of external administration an exemption from the requirement to hold an annual general meeting on application made by the external administrator. The new provision provides the ability for ASIC to impose conditions.

PART 4 — FACILITATING POOLING IN EXTERNAL ADMINISTRATION

Background

4.217 Part 4 of Schedule 1 sets out a statutory 'pooling' mechanism to facilitate the external administration of corporate groups. It proposes a new Division 8A for pooling in a voluntary administration under Part 5.3A and a new Division 8 for pooling in a liquidation under Part 5.6.

4.218 The proposed reforms draw on the recommendations of CAMAC on this topic.[9] Features of the model developed by CAMAC include:

- Practitioners would be permitted to unify the external administration of several companies, including combining their assets and liabilities as if they were in one company, treating the creditors of all the companies as if they were creditors of that company and giving creditors the right to enter into a single deed of company arrangement that binds all affected parties.
- Pooling would be permitted for holding/subsidiary companies and other related companies but also where there is a common ownership structure, a common exposure to specific actual or contingent liabilities, or ownership or operation of corporate assets in a common scheme or undertaking.
- Pooling would not alter creditors' rights against a particular company unless creditors agreed or the court so ordered.
- If a practitioner decided to pool the administration of several companies, they would give written notice of that decision to all creditors of that company together with:
  - a statement identifying the other group companies in the proposed pool;
  - a summary of all material information known to the administrator that is relevant to the creditors' decision whether to object to the pooling of those group companies; and
  - a statement of the right of any creditor to object and the procedure for lodging the objection.
- Pooling may then proceed if no creditor objects within a prescribed period, or the Court approves the pooling on the application of the practitioner, notwithstanding the creditor objection.
- When approving pooling, the court order should be able to set such terms and conditions as the Court may determine.

4.219 The CAMAC proposal envisaged:

- creditors of all pooled companies would be treated as one class, voting at one meeting according to number and value on a single deed of company arrangement; and
- the inclusion of solvent group companies in a pooled voluntary administration.

---

9 Final Report of the Companies and Securities Advisory Committee on *Corporate Groups,* (2000), pp 140--143 and the Report of the Corporations and Markets Advisory Committee on *Rehabilitating large and complex enterprises in financial difficulties*, (2004), pp 93--100 for pooling in voluntary administration; and the Final Report on *Corporate Groups,* (2000), pp 166--180 for pooling in a liquidation.

Pooling in voluntary administration

4.220 The proposed model under new Division 8A of Part 5.3A does not introduce the concept of one group (or one economic entity) replacing the particular companies that comprise the group to be pooled. It does not treat the creditors of all the companies as if they were creditors of that group (or economic entity) or give creditors the right to enter into a single deed of company arrangement. It allows a pooling proposal to be made during the period of administration as well as during the period of the deed administration. Only group companies that have entered into voluntary administration may be pooled.

4.221 The introduction of a 'single economic entity' concept would require extensive amendments to the Corporations Act. The Corporations Act does not include the concept of a corporate group as a distinct legal entity. The concepts of holding, subsidiary and related companies and parent and controlled entities are based on the notion of each company being a separate legal entity.

4.222 The proposed model allows for pooling in a voluntary administration in a range of circumstances provided that no creditor objects. It makes provision for objection by dissenting creditors and, in such case, the administrator may seek court approval.

4.223 In the case of a voluntary administration the model provides that the decision to pool be made by the administrator in the first instance and that the administrator seek the consent of creditors for pooling prior to any approach to the Court. It does not make provision for the inclusion of solvent group companies in a pooled voluntary administration, as this would raise difficult issues about shareholder protection. The proposed model aims to operate in harmony with, and in the context of, the current voluntary administration procedure.

4.224 A pooling determination has the effect that each of the companies in the 'pool' will be taken to be jointly and severally liable for each debt payable by each other company in the group and inter-company debts are extinguished. An administrator would have the power to modify this outcome. While this confers a broad discretion on the administrator, this is considered acceptable from a policy perspective because the determination can be 'defeated' by a single creditor objection, in which case the determination must be approved by a court if it is to take effect.

4.225 The key feature of the proposed model is that it allows creditors to decide on pooling arrangements or authorise an administrator to prepare a pooling proposal in a deed of company arrangement. In the event that any creditor objects, it permits the court to approve pooling arrangements on the application of an administrator and notwithstanding creditor objection.

4.226 The rights of external secured creditors will not be affected by the proposed pooling arrangements either in a voluntary administration or in a liquidation. They will retain their security rights.

Notes on items

4.227 Item 102 will provide for pooling in voluntary administration in a proposed new Division 8A to be inserted into Part 5.3A.

4.228 Proposed new sections 442G and 442H will permit an administrator or a deed administrator to make a determination that a group of companies is a pooled group for the purposes of the section. A pooling determination must be in writing and sent to creditors of the companies in the group.

4.229 The companies in the group must either all be under administration or all have had executed a deed of administration that has not yet terminated. The companies in the group must:

- be related companies, or

- be jointly liable for one or more debts, or
- own or operate property that was used in connection with a business, scheme or undertaking carried on jointly by the companies.

4.230 'Group' is not defined or used in a technical sense in the proposed model. It has its ordinary meaning as a collective noun. The companies that may be the subject of a pooling determination are specified in subclause 442G(1)(b) and 442H(1)(b). The relationships are not limited to those between related companies: new section 442V.

4.231 Pooling arrangements may be approved by creditors under the current law. New Division 8A is not intended to limit what creditors may decide in relation to the possibility of pooling currently: new section 442R.

4.232 'Pooling' is not defined in the proposed model. However, new subsections 442G(3) and 442H(2) outline the consequences of a pooling determination. They provide that the consequences of a pooling determination are:

- each company in the group is taken to be jointly and severally liable for each debt payable by and each claim against each other company in the group;
- each debt payable by a company in the group to any other company in the group is extinguished.

4.233 Under subsection 442G(1)(d) or 442H(1)(d) an administrator or deed administrator may modify the consequences of a determination as provided for in subsections 442G(3)-(8) or subsections 442H(2)-(7) if they consider it is just and equitable as between the various creditors to do so. This power will permit the maximum flexibility for the terms of the pooling determination to reflect the specific circumstances of the companies under consideration.

4.234 New subsections 442G(3) or 442H(2) will not apply to a secured debt unless the debt is payable by a company in the group to any other company in the group. External secured creditors are excluded from the scope of a pooling determination to the extent of their security: new subsections 442G(6), 442H(5).

4.235 New subsection 442K(1) provides that before an administrator may make a pooling determination they must give written notice of the proposed determination to as many of the company's creditors as reasonably practicable, together with a statement identifying each of the companies in the group, creditors' rights to object, the procedure for objecting and the information that will enable creditors to make an informed decision about whether to object. New subsection 442K(2) makes similar provision in the case of a deed administration. If a creditor objects to the determination the administrator/deed administrator cannot make the determination.

4.236 The Court may make an order under subsection 442L(1) approving the making of the determination. It may make such an order notwithstanding the earlier objection of creditors, if it considers it is just and equitable to do so. It may only do so on the application of the administrator or deed administrator (new subsection 442L(2)). In considering whether to make an order the Court must have regard to the following matters (new subsection 442L(3):

- the extent to which a company in the group and the officers or employees of a company in the group were involved in the management of any of the other companies;
- the conduct of a company in the group and the officers or employees of a company in the group towards the creditors of any of the other companies;

- the extent to which the circumstances that gave rise to the winding up of any of the pooled companies were attributable to the actions of any of the other companies in the group or the officers or employees any of the other companies in the group;

- the extent to which the business of the pooled companies has been intermingled;

- the extent to which creditors of any one or more of the pooled companies may be advantaged or disadvantaged by the making of the pooling order; and

- any other relevant matters.

4.237 Under new section 442M the Court may make ancillary orders in approving the making of a pooling determination. It may:

- exempt specified debts or claims from the determination;

- transfer specified property or liabilities from one company to another;

- modify the application of the deeds of company arrangement;

- modify the application of the Corporations Act in relation to the companies in the group; or

- make such orders, and give such directions as the Court thinks fit.

4.238 New section 442M will specify who has standing to make an application for an ancillary order (subsection 442M(2)) and provide for the making of conditional orders and variation of orders (subsections 442M(3) and (5)). New sections 442N and 442P provide for variations of pooling determination, and variations of deeds of company arrangement to reflect a pooling determination.

4.239 New section 442Q will make provision for consolidated meetings of creditors and permit related regulations to be made. Supporting regulations relating to the period for creditor objection, form of creditor objection, consolidated meetings and consolidated minutes have been exposed for public comment as part of the Corporations and Australian Securities and Investments Commission Amendment Regulations 2007.

4.240 New sections 442T and 442U make provision for transition to a creditors' voluntary winding up, similar to transition to a creditors' voluntary winding under Division 12 of Part 5.3A. A resolution to wind up the group must be passed at a consolidated meeting of creditors of the companies in the group.

4.241 Item 103 of Schedule 4 will add a note to subsection 444D(1) clarifying that the deeds of company arrangement for a pooled group are binding on the creditors of companies in the group.

Pooling in liquidation

4.242 The proposed model for pooling in a liquidation is similar to the model for voluntary administration, however it provides for two separate methods of pooling: voluntary pooling and Court ordered pooling. This is in contrast to the proposed model for voluntary administration, which envisages court approval only after a creditor has objected to the making of a determination.

4.243 In a voluntary pooling, the winding up of a group of companies may only be the subject of a pooling determination if every eligible unsecured creditor consents to the pooling (unanimous consent). The liquidator may make a determination that the winding up be conducted on a pooled basis. The determination takes effect if no eligible creditor objects to the pooling.

4.244 In the case of Court ordered pooling, the Court may determine, by order, that a group of companies in liquidation is a pooled group if it is satisfied that it is just and equitable to do so. The Court may make the order despite the objections of creditors.

Notes on items

4.245 Item 113 will provide for pooling in liquidation in a proposed new Division 8 to be inserted in Part 5.6.

4.246 New Division 8 will provide for voluntary pooling (new sections 572 and 573) and Court ordered pooling (new sections 576 and 577). New section 571 will include a definition of 'eligible unsecured creditor' for the purposes of new Division 8. An 'eligible unsecured creditor' is a creditor whose debt is unsecured and who is entitled to object to the making of a pooling determination under subclause 572(1). It will not include creditors that are companies in the pooled group.

4.247 Proposed new section 572 will permit a liquidator to make a determination that a group of companies is a pooled group for the purposes of the section. A pooling determination must be in writing and sent to the creditors of the company in the group.

4.248 For a liquidator to be able to make such a determination each company in the group must be being wound up. The companies in the group must:

- be related companies, or
- be jointly liable for one or more debts, or
- own or operate property that was used in connection with a business, scheme or undertaking carried on jointly by the companies.

4.249 'Group' is not defined or used in a technical sense in the proposed model. It has its ordinary meaning as a collective noun. The relationships between the companies that may be the subject of a pooling determination will be specified in new subsection 572(1)(b). The relationships are not limited to those between related companies.

4.250 'Pooling is not defined in the proposed model. However, new subsection 572(2) will outline the consequences of a pooling determination. The section provides that the consequences of a pooling determination are:

- each company in the group is taken to be jointly and severally liable for each debt payable by and each claim against each other company in the group;
- each debt payable by a company in the group to any other company in the group is extinguished.

4.251 The liquidator may modify the consequences of a determination as provided for in subsections 572(2)-(7) if they consider it is just and equitable as between the various creditors to do so. This power will permit the maximum flexibility for the terms of the pooling determination to reflect the specific circumstances of the companies under consideration.

4.252 New subsection 572(2) will not apply to a secured debt unless the debt is payable by a company in the group to any other company in the group. External secured creditors are excluded from the scope of a pooling determination to the extent of their security (subsection 572(5)).

4.253 New section 574 will provide that before a liquidator makes a pooling determination they must give written notice of the proposed determination to each eligible unsecured creditor together

with a statement identifying each of the companies in the group, creditors' rights to object, the procedure for objecting and information that will enable creditors to make an informed decision about whether to object. A copy of the pooling determination must be lodged with ASIC (new section 573). If a creditor validly objects within the prescribed time the liquidator may not make the determination (subsection 574(4)).

4.254 A pooling determination under new section 572 will not limit a liquidator's power under section 477, for example to make any compromise or arrangement with creditors or compromise any debts or claims (subclause 572(11)).

Court-ordered pooling

4.255 New section 576 will empower a Court to determine, by order, that a group of companies is a pooled group for the purposes of section 574. The Court may make such an order if it is satisfied that it is just and equitable to do so. It may do so notwithstanding the objection of creditors. In considering whether to make an order the Court must have regard to the following matters (new subsection 576(9)):

- the extent to which a company in the group and the officers or employees of a company in the group were involved in the management of any of the other companies;
- the conduct of a company in the group and the officers or employees of a company in the group towards the creditors of any of the other companies;
- the extent to which the circumstances that gave rise to the winding up of any of the pooled companies were attributable to the actions of any of the other companies in the group or the officers or employees any of the other companies in the group;
- the extent to which the business of the pooled companies has been intermingled;
- the extent to which creditors of any one or more of the pooled companies may be advantaged or disadvantaged by the making of the pooling order; and
- any other relevant matters.

4.256 New subsection 576(2) will provide that the consequences of a pooling order under section 576 are:

- each company in the group is taken to be jointly and severally liable for each debt payable by and each claim against each other company in the group;
- each debt payable by a company in the group to any other company in the group is extinguished.

4.257 An application under new section 576 may only be made by the liquidator or liquidators of the companies in the group: subsection 576(8).

4.258 Under new section 577 the Court may make ancillary orders in approving the making of a pooling determination. It may:

- exempt specified debts or claims from the determination;
- transfer property or liabilities from one company to another;

- modify the application of the Corporations Act in relation to the winding up of the companies in the group; and

- give such directions in relation to the winding up of the companies in the group as the Court thinks fit.

4.259 The Court's power to make an order or direction under section 577 includes power to provide for different returns for different classes of creditors or the subordination of the debts and claims of specified creditors but not so as to alter the order of priority under sections 556, 560 or 561: subclauses 577(4), 577(5) and 577(8).

4.260 Subsection 577(2) specifies that the liquidator or a creditor of a company in the group has standing to make an application for an ancillary order.

4.261 New section 578 makes provision for consolidated meetings of creditors.

4.262 Item 104 will add a note at the end of subsection 473(3) cross-referencing the provision that provides for the conduct of consolidated meetings of creditors. Under section 578 a resolution passed at a consolidated meeting of creditors of the companies in the group is taken to have been passed by the creditors of each of the companies in the group. A resolution about remuneration passed at a consolidated meeting of creditors of the companies in the group will be taken, for the purposes of subsection 473(3), to be a resolution of the creditors of a particular company.

4.263 Item 105 will permit regulations to be made in relation to a pooled liquidation so as to make provision for the matters currently dealt with in section 538, such as the maintenance of bank accounts by a liquidator, payments into such accounts, and the deposit of bills, notes and other securities. Item 106 will allow a liquidator of companies in a group to lodge one set of accounts of receipts and payments for the group. Items 107, 108, 109, 110 and 111 will make provision for the formation of a committee of inspection for the group.

4.264 Supporting regulations relating to the period for creditor objection, form of creditor objection, consolidated meetings and consolidated minutes have been exposed for public comment as part of the Corporations and Australian Securities and Investments Commission Amendment Regulations 2007.

4.265 Item 112 will include a reference to the new Division 8 in subsection 553(1).

Exercise of powers or functions by liquidator or administrator

4.266 In exercising a function or power in connection with a proposed pooling determination with due care and in good faith, a liquidator or an administrator will not to be taken to be in breach of fiduciary duties owed to a particular company or to creditors of a particular company, or duties to a company in a group under sections 180, 181, 182 or 184 (sections 442G(1), 442H(9) and 572(9))

5

DETERRING CORPORATE MISCONDUCT

Compulsory powers to investigate liquidators' conduct

Background

5.1 There are limitations on the circumstances in which ASIC may use its compulsory powers for the purpose of inquiries into liquidators' conduct generally. Section 13 of the *Australian Securities and Investments Commission Act 2001* (ASIC Act) sets out when ASIC's investigative powers in Part 3 of the ASIC Act are triggered. Those circumstances include investigation of a suspected contravention of the corporations legislation, or of a 'law of the Commonwealth, or of a State or Territory' relating to the management or affairs of a body corporate or involving fraud or dishonesty. For that purpose a 'law of the Commonwealth, or of a State or Territory' is limited to enactments of parliaments and does not extend to common law or equitable duties.

5.2 It is within ASIC's administrative functions under the corporations legislation to enquire into liquidators' actions (section 536 of the Corporations Act) and to make applications for disciplinary purposes to the Companies Auditors and Liquidators Disciplinary Board (CALDB) where a liquidator has failed to carry out the duties of a liquidator adequately (subsection 1292(2) of the Corporations Act).

5.3 However, it is not always clear that ASIC can use the full suite of its compulsory powers in Part 3 for the purposes of investigating the extent to which a registered liquidator has satisfied the duties owed by them in various proceedings. Unlike directors' duties, the fiduciary duties of registered liquidators are not codified in the corporations legislation.

Key changes

5.4 ASIC will be empowered to use its compulsory powers in Part 3 of the ASIC Act to investigate liquidators' conduct generally, including the extent to which registered liquidators comply with those fiduciary duties that are not codified in the corporations legislation. In order to use its compulsory powers, ASIC will need to have reason to suspect certain matters, for example that a person has or may have failed to carry out or perform adequately and properly the duties of a liquidator.

Notes on items

5.5 Item 1 of Schedule 2 will insert a new subsection 13(3) into the ASIC Act.

5.6 New subsection 13(3) will allow ASIC to use the investigatory powers in Part 3 of the ASIC when ASIC has reason to suspect that a registered liquidator has not, or may not have, faithfully performed his or her duties; or is not, or may not be, faithfully performing his or her duties as a liquidator.

Schemes of compromise or arrangement — right of recovery for breach of condition or alteration

Background

5.7 Part 5.1 of the Corporations Act provides for a scheme of compromise or arrangement, comprising a plan that binds a Part 5.1 body's creditors or members or both to some form of rearrangement of their rights and obligations.

5.8 When an application is made to the court to approve a scheme proposal that has been passed by members and/or creditors, the court will consider the application and may approve the scheme subject to any alteration or condition as the court thinks just (subsection 411(6)).

5.9 Currently, the provisions do not contain a mechanism for recovery where a person suffers loss or damage as a result of a breach of any alteration or condition imposed by the court pursuant to subsection 411(6). Introduction of such a mechanism will provide the court with broader powers to protect persons who may be adversely affected by a proposal. The desirability of such a mechanism was highlighted in the context of the James Hardie Report.

Key changes

5.10 It is proposed to amend the scheme of compromise or arrangement provisions in the Corporations Act to introduce a new right for a person to make an application for a court order to recover compensation where:

- the court imposes an alteration or condition on the scheme's approval pursuant to subsection 411(6);
- that alteration or condition is breached by the Part 5.1 body; and
- the person suffers loss or damage as a result of the breach.

Notes on items

5.11 Item 3 will insert a new subsection 411(6A), providing a right for a person to recover compensation if they have suffered loss or damage due to breach by a body of condition or alteration imposed by the court under subsection 411(6).

5.12 The new right will only apply to those parts of the arrangement or compromise that are altered by the court or added by the court, that is, where the scheme as approved differs from the proposal passed by members and/or creditors. It does not affect any right of recovery from a breach of the arrangement or compromise as passed.

5.13 If a breach of condition or alteration is made out, the court may make orders that it considers are just in the circumstances. Although such orders may be for orders to pay compensation or to enforce the condition or alteration (subsection 411(6B)), the court will not be limited to those remedies (subsection 411(6C)).

Court orders preventing company officers and others from avoiding liability

Background

5.14 Section 486A of the Corporations Act allows a court to make certain orders to prevent a company officer (or related entity of a company) acting in a manner that could allow the officer (or related entity) to avoid their liabilities to a company that is being wound up. Such orders include

prohibition on sending funds out of the jurisdiction, prohibitions on leaving the jurisdiction and the surrender of passports.

5.15 Currently, such an order may only be made by the court on the application of a liquidator or provisional liquidator, and the court can only make orders if 'the company is being wound up in insolvency or by the Court, or an application has been made for the company to be so wound up' (subsection 486A(2)). In a case where an application to wind up a company has been made but the winding up has not commenced, there will not necessarily be any liquidator or provisional liquidator appointed. Accordingly, there will not be any eligible party to make the application.

Key changes

5.16 It is proposed to amend section 486A to allow ASIC to also make an application to a court for an order preventing an officer or related entity from avoiding liability to a company. ASIC already has standing to make an application under section 486B.

Notes on items

5.17 Item 4 will insert the new Subdivision A — General Powers, which explains who is entitled to apply to the Court so it can make orders preventing a company officer or related entity of the company from avoiding their liabilities to a company that is being wound up.

5.18 Item 5 will amend subsection 486A(1) to remove the requirement of standing so that the subsection states that the Court may make one or more of orders listed.

5.19 Item 6 will change the wording in paragraph 486A(1)(a) from 'the company' to 'a company.'

5.20 Item 7 will change the wording in paragraphs 486(1)(b), (c) and (d) from 'the company' to 'a company.'

5.21 Item 8 will insert new subsection 486A(2A) so that ASIC, as well as a liquidator or provisional liquidator, has standing to apply for an order under subsection 486A(1).

5.22 Item 9 will clarify the wording in subsection 486A(3),(4) and (5) by inserting 'for an order' before 'under subsection (1)'.

Warrant to arrest a person

Background

5.23 Section 486B allows a court to issue a warrant to arrest and bring before the court a person who is absconding, or who has dealt with property or books, so as to avoid obligations in connection with a liquidation.

5.24 The provision was enacted in 1992, following recommendations in the Harmer Report[10] and is modelled on section 78 of the *Bankruptcy Act 1966*. However, the provision lacks any details about the procedure for how a person subject to a warrant is to be treated, both before and after they are brought before the court. In particular, the provision does not give the court any express power to order that the person remain in custody, or make other orders. In the absence of express

10 Australian Law Reform Commission 1988, *General Insolvency Inquiry*.

authorisation, a court would have no authority to detain a person in custody until, for example, an examination can take place, or to require bail or other security.[11]

Key changes

5.25 It is proposed to insert amendments to provide guidance on how a person who is subject to a section 486B warrant is to be treated, including:

- who may arrest the person;
- specifying that as soon as practical the person is to be brought before a court; and
- at the time of appearance in court, allowing the court to make orders remanding the person in custody or on bail, or remanding the person in custody or on bail until they are to be dealt with at a later date, or releasing them.

5.26 The amendments will also provide that the court may make orders relating to section 486A, 598 or 1323 when the person subject to a section 486B warrant is brought before it.

Notes on items

5.27 Item 10 will insert a note in section 486B stating that the procedures for the warrant are set out in a new Subdivision following the provision.

5.28 Item 11 will insert the new Subdivision B — Procedures relating to section 486B warrants, containing the process for how a person who is subject to a section 486B warrant is to be treated, (comprising new sections 489A, 489B and 489C).

5.29 Section 489A will set out the conditions for persons subject to warrant to be apprehended. It is loosely based on section 82 of the *Service and Execution of Process Act 1992 (Cth).*

5.30 Section 489B will set out the procedure after apprehension and is loosely based on section 83 of the *Service and Execution of Process Act 1992 (Cth).* Section 489B will provide that as soon as practicable after being arrested, the person is to be taken before the issuing Court. The issuing Court must order either that the person be remanded on bail, or that the person be remanded in custody or that the person be released. Other conditions can also be applied to the order.

5.31 Section 489C will set out the procedure on remand on bail. Section 489D will clarify the issuing Court's power to make orders under sections 486A, 598 or 1323. Section 489E will state that to avoid doubt, a matter arising under Subdivision B is a civil matter for the purposes of Part 9.6A.

Removal of penalty privilege in relation to banning and disqualifications

Background

5.32 Banning and disqualification orders and orders to cancel or suspend a licence contained in the Corporations Act are important tools for deterring corporate misconduct. They allow the removal of unwanted participants from the corporations and financial services market and thereby maintain the integrity of the market. One of their main benefits is that they allow for an expeditious response to corporate misconduct.

---

11 This was the view taken by Cooper J, in *ASC v Greig Ronald Heilbronn* (No. G 3002 of 1995, Fed No 27/95, Federal Crt of Australia in Qld) (Unreported).

5.33 Prior to the High Court's decision in *Rich v Australian Securities and Investments Commission*[12], the use of banning or disqualification as a remedy for corporate misconduct was viewed as protective rather than penal in nature. However, the High Court found that a banning or disqualification order was penal in nature and, consequently, common law privileges attaching to a proceeding to impose a penalty can be invoked to prevent ASIC's use or access to information that may expose a person to a penalty.

5.34 As a result of the *Rich* decision, ASIC is not able to obtain discovery of documents or the filing and serving of affidavits by defendants in proceedings seeking a banning or disqualification order, and material obtained by ASIC during an investigation which is subject to the privilege against exposure to a penalty will not be admissible in evidence in these proceedings. Relevant proceedings include administrative proceedings, for instance hearings before the Companies Auditors and Liquidators Disciplinary Board (CALDB), as well as judicial proceedings.

Key changes

5.35 It is proposed to remove the privilege against exposure to a penalty in relation to proceedings where ASIC is seeking a disqualification, banning, suspension or cancellation order, or a declaration to that effect, and no other penal or pecuniary penalty.

5.36 The relevant Parts of the Corporations Act to which this amendment is to be applied are Part 2D.6 (sections 206BA-F), Part 7.4 (section 853C), Part 7.6 (sections 915B-C, 920A, and 921A), Part 9.2 (sections 1290-1292), and Part 9.2A (sections 1299H and 1299I).

5.37 The removal of penalty privilege will apply to any act (or omission) required to be done (or omitted) in relation to the proceeding. In addition, where ASIC receives information during an investigation, pursuant to its powers in Part 3 of the ASIC Act, over which penalty privilege is claimed, ASIC may make use of this information for one of these proceedings.

Notes on items

5.38 Items in this Schedule will provide that orders, such as bannings, disqualifications, cancellations, suspensions and declarations, made under the relevant provisions of the Corporations Act are not taken to be by way of a penalty for the purposes of the law relating to privilege against exposure to penalty. These amendments are intended to reverse the practical effect of the High Court's decision in *Rich*, in relation to the specified provisions.

5.39 By deeming these orders not to be penalties for the purposes of the law relating to privilege against exposure to a penalty, the amendment by necessary implication removes the ability of a suspected wrongdoer to claim penalty privilege where ASIC, a court or tribunal requests or compels information or the performance (or omission) of some act for a relevant proceeding. That is, any claim of penalty privilege by a person during an ASIC investigation, such as over giving information, answering questions, signing records, providing books, or during a subsequent court or tribunal proceeding, such as over complying with discovery, answering interrogatories and preparing and filing affidavits, will not prevent the material from being used in the proceeding. The amendments are drafted in a form to clearly identify that only the law relating to penalty privilege is affected. No other privilege is removed, abrogated, or modified by these amendments.

5.40 Item 2 will insert a new section 206GB, which affects Part 2D.6 (disqualification from managing corporations).

---

12 [2004] HCA 42.

5.41 Item 13 will insert a new subsection 853C(5), which affects Division 2 of Part 7.4 (disqualification from a licence to operate a financial market or clearing and settlement facility).

5.42 Item 14 will insert a new subsection 915B(5), which affects Division 4 of Part 7.6 (immediate suspension or cancellation of an Australian financial services licence).

5.43 Item 15 will insert a new subsection 915C(5), which affects Division 4 of Part 7.6 (suspension or cancellation of an Australian financial services licence after a hearing).

5.44 Item 16 will insert a new subsection 920B(4), which affects Subdivision A of Division 8 of Part 7.6 (banning or disqualification of persons from providing financial services).

5.45 Item 17 will insert a new subsection 921A(6), which affects Subdivision B of Division 8 of Part 7.6 (disqualification by the court).

5.46 Item 18 will insert a new section 1299, which affects Division 3 of Part 9.2 (cancellation or suspension of registration as auditor or liquidator).

5.47 Item 19 will insert a new section 1299N, which affects Division 2 of Part 9.2A (cancellation of registration as authorised audit company).

5.48 The amendments are intended to apply to applications commenced after the date of Royal Assent.

Time limit for the lodgement of reports by liquidators

Background

5.49 If it appears to liquidators of a company, in the course of winding up, that there have been offences committed by officers or employees, or the company may be unable to pay unsecured creditors more than 50 cents in the dollar, then the liquidator is required by section 533 to lodge a report with respect to the matter with ASIC.

5.50 Currently, section 533 requires such reports to be lodged "as soon as practicable". ASIC guidelines suggest two months for lodgement. Subsequent reports are permitted to be lodged by the liquidator under subsection 533(2) if he or she thinks fit.

5.51 Reports are often lodged outside the time frame suggested by ASIC. Sometimes reports are lodged years after the commencement of the liquidation — which may be too late to take any remedial action. It is in the interests of creditors that corporate misconduct identified in the course of a liquidation be notified to ASIC within a reasonable timeframe.

Key changes

5.52 The law will provide a specific time limit of six months for the lodgement of reports by liquidators about the possible commission of offences by officers or members of corporations would ensure that ASIC is notified in a timely fashion. Reports should continue to be lodged as soon as practicable before six months.

5.53 There will be no additional mechanism for liquidators to seek an extension to the new timeframe. As ASIC's guidelines suggest a two month timeframe for lodgement, a six month statutory timeframe is considered ample time. In any case, subsequent reports are permitted to be lodged by a liquidator under subsection 533(2).

Notes on items

5.54 Item 12 will amend subparagraph 533(1)(d) to provide a time limit of six months on the current requirement ‘as soon as practicable’.

6

IMPROVING REGULATION OF INSOLVENCY PRACTITIONERS

Extending the prohibition on inducements for the referral of work

Background

6.1 Section 595 of the Corporations Act prohibits persons offering inducements to members or creditors of a company to secure an appointment as an external administrator. Concern has been expressed that this prohibition is unnecessarily narrow. Examples of persons that were not covered by the prohibition include directors, providers of professional services (for example accounting firms and legal firms) and associates of such persons.

Key changes

6.2 The proposed amendment to the Corporations Act will prohibit inducements being offered to any person or entity with a view to securing an appointment as an external administrator.

Notes on items

Items 1, 2 and 3 and 4: Subsection 595(1) and paragraphs 595(1)(a), (b), (c), (d) and (e)

6.3 Items 1, 2, 3 and 4 of Schedule 3 will amend subsection 595(1) of the Corporations Act to broaden the prohibition on the offering of inducements to secure an appointment as an external administrator. The proposed amendment seeks to apply the principle that the appointment of an external administrator should not be influenced by the offering of inducements by anyone to anyone else.

Item 4 makes a minor consequential amendment to paragraphs 595(1)(a), (b), (c), (d) and (e).

Education criterion for registration as a liquidator

Background

6.4 Only persons registered by ASIC as liquidators under the Corporations Act may be appointed external administrators.

6.5 Subsection 1282(2) of the Corporations Act sets out educational qualifications required to become a registered liquidator. Subparagraph 1282(2)(a)(i) sets out one of three alternative requirements as being membership of certain named or prescribed professional bodies. The other alternatives are holding a degree representing a course of study involving the study of accountancy and commercial law (subparagraph 1282(2)(a)(ii), or other qualifications or experience that ASIC considers equivalent (subparagraph 1282(2)(a)(iii)).

Key changes

6.6 It is proposed to delete the provision stating that the education criterion is satisfied if a person is a member of a named or prescribed professional body. ASIC will still have power to recognise membership of such a body as an alternative form of qualification by forming an opinion under subparagraph 1282(2)(a)(iii) that membership of a body is equivalent to the educational qualifications in subparagraph 1282(2)(a)(ii).

Notes on items

6.7 Item 5 will repeal subparagraph 1282(2)(a)(i), which provides membership of certain named or prescribed professional bodies is an acceptable qualification for the purposes of one of the elements required for registration as a liquidator.

6.8 Item 6 will make a minor consequential change to subparagraph 1282(2)(a)(iii).

Experience criterion for registration as a liquidator

Background

6.9 Paragraph 1282(2)(b) of the Corporations Act provides, as a criterion for registration, that ASIC is satisfied as to the experience of the applicant in connection with the winding-up of bodies corporate. Insolvency practice under Chapter 5 of the Corporations Act includes many activities other than those involving the winding-up of bodies corporate. Particularly given the prominence of the voluntary administration procedure in modern insolvency practice, it is desirable that experience in all types of external administration be taken into consideration when ASIC considers an application to register an insolvency practitioner.

Key changes

6.10 The proposed amendment to the Corporations Act will allow ASIC to take into consideration experience in all types of external administration under Chapter 5 of the Corporations Act when processing an application for registration of an insolvency practitioner.

Notes on items

6.11 Item 7 will amend paragraph 1282(2)(b) of the Corporations Act to require that ASIC be satisfied as to the experience of an applicant for registration in connection with 'externally-administered bodies corporate' instead of with 'the winding up of bodies corporate'.

Professional indemnity insurance

Background

6.12 Section 1284 of the Corporations Act requires that registered liquidators maintain with ASIC a security for the due performance of their duties. The required securities (insurance performance bonds) are no longer available, and in practice ASIC has been waiving this requirement for many years. Existing practice is for professional indemnity insurance and fidelity insurance to take the place of such securities.

Key changes

6.13 The proposed amendment to the Corporations Act will require registered liquidators to obtain and maintain professional indemnity insurance and fidelity insurance to cover their work as licensed practitioners.

Notes on items

6.14 Item 8 will remove the references to section 1284 in subsection 1282(6) which are no longer required.

6.15 Item 9 will repeal section 1284 of the Corporations Act which requires a registered liquidator to maintain with ASIC security for the performance of their duties as a liquidator. In its place a substitute section 1284 will require a registered liquidator, or a liquidator of a specified

body corporate, to maintain adequate and appropriate professional indemnity insurance and adequate and appropriate fidelity insurance.

Triennial Statements to be replaced by annual statements

Background

6.16 Section 1288 of the Corporations Act requires a registered liquidator to lodge a statement with ASIC every three years. This requirement is no longer considered adequate given the significant changes that may occur over a three year period and the affect that such changes may have on the suitability of a person for continued registration.

Key changes

6.17 The proposed amendment will replace the requirement for a triennial statement with a requirement for a more detailed annual statement. The existing statement requires a liquidator to provide: the name of the liquidator; the place of practice; a statement regarding residency, disciplinary action, conviction of offences and other matters which will result in disqualification; and a list of liquidations conducted.

6.18 The new requirement will be for an annual statement that includes the same information and also details of: professional development courses undertaken, a summary of insolvency work undertaken and details of professional indemnity and fidelity insurance.

Notes on items

6.19 Item 10 will amend section 1288(3) to replace the requirement for a triennial statement with a requirement for an annual statement. ASIC will alter the content of these statements by modification of Forms 907 and 908.

Cancellation of registration by ASIC

Background

6.20 Section 1291 of the Corporations Act provides ASIC with a broad discretion to cancel the registration of an official liquidator. Under section 1292, cancellation of the registration of liquidators is by application to the Companies Auditors and Liquidators Disciplinary Board (CALDB).

6.21 Where a person becomes disqualified by reason of bankruptcy or disqualification from managing corporations and where a person is convicted of a serious criminal offence it is desirable that ASIC should have power to quickly cancel that person’s registration without reference to CALDB. It is considered that such matters do not warrant a reference to CALDB due to the relatively objective nature of each matter.

Key changes

6.22 The proposed amendment will allow ASIC to cancel the registration of a liquidator in the aforementioned circumstances.

Notes on items

6.23 Item 11 will insert a new section 1290A to provide for ASIC cancelling the registration of a liquidator in the stated circumstances.

Transfer of books

Background

6.24 The Corporations Act does not specifically provide for the transfer of documents associated with an external administration upon the cancellation of the registration of a practitioner. In the absence of such a provision, there exists a possibility that a person whose registration is cancelled might fail to transfer documents to a replacement liquidator or administrator. Such failure might impose additional costs, or create additional delays, in relation to an external administration that was being conducted by a person whose registration is cancelled.

Key changes

6.25 The proposed amendment to the Corporations Act will create an obligation for a practitioner to transfer books related to an external administration to a replacement practitioner upon having their registration cancelled.

Notes on items

6.26 Item 18 will amend the Corporations Act to provide for the transfer of books related to the winding-up of a company when the registration of a liquidator is cancelled.

Disciplinary proceedings — CALDB

Background

6.27 CALDB may suspend or cancel a practitioner's registration if it is satisfied that the person has failed to lodge triennial statements, has ceased to live in Australia, has failed to carry out or perform adequately and properly the duties of a registered liquidator, or is otherwise not a fit and proper person to remain a registered liquidator.

6.28 Where ASIC's application to CALDB relates to a liquidator's failure to adequately or properly carry out or perform his or her duties, CALDB may admonish or reprimand the person or require the person to give an undertaking to refrain from certain conduct. The Government has decided that CALDB should be given greater flexibility in its processes and in respect of the penalties that it may impose.

Key changes

6.29 CALDB will be given the power to conduct a pre-hearing conference involving only the Chairman, for the purpose of determining a timetable for the matter. This change will avoid the cost and delay of having more than one member of the board attend for the purpose of deciding timetabling matters.

6.30 CALDB will be given the power to admonish or reprimand a person for failing to comply with orders made during the pre-hearing period. It is expected that providing CALDB with powers to admonish or reprimand practitioners for failing to adhere to its pre-hearing orders will encourage compliance with such orders.

6.31 CALDB will be given greater flexibility to publish reasons for its decision. Section 1296 of the Corporations Act requires that CALDB provide the person who is the subject of disciplinary proceedings with written reasons for its decision. The publication of these reasons will promote transparency in decision-making and will bring CALDB into line with other bodies that undertake disciplinary functions, such as the Administrative Appeals Tribunal.

6.32 CALDB will be given the power to delay the effect of its decisions for a period of up to 90 days. This is in accordance with existing practice of the board, which allows for the orderly transfer or completion of a liquidator's ongoing work.

Notes on items

6.33 Item 12 will amend the Corporations Act to provide for a pre-hearing conference with only the chairman of CALDB to consider timetabling matters and determine when submissions are to be made to the Board and when evidence is to be brought before the board in relation to the matter. It will also provide CALDB with power to reprimand or admonish a person for failing to comply with orders made in the pre-hearing period.

6.34 Items 13, 14 and 15 will amend the Corporations Act to require CALDB to publish a written notice in the Gazette setting out the decision.

6.35 Item 16 will amend the Corporations Act to provide CALDB with the ability to publish its decisions on the internet, or otherwise.

6.36 Item 17 will amend the Corporations Act to provide CALDB with the ability to give effect to its decisions at a point in time up to 90 days after providing a practitioner with notice of the decision.

7

FINETUNING VOLUNTARY ADMINISTRATION

PART 1 — GENERAL

Court's power to bind secured creditors

Background

7.1 Secured creditors and owners or lessors of real or personal property (herein, 'secured creditors') are not bound to the terms of a DOCA unless they agree (subsections 444D(2) & (3)). However, the court has the power to order that these persons be bound, notwithstanding that they have not agreed to be bound:

- where enforcement of their rights would materially adversely affect the arrangement; and
- provided that their interests are adequately protected.

7.2 The court's power applies where "it is proposed that a company execute a deed of company arrangement" (paragraph 444F(1)(a)).

7.3 There is some concern that the word "proposed" could be interpreted as meaning at the point the administrator first forms the view that it would be in the creditors' interests to enter into a DOCA. This is an earlier time than when creditors formally resolve that a DOCA be executed.

7.4 The concern is that such an interpretation may cause the court's power to operate before the details of the arrangement are considered and approved by creditors. Recommendation 28 of the CAMAC Report (1998) stated that the Corporations Act should be amended to deal with this issue.

Key changes

7.5 The Corporations Act will be amended to clarify that the Court may only make an order that secured creditors be bound by a DOCA after creditors have formally resolved that the DOCA be executed.

7.6 Clarification of the legislation in this area will provide certainty, and ensure that the court can only bind secured creditors at the later time. It will ensure secured creditors have adequate opportunity to consider the formal details of a DOCA proposal, and ascertain the position of other creditors on the matter.

Notes on items

7.7 Item 26 will amend paragraph 444F(1)(a) to provide that section 444F applies where creditors have resolved that the company execute a deed of company arrangement at a meeting under section 439A.

Third party guarantees

Background

7.8 A DOCA releases the company from a debt in so far as the deed provides for the release and the creditor concerned is bound (section 444H). In this way, it is said that the company's debt is extinguished by the deed.

7.9 Third parties may act as guarantors or indemnify a creditor against loss for various debts owed by the company to creditors.

7.10 A possible view is that the acceptance of a DOCA extinguishes the liability of guarantors for debts of the company, by extinguishing the debt that is being guaranteed. This argument would not apply to an indemnity, however, as the person in that case guarantees against loss and the creditor would have suffered a loss by the non-payment of debt.

7.11 There is authority that supports the position that creditors' adoption of a DOCA does not affect their rights against third parties, including their rights under guarantees.[13] Recommendation 34 of the CAMAC Report (1998) stated that the Corporations Act should be amended to deal with this issue.

Key changes

7.12 Certainty in this area is desirable. The law will be amended to unequivocally state that when creditors resolve to execute a DOCA, creditors' rights under a guarantee or indemnity are unaffected.

Notes on items

7.13 Item 28 will insert new proposed section 444J in Division 10, Part 5.3A that makes it clear that creditors' rights under a guarantee or indemnity are unaffected where a debt is released by acceptance of the terms of a deed of company arrangement (per section 444H).

Right to terminate a deed

Background

7.14 A DOCA will set out circumstances as to when it will terminate. Additionally, the Court, upon application by a creditor of the company, the company or an interested person, can order the termination of DOCA under section 445D.

7.15 Creditors can also terminate a DOCA by passing a resolution at a meeting called for that purpose under section 445F (section 445C).

7.16 Currently, the deed administrator may convene a meeting under section 445F at any time, but must convene such a meeting if requested in writing by creditors that make up at least 10% in value of the company's total claims.

7.17 There is a concern that a relatively small number of creditors could force an administrator to convene a meeting of creditors and a majority of those present and voting could terminate the DOCA, even where the company was complying with the terms. Recommendation 35 of the CAMAC Report (1998) stated that this area of law should be clarified.

---

13 *Re Garner's Motors Ltd* [1937] Ch 594; *Hill v Anderson Meat Industries Ltd* [1972] 2 NSWLR 704 followed in *Re Knebel Woodworking Company Pty Ltd* (1985) 3 ACLC 739; *Re Southern World Airlines Ltd* [1993] 1 NZLR 597; *Gan v Sanders* (1994) 15 ACSR 298; *Re Andersens Home Furnishing Company Pty Ltd* [1996] 14 ACLC 1,710.

Key changes

7.18 To give greater certainty to the rehabilitation of companies through deeds of company arrangement, creditors should only be entitled to terminate a DOCA by resolution following a material breach of the deed that has not been rectified before the resolution has been passed. The law will be amended to this effect.

7.19 In addition, the law will be amended to explicitly provide that ASIC can make an application for termination of a deed under section 445D.

7.20 It has been argued that ASIC is not included as an 'interested person' in this context. Circumstances may arise where it is in the public interest for ASIC to make such an application. An example is where creditors are unable, due to lack of financial resources, to make such an application, or where ASIC has information unavailable to creditors.

Notes on items

7.21 Item 31 will insert new section 445CA that provides that creditors are not entitled to pass a resolution terminating a deed unless there has been a breach of the deed and the breach has not been rectified before the resolution is passed.

7.22 The new provision does not require the breach to be material. However, it is envisaged that minor or technical breaches can be easily remedied before the resolution is passed. Consequently, requiring the breach to be 'material' is unnecessary. This also avoids the need for administrators to determine (or, potentially, seek court adjudication on) what is material to the deed and what is not.

7.23 This approach is preferred because of the potential complexities that may arise with general contract law in attempting to define what a material breach is in the context of DOCAs.

7.24 Item 32 will amend subsection 445D(2) to add ASIC as a party who may apply to the Court for an order to terminate a deed.

Notification when deed wholly effectuated

Background

7.25 Subsection 444A(5) of the Corporations Act provides that a DOCA also is taken to include prescribed provisions unless it provides otherwise. The prescribed provisions are set out in Schedule 8A of the Corporations Regulations. Item 12 of Schedule 8A provides that when a deed is terminated because it has achieved its purpose[14], the administrator must certify to that effect in writing and, within 28 days, lodge with ASIC a notice of termination.

7.26 As the requirement that a deed administrator notify ASIC when a deed is wholly effectuated is a prescribed provision in the Regulations, it can be excluded in the actual deed when executed. In practice the provision is commonly excluded.

Key changes

7.27 It is important that the public record reflect that the company has come out of external administration and that control of the company has reverted back to directors. Accordingly, the requirement to notify ASIC will be made a mandatory requirement.

---

14 "If the administrator has applied all of the proceeds of the realisation of the assets available for the payment of creditors or has paid to the creditors the sum of 100 cents in the dollar or any lesser sum determined by creditors at a general meeting".

Notes on items

7.28 Item 33 will insert new section 445FA, which requires a deed administrator to notify ASIC, in writing, when the deed administrator has applied all of the proceeds of the realisation of assets available for the payment of creditors, or paid to creditors the full sum determined by creditors to be received under the deed. Under the new provision, the deed administrator must lodge with ASIC a notice of termination of the deed within 28 days. This notice will be in a prescribed form, to be set out in the Regulations. It is envisaged that this form will largely replicate the form currently adopted in Item 12, Schedule 8A of the Corporations Regulations.

7.29 Items 29 and 30 will amend section 445C relating to when a deed terminates, to ensure that it is consistent with termination by way of a deed being wholly effectuated and notified to ASIC under the new section 445FA.

Power to consent to a transfer of shares of the company

Background

7.30 There is currently a lack of consistency across voluntary liquidation, court-ordered liquidation and voluntary administration, with respect to the practitioner's power to consent to a transfer of shares or an alteration in the status of members of a company.

- A transfer of shares in a company, or an alteration in the status of the members of a company, that is made during the administration of a company is void, unless the Court orders otherwise (section 437F).
- By contrast, a transfer of shares in a voluntary winding up is permitted with the consent of the liquidator (subsection 493(2)).
- Section 468(1) has the effect of making void any transfer of shares in a court-ordered winding-up.

7.31 Recommendation 37 of the CAMAC Report (1998) supported improved consistency in this area of the law.

Key changes

7.32 A consistent approach will be adopted across the three procedures, with respect to authorising a transfer of shares or a change in the status of members of a company. The intent is to provide maximum flexibility to practitioners in each of the types of proceeding, while retaining core shareholder protections.

7.33 Under the proposed approach, an administrator will have the power to consent to a transfer of shares in a company in administration. The administrator will need to be satisfied that it is in the best interests of creditors as a whole.

7.34 The ability to apply to the Court for an order authorising a transfer of shares will be retained, but will only be available where the administrator's consent has been unsuccessfully sought first. This will ensure the 'least cost' option for approval is explored first. The court's power will be exercisable on application by the prospective transferor or transferee of shares, with the administrator having standing to be heard on any application.

7.35 Administrators will also be granted a power to consent to an alteration in the status of members of a company. Such an alteration may not be approved unless it complies with the rules for alteration of class rights in Part 2F.2 of the Corporations Act.

7.36 The amendments to effect similar changes for court-ordered liquidation and creditors' voluntary liquidation are found at items 81-82 and 85-87 of Part 1 of Schedule 4.

Notes on items

7.37 Item 7 will replace section 437F with a new provision which will regulate transfers of shares during administration (subsections 437F(1)-(7)) and alterations in the status of members during administration (subsections 437F(8)-(15)).

7.38 In relation to a transfer of shares, new subsection 437F(1) will provide that a transfer is void unless the administrator gives written consent to the transfer, or the Court makes an order authorising the transfer. New subsection 437F(2) will provide that the administrator must be satisfied that it is in the best interests of creditors as a whole before granting his or her consent. New subsections 437F(3) and (5) will give the prospective transferor or transferee or a creditor standing to apply for a court order authorising the transfer if the administrator refuses consent or a court order setting aside any conditions imposed by the administrator. New subsection 437F(4) and (6) will empower the Court to authorise a transfer after an administrator has refused consent to the transfer, or has approved the transfer subject to conditions that have not been met, where the Court is satisfied it is in the best interests of the creditors as a whole to do so.

7.39 New subsection 437F(8) will provide that an alteration to the status of members of the company will be void unless the administrator gives written consent to the alteration, or the Court makes an order authorising the alteration. The administrator must be satisfied that the alteration is in the best interests of creditors as a whole before granting his or her consent and must refuse consent if the alteration would contravene the class rights provisions in Part 2F.2 (new subsection 437F(8)). The Court will be able to authorise alterations (unless they contravene the class rights provisions), or to set aside conditions to which the administrator's consent is subject.

Administrator's right of indemnity

Background

7.40 Division 9 of Part 5.3A deals with the administrator's liability and indemnity for debts of the administration. Under section 443D an administrator is entitled to be indemnified out of the company's property for debts for which they may be liable for. These debts include:

- general debts in the performance or exercise of the administrator's functions or powers for goods bought, services rendered or property hired, leased, used or occupied (section 443A);
- payments for property used, occupied or in possession of the company where an agreement has been made before the administration began (section 443B); and
- certain taxation liabilities ('remittance provisions') per section 443BA.

7.41 The right of indemnity also extends to the administrator's fixed remuneration. Section 443E grants a priority for these debts to the administrator, subject to the priority ranking order in section 556. Section 443F grants the administrator a lien over the company's property to secure these rights of indemnity.

7.42 However, the administrator has no statutory right of indemnity out of the company's property in respect of his or her liabilities that fall outside section 443D.

7.43 In *Commonwealth Bank of Australia v Butterell* (1994), an administrator who on-sold stock in the company's possession that was the subject of a retention-of-title (ROT) clause was possibly liable in conversion to the person holding the benefit of the ROT clause.[15]

7.44 Young J held that since the claim was for conversion, it was not a liability for goods bought or property hired, leased, used or occupied within the meaning of section 443A. The administrator had no statutory right of indemnity out of the company's property in respect of that liability under section 443D.

7.45 Although in *Butterell*, the administrator was held to have an equitable lien over the proceeds of the on-sale, the decision served as an indication that there may be limits to administrators' rights of indemnity in other areas of tortious liability. Recommendation 41 of the CAMAC Report (1998) recommended reform to deal with this issue.

Key changes

7.46 The draft Bill amends the law to provide that an administrator is not liable in conversion for the sale of property subject to a lien, pledge or ROT clause ('Charges, liens and pledges' refers).

7.47 However, there are other torts that may not be covered by the existing provisions. The law will be amended to extend the administrator's right of indemnity to include any personal liabilities incurred in the due performance of the administrator's duties (except liabilities incurred negligently or in bad faith).

Notes on items

7.48 Item 20 will amend section 443D to include a right of indemnity for any other debts incurred, in good faith and without negligence, by the administrator in the performance or exercise, or purported performance or exercise, of any of his or her functions and powers as administrator.

7.49 Item 43 will make a consequential amendment to paragraph 556(1)(c).

Deed administrator's ability to sell the company's shares

Background

7.50 The model deed of company arrangement in Schedule 8A of the Corporations Regulations provides that a deed administrator has the power to enter into and complete any contract for the sale of shares in the company (clause 2(zc)).[16]

7.51 This clause does not give deed administrators a power to issue shares directly. It authorises the administrator of the deed to deal in existing shares consistently with the deed. It also literally empowers the administrator to deal in shares of a shareholder. If a deed made provision for the disposition of shares of shareholders, the administrator may enter into and complete contracts for their sale/disposition.

7.52 In relation to the issue of new shares, deed administrators are not directly empowered to issue shares but the deed may provide for the issue of securities by the directors. A deed is binding on company officers (the company) as well as the company's creditors and members (section 444G).

---

15 35 NSWLR 64; 14 ACSR 343; 12 ACLC 727.

16 These prescribed provisions can be excluded per subsection 444A(5).

7.53 Unless the deed contains a contrary provision, the administrator has the power to carry on the business of the company for the purpose of administering the deed. Although it is the company (ie the directors) that are empowered to issue new shares, the deed administrator can cause this to happen.

7.54 There is a question as to whether the current law constitutes a power for the deed administrator to sell existing shares in the company without the consent of their holders (a compulsory sale power). In cases where the courts have considered the matter, it has been held that a deed administrator had no power to sell members' shares without their consent.[17]

7.55 A compulsory sale power may be beneficial to deed administrators, as it allows administrators to ensure trading of the shares resumes. It may be essential to the success of a deed that a share sale proceeds. For example, the DOCA may be based on an investor acquiring all (or a minimum proportion) of the shares in a company in return for a lump sum payment to creditors.

7.56 Often, the shares of a company under administration will have little residual value and members will not participate in any distribution. It may be argued that their consent should therefore not be required. However, a compulsory sale power may be open to abuse. For instance, a deed that involves creditors swapping their debt for equity in the company may unfairly advantage creditors if the underlying business of the company is strong.

7.57 Other considerations are that members have a proprietary right in the existing shares, and that other external administrators such as liquidators and receivers do not have comparable powers. Importantly, such a power could unfairly prejudice shareholders particularly where there is some residual value in the company.

Key changes

7.58 The law will be clarified to provide that the deed administrator is able to sell shares in the company with either the consent of the holders of those shares, or with leave of the Court in the absence of shareholder consent. This is consistent with recommendation 42 of the CAMAC Report (1998).

7.59 The Court may only grant leave if it is satisfied that the sale would not unfairly prejudice the interests of shareholders. This is intended to direct the Court to consider the impact of a compulsory sale of shareholders where there may be some residual value in the company.

7.60 Under the proposed approach, members, creditors and ASIC will have standing to oppose a court application for leave. These parties will also be able to apply to the Court to have an oppressive or prejudicial DOCA terminated under section 445D (as amended).

Notes on items

7.61 Item 27 will insert new section 444GA which provides for the sale of shares by a deed administrator.

Lodgement of accounts with ASIC

Background

7.62 There is no requirement for administrators to lodge with ASIC accounts of receipts and payments of the administration. In relation to deed administrators, the prescribed provisions in

---

17 *Mulvany v Wintulich* (unreported, Fed C of A, O'Loughlin J, SG 3184 of 1995, 29 September 1995, BC9507148); see also *Cresvale Far East Ltd (in liq) v Cresvale Securities (subject to DCA)* (2001) 37 ACSR 394.;

Schedule 8A require lodgement of accounts.[18] As noted mentioned, these provisions may be excluded.

7.63 Liquidators (per section 539) and controllers (per section 432) are required to lodge accounts on a six monthly basis.

7.64 The prescribed provisions in relation to lodgement of accounts by deed administrators are rarely adopted. The absence of a mandatory requirement for administrators and deed administrators to lodge accounts of receipts and payments with ASIC is inconsistent with other forms of insolvency administration. For external administrations where there is a requirement to lodge accounts, accounts are accessed by the public on a regular basis.

Key changes

7.65 To improve transparency and facilitate creditor monitoring, the law will be amended to ensure the accounts of administrators and deed administrators are lodged with ASIC and placed on the public record. The provisions requiring the lodgement of accounts on a six monthly basis will be modelled on the current requirements for liquidators under section 539. This is consistent with recommendation 43 of the CAMAC Report (1998).

Notes on items

7.66 Item 9 will insert new section 438E requiring administrators to lodge accounts with ASIC. Item 34 will insert new Division 11A containing new section 445J requiring deed administrators to lodge accounts with ASIC.

7.67 As with current section 539 in relation to liquidators, the new provisions require administrators to lodge accounts on a six monthly basis. The new provisions also provide for ASIC to be able to cause an audit of the accounts. In relation to voluntary administration, the costs of an audit will form part of the expenses of the administration (new subsection 438E(7) refers). In relation to a company subject to a deed of company arrangement, such costs are payable by the company (new subsection 445J(7) refers).

Reporting to creditors

Background

7.68 Concerns have been expressed that insufficient information may be provided to creditors where a company is put into voluntary administration. It has been suggested that reports sent by administrators when convening the major meeting of creditors should be required to include "any other matter material to the creditors' decision". The proposal is consistent with the Statement of Best Practice on the Content of Administrator's Reports produced by the IPAA. It is also consistent with recommendation 58 of the CAMAC Report (1998) and recommendations 35 and 37 of the CAMAC Report 2004.

Key changes

7.69 The information made available to creditors may be enhanced by including a requirement that the statement provided to creditors under subsection 439A(4)(b) must include other information known to the administrator that will enable creditors make informed decisions about whether to execute a deed of company arrangements, end the administration or wind up the company.

---

18 Clause 10: refers to section 432, stating that it operates as if the deed administrator was the 'controller'.

Notes on items

7.70 Item 10 will require administrators to include any other information known to them that will enable creditors to make an informed decision about the matters in paragraphs 439A(4)(b)(i)-(iii).

Fundraising in administration

Background

7.71 Currently, any offer by an administrator of a deed of company arrangement (DOCA) to creditors to substitute equity for all or part of their debt (an equity for debt offer) is subject to the fundraising provisions in Part 6D.2 of the Corporations Act.

7.72 An offer of securities under a Part 5.1 scheme of arrangement is exempt from the disclosure requirements in Part 6D.2: subsection 708(17). The rationale is that the offerees will have already received a detailed court-approved explanatory statement under section 412. Also a court must approve the final scheme.

7.73 A similar exception is desirable to facilitate equity for debt swaps in voluntary administrations. A similar exemption to that for a scheme of arrangement will enhance an administrator's capacity to issue a company's securities in a manner most beneficial to creditors. The exemption would not be available for offers or invitations to other parties. Recommendation 58 of the CAMAC report (1998) and recommendations 35 and 37 of the CAMAC Report (2004) stated that there should be an exemption from the fundraising provisions for offers or invitations to creditors to exchange debt for equity under a DOCA.

Key changes

7.74 The fundraising provisions in Part 6D.2 will not apply to offers to creditors to exchange their debt for equity under a DOCA. An administrator making an equity for debt offer will only be required to provide a statement setting out all the information that is known to the administrator about the merits of the offer. The administrator's statement should indicate that it is not a prospectus and therefore may contain less information than a prospectus.

Notes on items

7.75 Item 44 will insert new subsection 708(17A) into the Corporations Act. An offer of securities made to any or all of a company's creditors under a deed of company arrangement will not require detailed disclosure under Part 6D.2. The exemption will only apply where the offer does not require accepting creditors to contribute any further consideration. An administrator making an equity for debt offer will be required to provide a statement that sets out all relevant information about the offer that is within the knowledge of the administrator. The statement must indicate that it is not a prospectus and therefore may contain less information than a prospectus.

7.76 The effect of section 444D is that, once approved by creditors, a DOCA is binding on all creditors of the company in relation to claims arising on or before the date specified in the deed irrespective of whether a particular creditor voted in favour of or against the deed. On one view section 444D should be read subject to other provisions of the Corporations Act. On this basis, section 231 which contemplates a person becoming a shareholder through voluntary agreement may protect a creditor from being required to become a shareholder under a deed of company arrangement. Item 25 inserts new subsection 444D(4) into the Corporations Act, which will provide that section 231 does not operate to prevent a creditor from becoming a member of the company as a result of a creditor accepting an offer of shares in the company.

Appointment of administrator by directors and chargees

Background

7.77 The directors of a company that is being wound up (either under the order of the Court or after members have resolved that the company be wound up voluntarily) cannot appoint an administrator (subsection 436A(2)). This is because once winding up proceedings commence, the company's affairs are under the control of the liquidator, and this rule avoids a conflict between the two external administrations.

7.78 The directors of the company can appoint an administrator between the filing of an application in Court and the making of a winding up order. This reasoning is based on the ordinary meaning of the phrase "is already being wound up" in section 436A.

7.79 After an application for a winding up order is filed, the Court can appoint a provisional liquidator to preserve the company's property pending the hearing of the application. This occurs before the making of a winding up order by the Court (subsection 472(2)).

7.80 In a similar fashion to the provisions relating to the appointment of an administrator by directors, persons who are entitled to enforce a charge over all or substantially all of the company's property (substantial chargees) cannot appoint an administrator where the company is being wound up (subsection 436C(2)).

7.81 There is no provision expressly preventing the appointment of an administrator by directors of the company or chargees where the company has a provisional liquidator appointed.

7.82 Directors of a company under provisional liquidation should not be able to appoint an administrator, just as directors of a company under liquidation are not permitted. This is because only a provisional liquidator should be permitted to exercise the powers of officers of the company (including the power to appoint an administrator) whilst he or she is acting.

7.83 Further, voluntary administration and provisional liquidation should be regarded as mutually exclusive[19] and any continuing power of the directors to appoint an administrator is inconsistent with this notion.

7.84 However there is conflicting authority on the matter. In *Object Design Inc v Object Design Australia Pty Ltd* (1997) a single judge of the Federal Court considered that directors of a company under provisional liquidation could appoint an administrator.[20]

7.85 The judge in that case based his conclusion on his reading of subsection 471A(2A), reasoning that the Corporations Law (as it was then) expressly contemplates that an administrator may be appointed notwithstanding that a provisional liquidator is in place.

7.86 Subsection 471A(2A) refers to "an administrator appointed…beginning after the provisional liquidator was appointed" in relation to a power of an officer that is not suspended. However, it can be argued that this provision refers to the provisional liquidator's power under section 436B to appoint an administrator, rather than a residual power of the directors to do so.

---

19 See subsection 440A(3).

20 78 FCR 60; Compare to *Walker v Midlink Nominees Pty Ltd (prov liq apptd)* (2000) 22 WAR 318; where a single judge of the Western Australian Supreme Court held that they could not: Followed in *Brolrik Pty Ltd v Sambah Holdings Pty Ltd* (2002) 40 ACSR 361, NSWSC.

7.87 In relation to substantial chargees, a person (other than a provisional liquidator, an administrator appointed after the appointment of the provisional liquidator, or a person acting with the approval of the provisional liquidator or the court) cannot exercise powers as an officer of a company while a provisional liquidator is acting (subsection 471A(2)). However, neither a person entitled to enforce a charge or a receiver and manager appointed by that person is an 'officer' of the company.

7.88 The court in *Aloridge Pty Ltd (prov liq apptd) v Christianos*[21] accepted that a chargee over all or substantially all the property of a company in provisional liquidation had the power to appoint an administrator under section 436C.

Key changes

7.89 There is a need for a uniform prohibition for both directors and substantial chargees appointing an administrator where a company has already had a liquidator or provisional liquidator appointed. The same conflicts between the two appointments will apply, whether the appointment is made by a director or substantial chargee.

7.90 The law will be amended in this area, to make it clear that directors and substantial chargees may not appoint an administrator once a provisional liquidator has been appointed. This is consistent with recommendations 45 and 46 of the CAMAC Report (1998).

Notes on items

7.91 Item 1 will amend subsection 436A(2) to provide that a resolution of the board to appoint an administrator under subsection 436A(1) does not apply to a company to which a liquidator or provisional liquidator has been appointed.

7.92 Item 3 will amend subsection 436C(2) to provide that the power of a person entitled to enforce a charge (chargee) to appoint an administrator under subsection 436C(1) does not apply to a company to which a liquidator or provisional liquidator has been appointed.

Transition from liquidation to voluntary administration

Background

7.93 Section 436B permits a liquidator or provisional liquidator to appoint an administrator to the company. Subsection 436B(2) provides that a liquidator or provisional liquidator must obtain leave of the Court to appoint himself or herself as administrator where it appears that voluntary administration is the appropriate procedure for a company. In practice, liquidators call creditors meetings to discuss the company's affairs before appointing an administrator.

7.94 While section 436B would appear to allow liquidators and provisional liquidators to appoint their business partner, employer, or employee as administrator without first obtaining leave of the court, subsection 448C(1) disqualifies certain people related to the company from being appointed administrator without leave of the Court.

7.95 Subsection 448C(1) utilises the term 'officer', and disqualifies, inter alia, persons who are 'partners, employers, or employees of officers of the corporation (paragraph 448C(1)(g)). The term 'officer', as defined in section 9, includes liquidators but not provisional liquidators. In any case, provisional liquidators are supervised by the Court.

---

21 (1994) 13 ACSR 99, 12 ACLC 237.

Key changes

7.96 To streamline the transition from liquidation to administration, the Corporations Act will be amended to allow a liquidator to appoint himself or herself as administrator without leave of the court where the appointment is supported by creditors. This is consistent with recommendations 47 and 48 of the CAMAC Report (1998).

7.97 The Corporations Act will also be amended to treat equally any appointment of a business partner, employer or employees of the liquidator or provisional liquidator, or his or her firm or corporation.

7.98 As liquidators call creditors meetings to discuss the company's affairs before appointing an administrator, this meeting provides an appropriate forum to seek creditors' approval to enter voluntary administration.

7.99 This meeting would also afford creditors the opportunity to reject the appointment of that person as administrator. Liquidators will continue to have the right to seek leave of the Court for their appointment as administrator in the absence of a formal resolution of creditors.

Notes on items

7.100 Item 2 will repeal current subsections 436B(2) and 436B(3) and replace them with a new subsection 436B(2) which provides that the liquidator, provisional liquidator or certain related persons cannot be appointed administrator without either creditors' consent (by passing a resolution at a creditors' meeting), or with leave of the Court.

7.101 New paragraphs 436B(2)(a) — (e) will identify the types of persons the subsection applies to, namely the liquidator or provisional liquidator himself or herself, a partner, employee, employer or director, secretary, senior manager or employee if the insolvency practice is incorporated.

7.102 Item 37 will make a consequential amendment to subsection 448C(4) to ensure that 'officer' in paragraphs 1(g) and (h) does not include liquidator.

Stay and termination of a liquidation

Background

7.103 A liquidator or provisional liquidator can appoint an administrator where it appears that voluntary administration is the appropriate procedure for a company. If the company then executes a DOCA, an application must be made to the Court for a stay or termination of the winding-up (under section 482).

7.104 Under subsection 482(1A), the liquidator, a creditor or a contributory of the company has standing to make such an application. Deed administrators do not have standing to apply to the Court for a stay or termination of a winding up unless they are also the liquidator.

Key changes

7.105 The law will be amended to provide that once creditors have resolved to execute a DOCA, the deed administrator has standing to make an application for a stay or termination of the winding-up. This will ensure a smooth transition from liquidation to administration. This is consistent with recommendation 49 of the CAMAC Report (1998).

7.106 When granting the order on the application of a deed administrator (or a liquidator, where there is a deed in place), the Court will be directed to have regard to a non-exhaustive list of factors such as any misconduct by the company's officers and the commercial decision of creditors accepting the deed. The Court would also have regard to whether the company would remain

insolvent after the termination of the winding up (following creditors' acceptance of the DOCA). This reflects the general position of the courts in relation to not permitting insolvent companies to return to commercial life.

Notes on items

7.107 Item 41 will amend subsection 482(1A) to include deed administrators as persons who may make an application for a stay or termination of a liquidation.

7.108 Item 42 will insert new subsection 482(2A) which provides a list of non-exhaustive factors the Court must consider when considering such an application for a company subject to a DOCA:

- new paragraphs 482(2A)(a) and (b) will cover alleged misconduct by company officers reported to the Court by an administrator, liquidator or ASIC;
- new paragraph 482(2A)(c) will relate to the commercial nature of the decision of the company's creditors; and
- new paragraph 482(2A)(e) will require the Court to consider whether the DOCA is likely to result in the company becoming or remaining insolvent.

Application to replace administrator

Background

7.109 Under section 449B, ASIC or a creditor of the company may apply to the Court for an order to replace an administrator.

7.110 In addition, a member of the company can also apply to the Court for the administrator to be replaced where an administrator is acting in a manner prejudicial to some or all of the company's members or creditors. This utilises the court's general supervisory powers under section 447E, and permits the court to make an order as it thinks just.

Key changes

7.111 Liquidators and provisional liquidators of a company may be in a good position to assess the performance of an administrators of the company. Accordingly, the law will be amended to add these persons to the list of persons able to apply to the Court to replace the administrator. This is consistent with recommendation 50 of the CAMAC Report (1998).

Notes on items

7.112 Item 38 will amend section 449B to include a liquidator or a provisional liquidator of the company.

Meetings

Background

7.113 The current law requires the administrator to hold a first meeting of creditors within five business days after the administration begins (subsections 436E(1)-(2)), and a second meeting to determine the company's future within 28 days (in the usual case) or 35 days (where Christmas or Easter intervenes) of his/her appointment (subsection 439A(1)). Creditors must receive at least two business days' notice of the first meeting (subsection 436E(3)).

7.114 The administrator has 21 days (or 28 days if the administration begins just before Christmas or Easter) to convene the second meeting (subsections 439A(1), (5)). The second meeting must be

held within 5 business days after the end of the convening period (subsection 439A(2)). The law allows for administrators to apply to the court to extend the convening period for the second meeting (subsection 439A(6)), and once held the second meeting may be adjourned for up to 60 days (subsection 439B(2)).

7.115 The setting of tight time frames and milestones for completion of the various tasks in an administration is an important feature of the voluntary administration procedure. On the one hand it is beneficial for stakeholders that the process be conducted without delay. It avoids the delays, abuses and expense that may occur if a much longer or unrestricted time frame is allowed.

7.116 On the other hand a limited extension of the period of time for holding the statutory meetings may increase creditors' opportunities to participate, and allow administrators more time to conduct an examination of the company's financial circumstances and consider the best options for its future.

Key changes

7.117 It is proposed to allow a slightly longer time for holding the first and second meetings of creditors. The first meeting will be held within 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.

7.118 The proposed reforms are informed by recommendations 2, 6, 7 and 8 of the CAMAC Report (1998), recommendation 7 of the CAMAC Report (2994) and recommendations 15 and 16 of the PJC Report.

7.119 It is also proposed that, for consistency, references to 'days' in relation to meetings will be amended to 'business days' where appropriate. This is consistent with recommendation 59 of the CAMAC Report (1998).

7.120 In summary, the reforms proposed are as follows:

First meeting	**Current**	**Proposed**
Timing of meeting	5 business days	8 business days
Notice of meeting	2 business days	5 business days
Second meeting	**Current**	**Proposed**
Convening of meeting	21 or 28 days	20 or 25 business days
Notice of meeting	5 business days	No change
Adjournment period	60 days	45 business days

Notes on items

7.121 Item 4 will amend subsection 436E(2) to extend the period of time for holding the first meeting of creditors from 5 to 8 business days. Item 5 will amend subsection 436E(3) to extend the convening period for holding the first meeting of creditors from at least 2 business days to at least 5 business days.

7.122 Item 11 will amend subsection 439A(5)(a) to provide that the convening period is calculated from the day after the administration begins. Currently the convening period for the second meeting of creditors is calculated from the day when the administration begins. It is more usual to calculate the period from the day after the administration begins. The current method of calculation may jeopardise some administrations. The proposal is consistent with recommendation 7 of the CAMAC Report (1998).

7.123 Item 12 will amend subsection 439A(5) to extend the convening period from 28 days to 25 business days where the administration begins before Christmas or Easter. Item 13 will amend subsection 439A(5) to clarify the extent of the convening period in keeping with the change in terminology from 'days' to 'business days'. Item 14 will amend paragraph 439A(5)(b) to extend the convening period from 21 days to 20 business days. Item 15 will amend paragraph 439A(5)(b) to provide that the convening period is to be calculated in the usual case from the day after the administration begins and to clarify the extent of the convening period in keeping with the change in terminology from 'days' to 'business days'.

7.124 Item 16 will amend subsection 439A(6) to allow the Court to extend the convening period for the subsection 439A meeting on an application made after the convening period has ended. Item 17 will clarify that an extension granted on an application after the convening period has ended will be limited to situations where there would otherwise be substantial injustice to creditors. The court will be required to have regard to the administrator's conduct and any other relevant matters when considering the costs of an application. This is consistent with recommendation 8 of the CAMAC Report (1998).

7.125 Item 18 will amend subsection 439B(2) to clarify the power of an administrator to adjourn a meeting for up to 60 days, or to a notified date within the 60 day period. It will replace the current reference to 60 days with 45 business days consistent with the change in terminology from 'days' to 'business days'.

Conversion of 'days' to 'business days'

Background

7.126 Part 5.3A currently uses two different types of methodology for establishing periods or dates in the course of an administration, namely "business days" and "days". It would be preferable for a consistent terminology to be adopted. It is proposed that references to "days" in Part 5.3A of the Corporations Act should all be to "business days". This is consistent with recommendation 59 of the CAMAC Report (1998).

Key changes

7.127 In subsections 438B(2), 443B(2), 443B (3) and 446A(5), "7 days" will be changed to "5 business days". In paragraphs 444B(2)(a), 444B(2)(b) and 446A(5)(b), "21 days" will be changed to "15 business days".

Notes on items

7.128 Items 8, 19, 22, 35 and 36 substitute business days for days, as outlined above.

Role of administrator and administrator of deed

Background

7.129 The roles of the administrator and the administrator of the deed of company arrangement overlap. The period of administration is defined in subsection 435C(1) and (2). It extends to the 'event' referred to in subsection 435C(2), i.e. execution of the deed of company arrangement.

Subsections 444A(3) and 444B(5) impose obligations on the administrator of the deed before the relevant instrument is executed.

Key changes

7.130 The role of the administrator of the deed of company arrangement should commence when the deed of company arrangement is executed by the company and the deed's administrator. It is proposed that the obligation under subsection 444A(3) be an obligation of the administrator of the company and the obligations under subsections 444B(5) and (6) be obligations of the proposed administrator of the deed.

Notes on items

7.131 Item 21 will amend subsection 444A(3) so that it refers to 'The administrator of the company' rather than 'The administrator of the deed'.

7.132 Consequential amendments are made to subsections 444B(5) and 444B(6). Item 23 will amend subsection 444B(5) so that it refers to 'The proposed administrator of the deed' rather than 'The administrator of the deed'. Item 24 will amend subsection 444B(6) so that it refers to 'the deed's proposed administrator' rather than 'the deed's administrator'.

Notification that a company is subject to a deed

Background

7.133 Companies subject to a DOCA must indicate that fact on all of their public documents and negotiable instruments after the company's name where it first appears (subsection 450E(2)). This serves as an indication to any prospective creditors dealing with the company.

7.134 The notification that a company is subject to a DOCA may have adverse impacts on a company's goodwill and reputation. This will, in turn, affect the company's ability to continue trading and impinge on the rescue of the business, ultimately reducing the amount available to creditors.

7.135 It is acknowledged that there may be circumstances where a deed is still yet to be terminated but there is little risk to prospective creditors. An example of such a situation may be where a deed administrator has received the money to be paid to creditors but cannot pay such money because of unresolved disputes over proofs of debt.

7.136 In *Re Brashes Pty Ltd*[22], Hayne J held that the court could exercise its general discretion under section 477A to exempt a company from the obligation to include the words "subject to deed of company arrangement" on its public documents.

7.137 To remove any uncertainty, it is proposed to amend the Corporations Act to provide the company with an express right to apply to the court for an order that the company be exempt from including the relevant words in its name. This is consistent with recommendation 33 of the CAMAC Report (1998).

Key changes

7.138 Section 450E will be amended to provide that a company under a deed of company arrangement can apply to the Court for an exemption from the requirement to indicate that fact on all public documents and negotiable instruments after the company's name.

---

22 (1994) 15 ACSR 477 at 483, 13 ACLC 110 at 115--116.

7.139 The Court may grant such an exemption if it is satisfied that the granting of leave will not result in any significant risk to the interests of the company's creditors as a whole. The Court must also consider the interests of prospective (post-deed) creditors, who are at the most risk. Pre-deed creditors have had the benefit of notification so their interests are unlikely to be at risk in this context. (A similar ability to apply to the Court is proposed in relation to the requirement to disclose former names - see item 45 of Part 3, Schedule 1).

Notes on items

7.140 Items 39 and 40 will amend section 450E to provide that a deed administrator or any interested person can seek leave of the Court for an exemption from the requirements of subsection 450E(2).

Resolutions for removing an administrator

Background

7.141 Currently, the replacement of an administrator at the first meeting of creditors may require creditors to pass two resolutions:

- The first to remove the existing administrator; and
- The second to appoint the replacement administrator.

7.142 Consequently, an administrator could be removed without a replacement being appointed.

Key changes

7.143 Uncertainty in this area will be addressed by amending the Corporations Act to provide that the removal of a current administrator and the appointment of a replacement administrator must be effected through a single resolution. This is consistent with recommendation 3 of the CAMAC Report (1998).

Notes on items

7.144 Item 6 will amend section 436E(4) to clarify that the removal of a current administrator and the appointment of a replacement administrator must be effected through a single resolution.

PART 2 — RIGHTS TO PROPERTY DURING ADMINISTRATION

Right of a person to retain pledged property

Background

7.145 Under sections 440B and 440C of the Corporations Act, chargees and owners or lessors of property used, leased or occupied by the company are prohibited from exercising their rights once an administrator has been appointed to the company. Exceptions to this rule are where the administrator consents, or where the person acts with leave of the court.

7.146 There remains some uncertainty regarding the application of section 440B to lienees and pledgees. A key purpose of taking possession of property under a lien or pledge is to provide additional security for the lender. The proposed change to the law will clarify that a lienee or pledgee retains the right to retain property subject to a lien or pledge upon insolvency of the debtor. The right to retain property will be subject to a restriction upon the sale of the property during the course of a voluntary administration. The proposed amendments will recognise the purpose of a lien or pledge in providing additional security for a loan whilst also protecting the interests of other creditors.

Key changes

7.147 The Corporations Act will be amended to clarify that persons who hold property as security under a lien or pledge should be entitled to retain possession of that property when a company enters into external administration. The Corporations Act will also be amended to provide that a person is not entitled to sell that property during the course of a voluntary administration.

Notes on items

Item 46: After section 440B

7.148 Item 46 will insert new sections 440BA and 440BB into the Corporations Act. New section 440BA will provide that a person in possession of company property held under a lien or pledge will be entitled to retain possession of the property, but must not sell the property without leave of the Court or the consent of the administrator. New section 440BB will provide that, if a company in administration is a lessee of property, distress for rent may not be carried out against the property without the administrator's written consent or the leave of the Court.

Power of an administrator to sell property subject to a lien, pledge or retention of title clause

Background

7.149 Section 442C of the Corporations Act prohibits an administrator disposing of property that is subject to a charge, that is used or occupied by the company, or is in the possession of the company but of which someone else is the owner or lessor. Exceptions to this rule include where the sale is in the ordinary course of the company's business, where the administrator has the written consent of the chargee and where the administrator has the leave of the court.

7.150 The proposed amendments would clarify the law in relation to the sale of property subject to a lien, pledge or retention of title clause.

Key changes

7.151 Section 442C of the Corporations Act will be amended to clarify the administrator may sell property subject to a lien, pledge or retention of title clause, in certain situations. The amendments will allow for a chargee, lienee, pledgee, lessor or owner to apply to the court for an injunction if a

proposed sale of the property would prejudice their interests. The administrator will be provided a right of inspection for property held under a lien or pledge, and a right to take possession to sell such property in order to effect a sale.

7.152 To protect the interests of the security holder, the administrator will be obliged to retain the amount secured by a lien or pledge, for payment to the holders of those securities, when a power of sale is exercised over property subject to a lien or pledge. The administrator will be required to act reasonably in exercising the power of sale. Similar provisions will be introduced for property that is in the possession of the company but owned by a third party due to the operation of a retention of title clause.

Notes on items

7.153 Item 45 will amend section 9 of the Corporations Act to define ‘retention of title clause’.

7.154 Items 53, 54 and 55 will amend section 442C of the Corporations Act to clarify that the provisions stating when an administrator may dispose of encumbered property also apply to property subject to a lien or pledge.

7.155 Item 56 will insert new subsections 442C(4), 442C(5) and 4442C(6) into the Corporations Act to provide for a court injunction where a proposed disposal of property would prejudice the interests of an owner, lessor, chargee, lienee or pledgee.

7.156 Item 56 will also insert a new subsection 442C(7) into the Corporations Act to provide that a disposal of property by an administrator is sufficient to extinguish a charge, lien or pledge. This new subsection will ensure that persons acquiring property from the administrator of a company will obtain clear title to that property.

7.157 Item 57 will insert a new subsection 442CA(1) into the Corporations Act to provide for a right of inspection where an administrator proposes to sell property subject to a lien or pledge.

7.158 Item 57 will also insert a new subsection 442CA(2) into the Corporations Act to provide an administrator with a right to obtain possession of property of a company that is subject to a lien or pledge in order to effect a sale. This subsection will provide an administrator with immunity from any action in conversion that might otherwise arise from actions taken to sell property of a company that is subject to a lien or pledge.

7.159 Item 57 will also insert a new section 442CB into the Corporations Act to provide that an administrator must act reasonably in exercising a power of sale over property subject to a lien, pledge or retention of title clause.

7.160 Item 57 will insert new section 442CC into the Corporations Act to provide for the sale of property subject to a lien or pledge. The administrator will be required to set aside the net proceeds of the sale, to the extent required to satisfy the debt secured by the lien, pledge or retention of title clause, or any other security that has a priority over the debt secured by the lien, pledge or retention of title clause. If the net proceeds of the sale are insufficient to meet these debts, the entire amount must be set aside to pay those debts in order of priority.

Right of a creditor to sell property subject to a lien or pledge

Background

7.161 Under the proposed amendments discussed above, it will be clarified that a lienee or pledgee may not sell property subject to a lien or pledge without the agreement of the administrator. If the administrator agrees to the sale, a question arises about the allocation of the proceeds of the sale.

Key changes

7.162 Where the administrator agrees to a lienee or pledgee selling property in their possession, the power of sale will be subject to a requirement to return to the administrator any sale proceeds in excess of the debt secured by the charge. The power of sale will not be exercisable where there is a security of the property that has a higher priority in liquidation.

Notes on items

7.163 Item 52 will insert new sections 441JA into the Corporations Act to regulate the sale of property subject to a lien or pledge by a lienee or pledgee. New section 441JA will permit the holder of the lien or pledge who sells the property to retain the net proceeds where they equal or fall short of the debt secured. Where they exceed the debt secured, the holder will be required to pay to the administrator the excess. Where the net proceeds fall short of the debt secured, the holder will be able to prove for the balance as an unsecured creditor.

General moratorium for bankers' liens and collateral lodged with clearing and settlement facilities

Background

7.164 Bankers' liens over, *inter alia*, unpresented cheques and bills of exchange would be unworkable if the banker needed to obtain the consent of an administrator or prior leave of the court under new section 440BA in order to dispose of such instruments.

7.165 Shares are often lodged as security with the Options Clearing House (OCH). OCH has indicated that it cannot accept shares or money market securities as collateral should administrators be permitted to sell property that is subject to a lien or pledge under section 442C.

Key changes

7.166 The Corporations Act will be amended to provide that bankers' liens are exempt from the moratorium under Part 5.3A of the Corporations Act.

7.167 Securities lodged as collateral with a clearing and settlement facility will also be exempt from the moratorium under Division 6 of Part 5.3A of the Corporations Act.

Notes on items

7.168 Item 47 will insert a new section 440JA into the Corporations Act to exempt property that is the subject of bankers' liens and securities held as collateral by a clearing and settlement facility from Division 6 of the Corporations Act.

Clarifying the injunction power allowing a court to prevent enforcement of a charge

Background

7.169 Where a chargee takes action that falls within section 441B by dealing with property under a charge, the administrator may apply to a court for an injunction to prevent that action. A court's injunction power under paragraph 441D(1)(a) covers actual, but not foreshadowed, enforcement action by a chargee over particular property. In some circumstances an administrator may have notice of conduct of a chargee that is likely to occur in the future that would adversely affect the interests of creditors. It is desirable that the power of the court to grant an injunction be extended to cover injunctions against threatened enforcement action by a chargee.

Key changes

7.170 The Corporations Act will be amended to clarify the power of a court to grant an injunction to prevent threatened enforcement action by a chargee.

Notes on items

7.171 Item 51 will amend paragraphs 441D(1)(a) and 441D(1)(b) to provide a court with power to grant an injunction where a person proposes to engage in conduct to enforce a charge of a type that is listed within subsection 441B(1).

Clarifying the powers of a court to allow the enforcement of a charge

Background

7.172 A chargeholder over all or substantially all the property of a company can continue enforcing its charge if it commenced enforcement before or during the 10 day decision period that follows the commencement of the administration (this is known as the substantial chargeholder's exception). This exception is contained within section 441A of the Corporations Act.

7.173 Other chargeholders can continue enforcing their charges under the circumstances identified in section 441B of the Corporations Act.

7.174 The case of *Albert v Namba Pty Ltd* (1997) 24 ACSR 577 raised the possibility that chargeholders may not be able to enforce their charges through court proceedings, given the separate prohibition on court enforcement procedures in sections 440F and 440G of the Corporations Act.

7.175 Chargeholders who are permitted by the Corporations Act to enforce their charges should be able to do so during the administration period through court enforcement, as well as extra-curial action.

Key changes

7.176 The Corporations Act will be amended to clarify that a chargeholder who is permitted to enforce a charge under sections 441A or 441B is able to do so through court enforcement as well as the extra-curial action provided for in those sections.

Notes on items

7.177 Items 49 and 50 will amend subsections 441A(3) and 441B(2) to clarify that court enforcement of a charge is not prevented by the prohibition on court enforcement procedures in sections 440F and 440G of the Corporations Act.

PART 3 — LIQUIDATION FOLLOWING ADMINISTRATION

Relation-back period

Background

7.178 Under the Corporations Act, certain transactions, or acts to give effect to transactions, occurring prior to liquidation may be avoided if they occurred during a period ending on the 'relation back day'. If the liquidation is the result of a court order, section 9 provides that the relation-back day is the day the application for winding up was filed. Sometimes the date of filing can be many months from the date the order is made. However, that if a company goes into liquidation following the appointment of an administrator or immediately following a DOCA, then the relation-back day is the date of the appointment of the administrator.

7.179 That means that if an application for winding-up is made but has not been dealt with, directors may limit the relation-back period that would otherwise apply by appointing an administrator some months after the application for winding-up has been made. There is a concern that it may be open to directors to use this "loop-hole" in order to restrict the reach of the relation-back period that would otherwise apply if the winding-up application had been allowed to proceed.

7.180 To address these concerns, it is proposed to change the relation-back day in relevant circumstances to the date the initial winding-up application was filed, even if the liquidation was not a result of the application.

7.181 This is consistent with recommendation 52 of the CAMAC Report (1998).

Key changes

7.182 The definition of 'relation-back day' in section 9 will be expanded in order to make the relation-back day the date of an application for winding up where a liquidation is preceded by a voluntary administration or DOCA, even if the winding up was not a direct result of the application.

Notes on items

7.183 Section 9 currently defines relation-back day. Item 58 will include a number of additional paragraphs dealing with various possible scenarios in the lead up to liquidation and defines the relation-back day in respect of each. The objective is to ensure that where liquidation follows administration or a DOCA, the relation-back day is taken to be the day a winding up application was filed, even if the liquidation was not a result of the application.

7.184 The 'section 513C day' in relation to an administration is the day the administration began, unless a liquidation was in progress when the company went into liquidation, in which case the section 513C day is the day the winding up is taken to have begun under section 513A or 513B.

7.185 The effect of the new paragraphs is that where a company is in administration or under a deed of company arrangement immediately prior to going into a court-ordered liquidation, a members' voluntary liquidation or a creditors' voluntary liquidation, the relation-back day is the section 513C day of the preceding administration <u>unless</u>:

- the company was in administration immediately before a court-ordered liquidation and the order was made in response to an application filed <u>before</u> the beginning of the administration (paragraph (ab));

- the company was under a DOCA immediately before a court-ordered liquidation and the order was made in response to an application filed before the beginning of the administration that preceded the DOCA (paragraph (ad));

- the company was under administration immediately before a resolution of creditors to wind it up voluntarily (including a deemed resolution under subsection 446A(2)) and an application for a winding up order was made before the beginning of the administration which had not been withdrawn or dismissed at the time the resolution was passed (paragraph (ag)); or

- the company's creditors resolved to terminate a DOCA and put the company in liquidation, and an application for winding up was made prior to the administration that led to the DOCA which was not dismissed or withdrawn prior to the resolution (paragraph (ai)).

Priority for debts incurred during a DOCA

Background

7.186 There is some uncertainty about the priority of post-deed creditors, where a liquidation follows a DOCA.

7.187 Although the provability of debts incurred by a company under a DOCA was addressed through the enactment of subsection 553(1A), that provision does not deal with priorities.

7.188 A provision will be included to clarify that post-deed creditors have no statutory priority over pre-deed creditors, except where the deed administrator is personally liable for debts that fall within paragraph 556(1)(a).

7.189 This is consistent with recommendation 55 of the CAMAC Report (1998).

Key changes

7.190 It is proposed to amend section 556 to state that, where a liquidation immediately follows a deed of company arrangement, the statutory priority afforded to debts owed to post-deed creditors under paragraph 556(1)(a) only applies in circumstances where the deed administrator is personally liable for those debts.

Notes on items

7.191 Item 66 will amend subsection 556(1) to provide that the priority afforded to post-deed creditors under paragraph 556(1)(a) only applies to expenses incurred by the deed administrator, or claims made under section 553(1A) for debts incurred during a DOCA, if the deed administrator is personally liable for the expenses.

7.192 Item 63 will add a note at the end of subsection 553(1A) to signal that the paragraph 556(1)(a) priority applies only to debts incurred under a deed of company arrangement for which a deed administrator is personally liable.

Priority for borrowings during administration

Background

7.193 During administration, it is very often vital in order to maintain the business of a company that it obtains new finance. However, lenders may be reluctant to advance funds to a company in administration on an unsecured basis unless they will receive priority treatment in the event that the company ultimately fails.

7.194 To deal with this issue, recommendation 31 of the CAMAC Report (2004) stated that a post-administration lender should be given priority over pre-administration creditors provided a special majority of the pre-administration creditors agreed. However, a possible difficulty with this proposal is that it requires a meeting of creditors, which is expensive to organise and may not be practical within the commercial time constraints.

7.195 An alternative solution to this issue would build on the system of personal liability, indemnity rights and priority already in place regarding certain debts incurred by an administrator.

Key changes

7.196 A deed administrator is personally liable for debts he or she incurs in the course of the administration, but only for services rendered, goods bought, and property leased or hired (subsection 443A(1)). Administrators have a right of indemnity from the company's property to cover those expenses under section 443D. If the company does proceed to liquidation, such expenses are generally entitled to a priority under paragraph 556(1)(c). In some cases they may be entitled to a higher priority under paragraph 556(1)(a) or lower under paragraph 556(1)(de). By this mechanism, those debts incurred by an administrator effectively receive priority over pre-administration debts.

7.197 It is proposed to include debts incurred by the administrator in relation post-administration finance in section 443A, so that a similar mechanism can be used to give post-administration borrowings priority over pre-deed creditors. As the administrator will be personally liable for those borrowings, it is expected that administrators would exercise appropriate caution in using this option. However, in appropriate circumstances it would provide an administrator with the facility to offer a lender enhanced comfort that their funds will be repaid in the event of a failure.

7.198 Under current section 443E, debts covered by the administrator's right of indemnity, in some circumstances, take priority over debts secured by a pre-existing floating charge. However, it is not considered appropriate to allow new borrowings to take priority over debts secured under a pre-existing floating charge, unless the holder of the charge first consents to that result.

Notes on items

7.199 Item 59 will insert new paragraphs (d), (e) and (f) in section 443A(1) to make administrators personally liable for debts incurred by administrators in relation to post-commencement finance. It is intended that this would cover not only the borrowing itself, but also interest and other expenses related to the borrowing. Through the operation of sections 443D and 556, those debts will receive priority in a subsequent liquidation.

7.200 Item 61 will insert a new subsection 443E(4), which provides that the right of indemnity in respect of borrowings under the new paragraph 443A(1)(d), (e) and (f) does not take priority over debts secured by a floating charge on property of the company except to the extent the chargee has consented in writing.

7.201 Item 60 will make a consequential amendment to paragraph 443E(1)(b).

Uncommercial transactions during voluntary administration and deed of company arrangement

Background

7.202 Part 5.7B of the Corporations Act provides for the recovery of property or compensation for the benefit of creditors of an insolvent company. Transactions which may be 'voidable' under section 588FE include uncommercial transactions which are also insolvent transactions.

7.203 Companies might enter into uncommercial transactions during the administration or, particularly, under a DOCA when the company remains in the control of the directors. However, if the company later enters liquidation, those transactions may not be voidable because of requirement that the uncommercial transaction is also an insolvent transaction. Under section 588FC, the company's own insolvency is an element of the definition of an insolvent transaction.

7.204 Unfair loans and unreasonable director-related transactions are voidable under subsections 588FE(6) and 588FE(7) respectively regardless of whether they are also insolvent transactions.

7.205 Due to the potential for abuse, it is proposed to allow uncommercial transactions entered into during a voluntary administration or DOCA immediately preceding a liquidation to be voidable, regardless of whether the company was insolvent at the time of the transaction or became insolvent due to the transaction. However, any transactions done by or under the authority of the administrator or deed administrator will not be voidable.

7.206 This is consistent with recommendation 51 of the CAMAC Report (1998).

Key changes

7.207 New provisions will make voidable uncommercial transactions occurring between the relation-back day and the date of the resolution or court order for winding up, in circumstances where the winding up was immediately preceded by voluntary administration or a DOCA. However, transactions entered into by or on the authority of the administrator or deed administrator will not be subject to the new rules.

Notes on items

7.208 Item 67 will add two new subsections to section 588FE. Subsection 588FE(2A) will apply when the company concerned was under administration immediately before the company resolved that it be wound up, or the court ordered that it be wound up. Subsection 588FE(2B) will apply when the company concerned was subject to a DOCA immediately before those events.

7.209 If a liquidation is immediately preceded by a voluntary administration or DOCA, any uncommercial transactions entered into by the company (or an act done to give effect to the transaction) on or after the relation-back day, but before the order or resolution to wind the company up, will be subject to avoidance. However, transactions or acts done on behalf of the company by, or under the authority of, the administrator or deed administrator will not be voidable under the subsections.

Period for challenging voidable transactions

Background

7.210 A liquidator's power to challenge voidable transactions must be exercised within three years after the relation-back day, or such further time as the court permits (subsection 588FF(3)).

7.211 Where liquidation follows the failure and termination of a deed of company arrangement, the relation back day will generally be the day on which the administration began. If the company is under a DOCA for a long period, the liquidator may have only a short time frame in which to bring an action, or the time for bringing an action may have even expired before termination of the deed.

Key changes

7.212 To address situations where there is a long period between the relation-back day and the termination of a DOCA, subsection 588FF(3) will be amended to allow a liquidator either three

years from the relation-back day or one year from their appointment to challenge voidable transactions, whichever is later.

7.213 This proposal is consistent with recommendation 50 of the CAMAC Report (2004).

Notes on items

7.214 Item 68 will amend paragraph 588FF(3)(a) to allow a court to make orders in relation to voidable transactions under an application made up to 3 years after the relation-back day or 12 months after the appointment of a liquidator, whichever is the later.

7.215 Item 69 will make a consequential amendment to paragraph 588FF(3)(b).

Report as to affairs

Background

7.216 Currently there is no requirement for creditors to be given an updated report as to the affairs of the company if an administration or DOCA proceeds to liquidation by way of a special resolution (which would usually be deemed to have been passed pursuant to subsection 446A(2)). Such a report may be of benefit to any new insolvency practitioner who assumes control of the company's affairs and to creditors generally.

7.217 Recommendation 53 of the CAMAC Report (1998) proposed that the officer in control of a company under administration (or under a deed of company arrangement) should be required to lodge with ASIC at the time the company goes into liquidation a copy of the section 439A report in relation to the company, together with a further report on any additional matters or material changes which affect the financial position of the company that the person is aware of.

7.218 There is, however, no requirement currently to lodge the section 439A report, as it may contain commercially sensitive information. Notwithstanding that, when the company is in liquidation, this is likely to be less of a concern, it is not proposed to require its lodgement as recommended by CAMAC.

7.219 Rather, it is proposed to allow a liquidator who takes office immediately following a period of administration or a DOCA to request a report from any officer of the company about the company's affairs as at a date specified in the notice. This is similar to the power a court-ordered liquidator has under section 475 of the Corporations Act.

Key changes

7.220 The new provision is modelled on the current powers of a court-appointed liquidator to seek a report as to affairs under section 475 of the Corporations Act. The notice may require information about particular affairs, or the affairs of the company more generally.

7.221 There will be an obligation for company officers in receipt of such a notice to provide the information sought. Failure to do so without reasonable excuse will be an offence of strict liability.

7.222 Reasonable costs of preparing the report may be claimed and paid by the liquidator out of the property of the company as a priority debt.

Notes on items

7.223 Item 62 will insert a new section 446C. The section will apply in circumstances where a company resolves that it be wound up voluntarily while it is under administration or a DOCA. It is intended that a deemed resolution under subsection 446A(2) would also trigger the provision.

7.224 The general framework of the new section 446C is modelled on the provisions of section 475 of the Corporations Act. Subsection 446C(2) will give a liquidator of a company in a voluntary liquidation that follows an administration or a DOCA power to give a written notice to current or former officers of the company requiring information to be provided about the affairs of the company.

7.225 Subsection 446C(3) will provide that the information sought must be provided within 14 days of the officer receiving the notice. However, the officer may apply in writing for an extension and, if there are special reasons for doing so, a liquidator may allow a longer period (subsections 446C(4) and 446(5)).

7.226 Unless the officer has a reasonable excuse for failing to comply with a notice (subsection 446C(8)), failure to provide the information within the time period will constitute an offence, which is declared under subsection 446C(9) to be an offence of strict liability. Item 70 will insert into Schedule 3 a penalty for the breach of subsection 446C(3) of 25 penalty units or imprisonment for 6 months, or both.

7.227 Subsection 446C(7) will allow the person in receipt of the notice to claim from the liquidator reasonable expenses for preparing the report, which will be paid out of the property of the company. Item 65 will provide for such expenses to have a priority in the liquidation under a new paragraph 556(1)(da).

Priority for costs of making a winding up application

Background

7.228 The costs of making an application for a winding up order are generally afforded priority in a liquidation. A decision of the New South Wales Supreme Court, *McDonald v Deputy Commissioner of Taxation* (2005) 23 ACLC 324, has indicated that the costs of an application for a winding up order will not receive priority where an application for a winding up order is made, but prior to court approval of the winding up the company is put into voluntary administration and then into liquidation through the route of voluntary administration rather than as a result of the application. The circumstance that the court considered in that case is not uncommon.

7.229 To encourage members of the public to make applications for the winding up of insolvent companies, it is desirable for the costs of a winding up application which is not withdrawn or dismissed before the company enters administration to be recoverable as a priority in a subsequent liquidation, even if the liquidation was an outcome of the voluntary administration process rather than as a direct result of the application.

Key changes

7.230 The costs of making an application for a winding up order against a company will receive priority where the company is later liquidated in a creditors' voluntary winding up initiated through the voluntary administration procedure. This may occur if creditors resolve that the company be wound up under paragraph 439C(c) and a deemed voluntary winding up occurs through the operation of subsection 446A(2) or if the company goes into liquidation following a DOCA. This may arise in the circumstances set out in paragraphs 445C(a), (b) or (c) because of the operation of subsection 446A(2).

7.231 New paragraph 556(1)(ba) will have the result that the costs of making an application for a winding up order attract priority under that paragraph, where the company is placed into voluntary administration after the filing of a winding up application and liquidated under Part 5.5 through the operation of subsection 446A(2).

Notes in items

7.232 Item 64 will insert a new paragraph 556(1)(ba). Paragraph 556(1)(ba) will give priority to the costs of a winding up application where the application was made under section 459P during the 12 months ending when the winding up that has come about through the operation of the voluntary administration procedure commenced, the application has not been withdrawn or dismissed and the Court did not make an order under section 459A that the company be wound up in insolvency.

8

MISCELLANEOUS

Priority of administrative expenses in voluntary liquidation

Background

8.1 Sections 512 and 516(1) both purport to determine the priority of amounts payable in a creditors' voluntary winding up. The relationship between the provisions is currently unclear. Barrett J suggested in *McDonald v Deputy Commissioner of Taxation*[23] that consideration be given to resolving the conflict between sections 512 and subsection 556(1). His Honour stated: *"I ... note briefly the obvious difficulty in reconciling ss 512 and 556(1) in a case of voluntary winding up. The former professes to identify items payable 'in priority to all other claims', while the latter refers to items that, subject to other provisions of Division 6 of Part 5.6 (which does not include section 512), are to be paid 'in priority to all other unsecured debts and claims'".*

8.2 Subsection 556(1) was inserted in the Corporations Act in 1992 to govern the ranking of debts in a liquidation. It covers voluntary liquidations (see section 513). Accordingly, section 512 is no longer necessary.

Key changes

8.3 Section 512 of the Corporations Act will be repealed.

Notes on items

8.4 Item 6 will repeal section 512. The priority of administrative expenses in voluntary liquidation is dealt with in subsection 556.

Correction of anomalies

8.5 Items 1, 3, 8, 9, 11, 12 and 13 will remove references to the obsolete 'official management' procedure in the specified provisions. Item 2 will remove an incorrect cross-reference in the definition of 'administration' in section 9. Item 5 will correct a cross reference to subsection 443BA(2) in section 443D. Item 7 will correct a drafting anomaly in section 533 of the Corporations Act. The "and" at the end of paragraph 533(1)(a) should be "or". Item 10 will remove the unnecessary word "with" from subsection 539(3). Item 14 will remove the obsolete reference to 'examinable officer' in paragraph 597A(1)(b).

Share capital reductions — partly-paid shares

Background

8.6 Section 256B provides a general mechanism allowing companies to reduce share capital where a reduction is not otherwise authorised by a specific provision in Part 2J.1 of the Corporations Act.

23 (2005) 23 ACLC 324.

8.7 A reduction of a company's share capital for consideration can have an adverse impact on creditors, as it effectively reduces the pool of assets over which creditors may make a claim. As such, if a company wishes to use the section 256B process to reduce share capital, paragraph 256B(1)(b) provides that a reduction for consideration may not proceed if it would materially prejudice the company's ability to pay its creditors.

8.8 Flowing from this, where shares are cancelled for no consideration, the company does not have to determine whether the cancellation will materially prejudice the company's ability to pay its creditors. Generally, a cancellation of a share for no consideration will have no effect on the amount of assets over which creditors may make a claim.

8.9 On its face, this provision does not expressly distinguish between fully-paid and partly-paid shares. Where shares are partly-paid shares, their cancellation amounts to the cancellation of a right to claim monies from another party and thereby reduces the pool of assets available to creditors.

8.10 The law is currently interpreted so that the cancellation of a partly-paid share will always involve consideration. Even where no money is payed for the partly-paid shares, the consideration will be provided by the company giving up its right to make a call on the share (and the shareholder receiving the benefit of not having to pay a debt). Following from this interpretation, paragraph 256B(1)(b) will always apply to the cancellation of a partly-paid share. However, there was some discussion of this issue in the context of the James Hardie Inquiry.

Key changes

8.11 It is proposed to amend the section to state expressly that, to avoid doubt, a cancellation of a partly-paid share is taken to be for consideration. The effect of this amendment is to provide express guidance that the share cancellation process described in subsection 256B(1) can only be used to cancel partly-paid shares if the cancellation does not materially prejudice the company's ability to pay its creditors.

Notes on items

8.12 Item 4 will insert a new subsection 256B(1A) to provide expressly that to avoid doubt, a cancellation of a partly-paid share is taken to be for consideration. The new subsection is intended to add clarification to the current interpretation of the law, and not interrupt the law's current operation. The amendment is strictly prospective.

9

TRANSITIONAL PROVISIONS

9.1 Item 1 will set out transitional/application provisions for the introduction of the amendments in the draft Bill.