Submission for Senate Inquiry into Australia's Insolvency Laws

Author details

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I make this submission as a private individual, more specifically, as an ex-employee of an insolvent company, Open Telecommunications.

Abstract

This submission highlights some deficiencies evident in the laws dealing with insolvency in Australia, including the Corporations Act, the Operational Arrangements in relation to GEERS, employment law, and Social Security law.

The paper is in three parts:
- The story of an insolvency
- Issues arising from the insolvency
- Recommendations

I am a former employee of Open Telecommunications Ltd., which went into Voluntary Administration last year, and is currently under a Deed of Company Arrangement. After some ten months, we are still waiting for a payment from either the Government (under GEERS) or from the Administrators of the Deed.

This submission tells the story of the insolvency of Open Telecommunications, and this is done to highlight a real case of where the law lets down creditors. It then draws out issues from the story, including:
- Finding out the details of the Deed of Company Arrangement less than one working day before the meeting where this was to be voted upon,
- The Deed conflicting with the GEERS operational arrangements,
- The 43% recovery rate for employees under the Deed.
- The employees have lodged claims under GEERS, but still haven't been paid after 10 months.

The submission then recommends changes to the law. They include these recommendations:
- No change required to the priority of employee wages and superannuation. Instead, various core issues being experienced by employees and other creditors should be addressed.
- That a Deed of Company Arrangement always provides for full payment of all debts.
- That a Deed be much more like a Company Liquidation, except that the company keeps going.
- The behavior of Insolvency Practitioners should be tightly controlled
- An Ombudsman or Complaints Resolution Service should be set up to deal with complaints from creditors
- Stood down employees should gain the right to claim Social Security and hunt for alternative employment.
- The ability of creditors to assign their rights (subrogate) should be enshrined in law.
- Measures against directors of failed companies. Also, directors to lose their rights as secured creditors (in most cases).

One of the main problems is that most creditors (and especially employees) only deal with a company insolvency once in their lifetime, which puts them at a disadvantage when put against Administrators and other Insolvency Practitioners, who deal with insolvency every working day, and know the law inside out. The other problems for creditors arise from the lack of control over what can be written into a Deed of Company Arrangement; that is to say that almost anything is allowed, because it is not illegal.

Both of these problems are very similar to those in the Real Estate Industry: most people seldom buy and sell property, but they deal with those in the industry that work with real estate every day. A wide range of unethical behavior goes on unchecked, because it is not illegal.

After working hard in my career, going the extra mile, and delivering quality work, I was disappointed that I was caught in a company collapse. However, this was not as bad as the actions of the Administrators, which I felt were inexcusable. To stop this, the law must change.

The story – a company goes under

Open Telecommunications went into Voluntary Administration on 12 July 2002. Rather than telling the "Official" story, I prefer to highlight the thoughts that the employees had at various stages of the Administration procedure.

The official story can be seen from the announcements made to the Australian Stock Exchange (ASX).

"My bank account is overdrawn"

15 May 2002 It was only when a work-mate remarked that his bank account was in overdraft that we knew something was wrong and we hadn't been paid. We were paid the following day, but it was explained verbally later there had been fears about the company cash flow.
However, the Continuous Disclosure Regulations of the ASX prohibited the company from saying anything at all. One employee had booked a holiday, and was unsure whether to cancel it or not.

The Administrators walk in

12 July 2002 An attempt to sell part of the company fails. The directors immediately call in the Administrators (Robert Whitton & Peter Yates of Deloitte Touche Tohmatsu).
Most of us find out from a staff member who discovered the announcement on the stock exchange, and attached it to an email.

The job hunt begins – without Social Security

15 July 2002 Almost all employees are stood down, but a number of them complained that Centrelink rejected their claims – technically they are still employed. However, results varied quite widely across different Centrelink offices.
If we take another (temporary) job, the company can avoid paying redundancy because they can say we resigned by taking that other job.

15 July 2002 An email list is set up on the company computer. This is one of the few cases where an effective mechanism exists to get information out to some employees. However, it does not cover all creditors, and it only covered Melbourne-based employees (about half of the total that were directly affected). This was later replaced by a Yahoo email list that I set up.

26 July 2002 Administrators officially make 93 staff (including me) redundant.

Deloitte adds to the confusion

19 July 2002 First meeting of Creditors
There were complaints that some people had received empty envelopes from Deloitte Touche Tohmatsu.
There is considerable confusion surrounding how to fill out the Statement of Claim form – whether or not redundancy is included. There are no instructions covering this on the form.

Deloitte tries to avoid paying redundancy

22 Aug 2002 Statement of Personal Entitlement issued by Deloitte – without redundancy. It emerges that since redundancies were not written into the contract, the view from Deloitte was that it wasn't payable.
Has any contract in Australia got redundancy written directly into it?
Why has the company been paying redundancy before?

23 Oct 2002 Deloitte reviews their position on redundancy – but does not provide recalculated

Statement of Personal Entitlements. We are still waiting to this day (25 May 2003).

Deloitte shuts out the creditors

8 Aug 2002 Second Creditors' meeting held, which resolved to adjourn the meeting, for up to 60 days

27 Sept 2002 Court granted an extension for the reconvening of the Second Meeting, until 28 October 2002, with notice to be sent by 5:55pm 18 October 2002.

18 Oct 2002 Covering letter, Notice of Meeting (Form 529), and Proxy Form (Form 532) sent. No report, recommendations, or details of any Deed of Company Arrangement are attached.

23 Oct 2002 (Wednesday) An email is sent onto the email list, from an employee still working at the company, that voting for or against the Deed may adversely affect how much GEERS will pay. It is said that Wayne (Passlow) and the other Directors are recommending that terminated employees ABSTAIN from the Deed.

24 Oct 2002 (Thursday) Administrators' Fifth Report to Creditors sent (my copy was recorded by the Postal Service as having passed through Nunawading 6:12am Friday)

25 Oct 2002 (Friday) Received the above report, which recommends a Deed of Company Arrangement. This is the first time that we find out that the recovery rate for employees is as low as 43%.
I could not get hold of a lawyer to discuss the Deed and its implications.
Considerable confusion on the email list – with this Deed, will GEERS pay out just the 43%? Will they even pay at all? What happens if you vote for or against the Deed?

26/27 Oct Weekend. It's hard to get a lawyer during the weekend, let alone an insolvency lawyer. Deadline for proxies is 5:00pm Saturday 26 October.

27 Oct 2002 A Facsimile was sent to the Administrators expressing an opinion that the report (in this case, the Fifth Report as described above) must accompany the Notice of Meeting. It therefore makes the assertion that the meeting was not lawfully called. A copy of the facsimile is circulated on the email list. To my knowledge, the Administrators never replied.

28 Oct 2002 Meeting held. A number of unhappy creditors (both employees and trade creditors) ask various questions, including raising the issue that the report was sent out late. Robert Whitton (Deloitte) defends this saying the Court ruling allowed this.
Continuing employees and most trade creditors vote in favour of the Deed.
After the meeting: I get the sense that the Deed is very divisive – it pits continuing employee against ex-employee.

27 Nov 2002 A message on the email list indicates that in actual fact the Court ruling makes no mention at all about allowing having "this report sent subsequently" (Robert Whitton's words).

The Deed: Devil in the detail

28 Oct 2002 At the meeting, the resolution to execute a Deed of Company Arrangement is carried.

18 Nov 2002 The Deed of Company Arrangement is executed (signed).
Marcus Ayres (Deloitte) advises me not to waste my time getting a full copy of the Deed, because it is one page of what we already know and 28 pages of "legal formalities".

While it is true that the basic structure of the Deed is as described by the Administrators

in their report, we soon learn that the 28 pages of legal formalities are causing difficulties, and to this day (21 May 2003) we are still discovering worrying issues within the legal formalities. The two main issues are:

- Subrogation rights: the right of the Department to pay out claims under GEERS to employees, then to claim that money on behalf of those employees is hampered.
- The priorities described in Section 560 of the Corporations Act are not followed in the Deed. This conflicts with the GEERS Operational Arrangements.

Other issues arising from the legal formalities:

- The company must pay funds into the accounts according to the Deed, but there is no clause compelling the Deed Administrators to make the payment from the accounts to the creditors.
- Confusion as to when claims (for the other 57%) are extinguished.
- Early payments by the company are permitted. This is welcome, but there is nothing preventing the company from paying ordinary unsecured creditors first (by making a very early payment into their fund). This is hardly fair to employees if this were to happen.

It may have been the Company Directors who drafted the Deed, but I hold the Administrators responsible for these issues, because the Directors do not have experience in insolvency. The Administrators, with all their experience, should have advised the directors on correcting these issues in the Deed prior to execution.

The lawyers are playing ping-pong

For those waiting on a payment of their GEERS claims, it feels that the lawyers are playing ping-pong. I assume this is not deliberate, but it is frustrating. The details are below.

The Department is not paying out GEERS claims until it is satisfied that their subrogation rights are protected. This issue was discussed with the Department's lawyers, then referred to Deloitte and their lawyers. Then it was referred back to the Department and their lawyers. The Department got some more legal opinion, and referred it back to Deloitte who have now switched lawyers.
The issue is being bounced around, and three sets of lawyers have been involved so far. This started in January 2003 and continues to this day (20 May 2003).

Current status

1. Current employees are waiting to be paid for about one month's of work and about three months' superannuation, and some are waiting for work-related expenses to be reimbursed.

2. Redundant employees are waiting to be paid redundancy, unpaid wages, notice, and superannuation. Some employees are also waiting for packaged car payments, or work-related expenses to be reimbursed. The GEERS claim for this group of employees is being held up on three issues:

   - The subrogation issue: the Deed does not make provision for the Department to step in and assume the rights of redundant employees if they pay out on their GEERS claims. This decides whether GEERS is payable at all.
   - The order of priorities as laid out under Section 560 of the Corporations Act is disturbed by the Deed paying out approximately 20% of ordinary unsecured creditors' claims while the employees are not fully paid out. This decides whether GEERS is payable at all.
   - Whether Deloitte accepts that redundancy is payable. This decides whether the Department will pay the redundancy component of the GEERS claims.

- Whether the Department accepts that we had no control over the construction of the Deed which gives a recovery rate of approximately 43%. This decides whether the Department will pay 100% of our claim, or only 43%.

3. Contractors and other Ordinary Unsecured Creditors are waiting for their payments. The first payment, of about 10% is due in June 2004.

4. All creditors and shareholders are waiting for the Annual Report, due in two weeks' time (from 24 May 2003), for the details of a Put and Call option with Siemens. This is an option that pre-dates the appointment of the Administrators. There is some rumour that this was paid out, but no information was made available from the Administrators.

Issues arising

Open Telecommunications issues

These are the issues that arise directly from the Open Telecommunications case, as detailed above.

- The low recovery rate under the Deed of Company Arrangement. The company only has to pay approximately 43% of employee claims, and 20% of trade creditor claims, then it is no longer liable, regardless of any big profits it may make in the future.
- Finding out the basic details of the Deed only one working day before the meeting (at best).
- The rights of terminated employees to claim under GEERS may have been voted away, in part because of the issue of subrogation. We still don't know this for sure.
- Confusion about the forms sent out to creditors, particularly employees. This is because there were no instructions; there was no indication whether or not to include redundancy, and many employees would not know how much superannuation was unpaid. There was also some confusion whether creditors had to fill out a Statement of Claim for each meeting they attended.
- Information on creditor rights and responsibilities. While it is true that a two-page leaflet, jointly authored by ASIC and the IPAA, was sent to creditors, this does not contain nearly enough information. Creditors require information on their rights (do creditors have the right to look at the Company books?), on their non-rights (for example: the first meeting of creditors is the last chance to appoint an alternative administrator and/or to join a Committee of Creditors), and their responsibilities (for example: what forms they need to fill in). Employees also require information tailored to them – such as when a claim for redundancy is recognised. A Frequently Asked Questions list, with answers, for all creditors, would also help.
- Employment law and Social Security law: while employees are stood down, and not being paid (in a practical sense), the law says that they are still employed, and cannot claim a Social Security benefit. They cannot take a temporary job without risking their entitlement to redundancy.
- Continuous Disclosure regulations of the ASX: A company cannot discuss cash-flow issues with employees. This prevents employees from planning ahead to conserve money.

Other issues to consider:

These issues were not directly evident in the Open Telecommunications case, but they deserve mention.

- Lack of control over what can be put into a Deed of Company Arrangement. This translates into the specific issues above of the low recovery rates, and lack of subrogation rights.
- Most creditors are unfamiliar with insolvency law. One of the main problems is that most creditors (and especially employees) only deal with a company insolvency once in their lifetime, which puts them at a disadvantage when put against Administrators and other Insolvency Practitioners, who deal with insolvency every working day, and know the law inside out.
  This is very similar to the Real Estate Industry: most people seldom buy and sell property, but they deal with those in the industry that work with real estate every day. In both industries, this is a recipe for deception and misinformation.
- Subrogation rights not having protection in a Deed of Company Arrangement. Not only does this affect claims under GEERS, it also affects Trade Insurers (like QBE), and creditors who sell their debt to third parties (which is a perfectly legitimate commercial activity).
- I am suspicious that some Insolvency Practitioners disempower creditors by presenting options (like a Deed) as a *fait-accompli*, or by using the TINA strategy (There Is No Alternative – see glossary). What is certain is that there is no effective mechanism for the proposed Deed to be questioned, and no effective mechanism for alternative Deeds to be presented.

Recommendations

The recommendations are grouped under the points laid out in the Terms of Reference, along with a group at the end, which relate to Insolvency Law, but do not fit into the Terms of Reference points.

(a) the appointment, removal and functions of administrators and liquidators

(no specific recommendations for their **appointment** or **removal**. Recommendations below cover their **functions**).

- The behaviour of Insolvency Practitioners should be tightly controlled; for example: they should not withhold information from creditors.
- An Ombudsman or Complaints Resolution Service should be set up, for complaints from creditors about Insolvency Practitioners. This will remove the need for creditors to go to court in some cases. It should be noted that some creditors do not have the funds to afford legal advice or legal action.

(b) the duties of directors

- Directors "and associates" should lose their rights as secured creditors. An exception needs to be made for directors who act as representatives of an independent lender on a Company Board; the benefit of the exception will only extend to the lender. A lender is one who offers money for loan to many unrelated parties as part of its normal business operations (for example: an investment bank).

This will encourage directors to run the company sustainably.

(c) the rights of creditors

I have included under this point comments on the **responsibilities** of creditors.

- Subrogation rights (the ability for a third party to take over the rights of a creditor) need to be enshrined in law. It should be possible to assign the rights for all or part of the debt, and the third party should gain the same priority(ies), and possibly the same voting power (which will be proportionate for part assignments), and the right to collect any payout in their own name. The creditor should tell the Insolvency Practitioner what parts of the debt are being assigned, and if voting powers are being assigned.
- Creditors often do not know their full rights. An expanded information leaflet listing the rights, non-rights, and responsibilities of creditors, produced by ASIC, should be sent to all creditors.
- A *Frequently Asked Questions* document, produced by ASIC, would be helpful for creditors.
- Insolvency Practitioners should be more responsible in getting information to creditors. The information:
  - Should be timely,
  - Should be detailed enough (for example: how to fill in forms)
  - Explain clearly what is required of creditors, and when.

(d) the cost of external administrations

(no specific recommendations)

(e) the treatment of Employee Entitlements

I note a proposal to put employee entitlements ahead of secured creditors in a distribution of assets. I am recommending against this, and my reasons are:

- It will not fix many of the core issues being experienced by creditors (including employees)
- The priorities may be over-ruled by a Deed of Company Arrangement, so employees may be no better off, anyway.
- Contractors will be no better off. Many contractors work under conditions that are very similar to employees, and are now taxed in a very similar way. This will increase the disparity of treatment between the two groups of creditors.
- It may lead some companies (or their secured creditors) to pressure employees to resign and become

contractors.

It is better to fix the core issues being experienced by employees (and other creditors), rather than to shuffle the priorities of different groups of creditors.

Additional employee-related recommendations appear near the end of the recommendations.

(f) the reporting and consequences of suspected breaches of the *Corporations Act 2001*

I have expanded this to include the **enforcement** of the *Corporations Act 2001*

- The Government should take a leading role in the prosecution of Insolvent Trading, Unfair Preferences and similar cases. At present, the responsibility for prosecuting these cases rests with the Liquidator, and is not available unless the creditors vote for liquidation. There are probably a large number of these cases which are left unpursued because of the sheer cost.

(g) compliance with, and effectiveness of, deeds of company arrangement

(no specific recommendations. However, recommendations regarding Deeds of Company Arrangement appear below)

(h) whether special provision should be made regarding the use of phoenix companies

- A company is either profitable or not. If not, then it really shouldn't operate and should be liquidated. If it is, then it will eventually pay off its debts in full, and the Deed of Company Arrangement should be constructed accordingly.
- If a company is to be liquidated, the Directors should be prevented from setting up a similar business, with the assets of the liquidated company, or working "in close proximity" to such assets (like becoming an ordinary employee and controlling a puppet director). Furthermore, the Directors should be banned if they have had (say) two company collapses in five years, or if they have few assets. Appropriate thresholds for Director's assets need to be devised.

Deeds of Company Arrangement - recommendations

Some back-ground information: Benefits of Administration

A company entering Administration immediately gains two (or three) benefits:

1. Creditors cannot enforce their rights against the company – this protects the company from disruptive enforcement action, such as repossession of plant.
2. Interest on debts stops accruing. This gives the company some hope that it will be able to pay its way out of insolvency without being out-run by the interest.
3. It is also possible that they gain the right to terminate a commercial property lease.

It seems feasible that a company that is to trade its way out of insolvency should eventually pay its debts in full.

Observation

- A company is either profitable or not. If not, then it really shouldn't operate and should be liquidated. If it is, then it will eventually pay off its debts in full, and the Deed of Company Arrangement should be constructed accordingly.

Recommendations

At present, almost anything can go into a Deed, and it is legally binding if voted in by a majority of creditors (possibly under a TINA strategy). It is noted that recoveries for insolvent trading and the like are not available to a Deed Administrator. I make the following recommendation:

- The operation of a Deed of Company Arrangement be made much more like a liquidation (with respect to subrogation rights, the priorities of various classes of creditor, and recoveries for insolvent trading and the like) with the primary differences being:
    - The company keeps operating
    - Payment of 100% of debts (as discussed above)

The primary issues to be decided in a Deed would therefore become:

- The timetable of when creditors are to be paid
- Whether secured creditors maintain their investment or not
- Which assets are to be sold and kept
- Business plans

In a practical sense, an obvious difference between a Deed (as proposed here) and a Liquidation is that creditors' claims are funded by profits in a Deed, and funded by asset sales in a Liquidation.

Employment Law recommendations

Protect the right of employees to take alternative employment while stood down, unless the employer is actually paying at least basic wages "as and when they fall due". If the employee is called back to work, they must be given one working day's notice, unless another period is agreed to. The employee should only lose redundancy if they are terminated because of their failure to return to work after the notice period.

Social Security Law

Claimants should have the right to claim Social Security while stood down, unless the employer is actually paying at least basic wages "as and when they fall due". If the employee is called back to work, it is treated as "having found another job". The claimant should assign the rights they have as a creditor to the period of time stood down, and for payment in lieu of notice.

In practice, the time spent stood down will usually be a lot less than the waiting period for Social Security benefits, so the only difficulty in most cases is, for a claimant eventually made redundant, to reconcile social security adjustments when a payout occurs after a long period of time. This is particularly relevant for people ineligible for GEERS assistance. This could be handled by the claimant assigning their rights as a creditor to the agency paying Social Security (usually Centrelink) for part of their debt.

Glossary

Some clarifying notes are included in some of the entries.

ASIC	Australian Securities and Investment Commission Administers company law, including some insolvency laws http://www.asic.gov.au
ASX	Australian Stock Exchange Trading medium for shares in publicly listed companies. To ensure fair trading, they have Continuous Disclosure regulations. http://www.asx.com.au
Deed	Deed of Company Arrangement.
Deloitte	Deloitte Touche Tohmatsu. The accountancy company who employ the Administrators of Open Telecommunications (Robert Whitton and Peter Yates).
DEWR	Department of Employment and Workplace Relations Federal Government Department who operates the GEERS scheme, that pays the entitlements and redundancies of employees who lose their employment because of an insolvency.
GEERS	General Employee Entitlements and Redundancy Scheme. A scheme, operated by the Department of Employment and Workplace Relations, to pay the entitlements and redundancies of employees who lose their employment because of an insolvency. There are certain maximum limits that apply. http://www.workplace.gov.au then select Employee Entitlement Schemes, then select GEERS.
IPAA	Insolvency Practitioners Association of Australia An industry body of Administrators, Receivers, and similar professionals. It should be noted that, in common with most industry bodies, they look after the interests of their members, rather than the consumers their members are dealing with.
QBE	An insurance company providing various business insurance products. http://www.qbe.com.au/
Siemens	Siemens Research Ltd. In June 1999, Siemens sold a business unit that wrote and maintained a system called Capacity Integrator, a software package to record (telecommunications) network capacity, to Open Telecommunications Ltd.
Subrogation	The ability of a creditor to assign their rights to a third party (who may pay the creditor all or part of their claim) and for that third party to have their claim recognised by the Administrator.
TINA	There Is No Alternative. This is a strategy that was used by the Thatcher Government in the UK, to push through unpopular reforms and environmentally damaging road projects. I suspect other governments and some Insolvency Practitioners are using the TINA strategy.

Bibliography

Open Telecommunications Specific

- http://www.asx.com.au (Australian Stock Exchange) can be used to search for company announcements using code **OTT** (Open Telecommunications Ltd.).
- http://yahoogroups.com.au/group/otmushrooms is a web-based email list used by (ex-)employees of Open Telecommunications Ltd. It contains publicly available, searchable archives of messages. There are also some files, such as scanned images of letters and reports. No username or password is required to look at archives and files.
  The messages that circulated on the company's email list before this Yahoo list was set up have been imported into the archives.
- http://www.ot.com.au is the company's web site. It contains all annual reports, certain press releases, and other Investor Relations information.

General

These information sources contain general information applicable to the topic of company insolvency.

- http://yahoogroups.com.au/group/otmushrooms (mentioned above) contains a complete copy of the Corporations Law, and some material from the Courts dealing with other company insolvencies.
- http://www.asic.gov.au (Australian Securities and Investment Commission) for skeleton information on company insolvencies, and an on-line complaint form that can be used to complain about Insolvency Practitioners.
- http://www.workplace.gov.au is operated by the Department of Employment and Workplace Relations. Browse to that web site, then select Employee Entitlement Schemes to get information on the various schemes available.

- *A Very Public Solution*, Paul Mees 2000. Includes a description of how the TINA strategy was used by the Thatcher Government to push through environmentally damaging road projects.