Submission for Senate Inquiry into Administrators and Liquidators

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Author details

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I make this submission as a private individual, more specifically, as one who has been an employee creditor in two separate Voluntary Administrations.

Abstract

My submission examines the perceived (and actual) lack of independence of administrators and strongly recommends that ASIC runs a random or round-robin allocation of appointments to insolvency cases, with an initial allocation of **three** administrators, with creditors to choose one by vote. It also examines the behaviour of administrators from a creditor's viewpoint, and the behaviour of ASIC when creditors lodge complaints. I feel that administrators provide poor service and and that there are several improvements that should be made to the way administrators (and liquidators) discharge their duties to credotors, to make the process better for everyone involved. This submission briefly touches upon several other issues.

This submission contains two attachments:

- Attachment 1: Copy of my *Submission for Senate Inquiry into Australia's Insolvency Laws*, 21 May 2003, published by the Senate Committee as Submission 36
- Attachment 2: Copy of my *Technical Correction for previous Submission #36*.

These submissions describe my experience as a creditor of Open Telecommunications.

Terminology

For brevity I will refer to *administrators* to mean both **administrators** and **liquidators**; most of the discussion also applies to **deed administrators** and **receivers**. I only discuss company insolvencies – not personal insolvencies.

About the Author

My experience with administrators (and liquidators) comes from being a creditor in two Voluntary Administrators – Open Telecommunications in July 2002 and Mobilesoft in August 2006. Brief particulars are indicated below.

	Open Telecommunications (OT)	**Mobilesoft**
Appointment Date (day 0)	12 July 2002	21 Aug 2007
Appointeee(s)	Peter Yates/Robert Whitton	Rod Sutherland/Sule Arnautovic
Appointed by ...	Directors	Secured Creditor
Commencement of DoCA	18 Nov 2002 (129 days)	19 Oct 2007 (59 days)
Date fully paid out & percentage (employees)	9 Jan 2004 (546 days)	16 Jan 2008 (148 days)

In addition I make observations of the Swish Group Voluntary Administration which commenced in late 2002.

I also set up an email group called *OT Mushrooms*, initially for OT creditors to help each other. This was renamed as Unpaid Mushrooms and opened up to creditors of all insolvencies, and an article about this group appeared in the Business Review Weekly (*Enough! Say creditors*, p71, BRW October 21-27, 2004). Shortly after this, a Swish Group employee creditor joined the group and gave particulars of their story. This email group is still operational, but activity has vastly decreased.

In May 2003, I made a submission to the Senate Inquiry into Australia's Insolvency Laws.

Independence of the appointee(s)

The Corporations Act provides that the administrators act in an independent manner, but many creditors feel that this does not happen in practice.

Case studies

- During the OT administration, some questions were raised by creditors about the independence of the administrators, particularly as the same people had been engaged in examining the company accounts immediately prior to entering administration.
- Many OT creditors felt that the administrators were structuring things for the benefit of the company and its directors, at the expense of creditors. Comments about “cases of Grange” in exchange for favours were common.
- One Mobilesoft creditor vehemently made allegations about business links between the secured creditor (which was a private superannuation fund, and the one **who made the appointment**) and the administrators they appointed.
- The Mobilesoft directors were frozen out of the process – one was sacked, the other resigned in frustration.
- In both cases, the administrators' actions, and the final outcome, clearly favoured the party that made the appointment.

Discussion

The main issue is the method of appointment: the person(s) making the decision to enter insolvency (either the Board of Directors, by resolution, or the major secured creditor(s)) is the same person who chooses the appointee. This means that those making the appointment are likely to choose apointees who "do the right thing" (which is wrong in the wider sense). Those with a reputation of **fearless independence** are unlikely to be chosen (think: *"biting the hand that feeds them"*). In common with several submitters to the previous Senate Inquiry, I recommend that ASIC runs a round-robin or random allocation of Insolvency Practitioners to cases as notified – those making the decision to enter insolvency simply notify ASIC. This would go a long way to addressing commonly held beliefs that the administrator is favouring the directors or major creditor, to the detriment of smaller creditors.

A variation to the scheme is possible: ASIC may appoint **three** administrators; the creditors to choose one (by vote at the first meeting of creditors) with the other two earning a statutory fee, to compensate them for the analysis they did prior to the first meeting.

Benefits:

- ASIC chooses the administrators without fear or favour.
- Insolvency Practitioners know they will usually get an appointment, regardless of how fearlessly independent they were in the past
- Gives a real purpose to the first meeting of creditors: each administrator will describe their initial analysis of the company accounts (and perhaps "sell" their service to the group of creditors).
- At the first meeting, creditors now have a real choice to make. This should improve participation rates.
- Introduces some competition into the process (this is explored later).

At present, the first meeting is held on the fifth working day. It is possible to change the law to give the three administrators time to do a proper analysis (eg. hold the meeting on the **tenth** working day).

Creditor Education

While most Insolvency Practitioners send out a sheet summarising the process (of Voluntary Administration, or other process) and describing creditors' rights, the information is very scant, and in some respects, incomplete.

It is not feasible in many cases for creditors to obtain professional advice, because of cost, and most creditors will be unfamiliar with the process.

There needs to be much better education about creditors' rights. The existing information on the internet needs to be vastly expanded, and made available in print to anyone without internet access.

Some examples of what needs to be included:

- It is possible for creditors to vote to replace the administrator **at the point of voting to go into a Deed of Company Arrangement** (at the second creditors' meeting) [in addition to replacing the administrator at the first meeting – which *is* noted in the material]
- It is possible for an administrator to seek an extension of time for the second creditors' meeting (or its adjournement) from the Supreme Court – and to this day I do not even know if creditors have the right (1) to know that this has happened, or (2) to present a counter-argument to the Court.
- What does a **Deed of Company Arrangement** mean? What is allowed in a Deed of Company Arrangement? What is prohibited?
- The priorities as laid out in Schedule 8A – in simpler language, and whether this can be over-ridden in a Deed of Company Arrangement (which it was, in the OT administration).
- The possibility, that during the currency of a Voluntary Administration, a major creditor could put the company into Receivership (including the Secured Creditor, within the first 10 days). Other combinations are also possible, and should be laid out.

Poor Service

Several improvements should be made to the way administrators discharge their duties to creditors, so that creditors, already suffering from being denied payment, do not experience even more disadvantage.

Case studies

- As indicated in more detail in Attachment 1 (sections *Deloitte adds to the confusion* and *Deloitte shuts out the creditors*), service ranged from basic errors to issuing an important report late.
- Neither administrator (Deloitte or Jirsch Sutherland) provided minutes to creditors' meetings (except for one which I specifically asked ahead of the meeting).
- Both administrators provided information on their web site, but it was very scant – no answers to common questions or progress updates.
- Both administrators failed to issue the required tax forms for employees, to varying degrees.
- Further specific points are raised below, in [(double-bracketed text)].

Discussion

While I am reluctant to have Government legislate for commonsense, it appears to be necessary in this case. Recommended legislative obligations of administrators:

- Minutes to be made available for all meetings (including Committee meetings)
- An absolute requirement that all information for a meeting (reports, notices, forms) be provided five business days prior (to remove doubt – ensure this cannot be over-ridden by the Supreme Court).
- A requirement that administrators provide teleconference facilities for each meeting they hold (including Committee meetings) [(Jirsch Sutherland refused such a request)]. As technology evolves, this could be extended to video-conferencing or real-time speech-to-text-on-Instant-Messaging facilities.
- An absolute requirement on the administrator to provide correct and complete tax forms, tax returns, and Payment Summaries: (1) to account for every payment they make to employees, (2) for all periods prior to their appointment (where the company has failed or not yet furnished same), and (3) for the entire period of their appointment.
  NOTE: Missing Payment Summaries and ETP forms are a common frustration for employee creditors.
  NOTE 2: Other tax obligations also need consideration (except the actual payment of tax debt covered by the insolvency process).
  [(Deloitte did not provide an ETP form. Jirsch Sutherland did not provide a Payment Summary for salary paid prior to ther appointment. They stated the company was responsible, but it was not possible for the company to issue the forms, because Jirsch Sutherland had physical posession of the required records)].
- An absolute requirement to deduct superannuation and/or tax from payments they make to employees (and other suppliers, where applicable) and to promptly forward same to the

super fund(s) and the taxation authority/ies. This applies both to expenses (wages) incurred while trading out (ie during the term of their appointment) and for dividends to creditors (eg wages that were due as at commencement of insolvency).

- Provide advice of progress and issues being encountered at regular intervals (not just for meetings).
- Maintain creditors' contact details in a professional manner [(an address change, acknowledged, got lost in the system)], with respect for privacy.
- Maintain a *separate* public list of contact details for creditors to contact each other – with creditors to supply or not supply public contact information at their absolute discretion.

Effective use of the Internet can help enormously with the last three points. In an ideal scenario, creditors should be able to view broad details and public information, as well as be able to view personalised details **upon logging in**, and to change their contact details, lodge a proxy, lodge a claim, and send a message to the administrator (or their staff).

Fees charged by Administrators and Liquidators

While I do not believe that the fees charged by Insolvecy Practitioners is excessive, it should be noted that the usual market forces of Supply and Demand do not apply to this industry, and that those who make the decision on their appointment do not bear the economic burden of their decision (the fees come out of available company assets, at the expense of creditors and shareholders).

I believe that any attempt at pricing control (by Government) is doomed to failure.

Instead, I believe that my proposal, described earlier in this document, of a round-robin or random allocation of administrators (Insolvency Practitioners), **with ASIC assigning three administrators to any given case** will provide some competition into the process.

Under my proposal, creditors will choose one administrator out of the three (by vote), at the first meeting. This should mean that the various administrators will pitch their service to the creditors, who will make their decision on a range of factors such as:

- cost, or value for money (this will probably be one of the main drivers)
- reputation (any dodgy dealings in the past?). I would expect (given the nature of the Internet), that websites will spring up that will allow people to compare administrators, or provide comments, in a similar way to how *iSelect* plays its role in the health insurance industry, or how *Whirlpool* plays its role in the telecommunications industry.
- features of their service (do they answer their phone calls? do they make mistakes? can they view important information on their web page?)

Because there can be only one winner, adminstrators may be wary about doing any detailed analysis until after the first meeting – which would be counter-productive. It is therefore important to **set a statutory fee that should be paid to the losers**, along with some minimum hurdles they must meet to earn the fee. As an additional measure to improve the level of analysis before the vote, and as a deterrent against “stacking”, creditors should be given the option of voting **No Confidence** (that they don't like *any* of them).

The role played by ASIC

This section concerns the *enforcement* role played by ASIC.

Case study 1

Attachment 1 describes the case where Deloitte did not send an important report (section: *Deloitte shuts out the creditors*, date: 18 to 24 Oct 2003). Several people (including me) lodged complaints with ASIC about the timing of this report, pointing out that under the law, a report of this type must be included with the notice of meeting, and that this must be sent five or more days prior to the meeting. You will observe the report was sent two working days prior, with most creditors receiving it the Friday night prior to the Monday morning meeting.

This report was the *first time* that employee creditors found out the proposed payout rate of about 43%.

Most creditors were unable to seek professional advice prior to the meeting.

ASIC dismissed our complaints saying that the Supreme Court, in authorising the extension of time, implicitly stated there was no requirement for any report to be sent with the notice of meeting, and therefore the meeting was lawfully called.

I do not believe that to be the case, and to this day, I still believe that the law was broken. While this is speculative, I believe one or more of the following reasons applied:

- Lack of funding for ASIC, leading them to dismiss many complaints.
- They didn't want to “rock the boat”.
- They had the wool pulled over their eyes (of course a proper investigation would solve this kind of problem).
- A feeling that prosecution, or the reputational risks involved, is not worth it (much stiffer penalties, or a cheaper enforcement option, would solve this kind of problem).
- It's not worth it because it's such a small case (remembering that Ansett and HIH were ongoing cases at the time)

Case study 2

Several other complaints (different to my complaint above) were made, directly against the non-standard order of creditors' priorities within the OT Deed of Company Arrangement (which made the employees ineligible for GEERS assistance). As with my case, ASIC dismissed these complaints:

- ASIC initially dismissed the case,
- the complainants objected (to Ministerial level)
- ASIC then obtained legal advice, to see if anyone could be charged, ...
- ... then dismissed the complaint without explanation (it was also verbally explained to us that an FOI request aimed at determining the reasons for rejection would be denied).

Case study 3

A group of complainants (employee creditors of the Swish Group) lodged a complaint with ASIC that the Voluntary Administrator knowingly or recklessly structured the Deed of Company Arrangement so that employees became ineligible for GEERS. They were told by Catherine Whitby of the Complaints Unit that ASIC was unable to help because they 'voted for the DoCA and Trust Deed' and by doing so accepted the consequences and any resolution should best be done in Court.

The employee creditors maintain they were out-voted by trade creditors, that misleading information was given out to influence the vote, and that it is unreasonable for unpaid redundant employees to have the funds to take an administrator to Court.

Discussion

The Australian Securities and Investment Commission (ASIC) has an important role to play – amongst other things, ensuring company directors, secured creditors (usually major investors), and administrators follow the law for the benefit of all involved. It should be remembered that "legal trickery" by any of these people usually means deprivation of income to employees and other creditors.

> It can mean people being made homeless or bankrupt; it can also contribute to divorce.

Unfortunately, many creditors feel that ASIC fails to take action when required. The perception is that ASIC will not investigate complaints unless it is a high profile case like HIH or James Hardie, and even then, the penalties metted out are inadequate.

Except for the stiff penalties, including jail sentences, handed out to HIH directors, a casual glance at other cases reveals that those *downloading music* face stiffer penalties than crooked company directors:

- Several people caught downloading music tracks are facing penalties to several million dollars – usually itemised at about $50,000 to $500,000 *per track*.
- Many more music downloaders settle out of court for amounts of about $100,000.
- The crooked James Hardie directors were handed fines between $30,000 and $350,000.

If you compare the penalties against the earning power of the offenders, the difference is even more stark (several decades of wages for the music downloaders, several *hours* to several months for the James Hardie directors).

ASIC should also be launching many more prosecutions (quite possibly, several per day, rather than several per year). While some vexatious claims are inevitable, along with some complaints made without an understanding of the law (eg "Why am I only getting 5% of what I'm owed?"), other claims should be treated with merit, and many more prosecutions should be brought.

It should always be remembered that most complainants have been denied part or most of their income, and that legal action is very expensive for insolvency cases.

Conclusions and Recommendations

While Australia's insolvency law is well regarded, there are many smaller creditors who feel bewildered, shunned, or betrayed by the process of administration (or liquidation, or other insolvency procedure). There is also a widespread perception that the regulator (ASIC) does not do its job.

Summary of recommendations:

- Much better information aimed at educating employees and other smaller creditors about the process, and their rights, in detail.
- ASIC to run a round-robin or random allocation of Insolvency Practitioners to insolvency cases, with three being assigned to each case. Creditors will then make a choice of one of these, by vote, with the losers being paid a statutory fee. This has the benefit of introducing true independence into the process, as well as a degree of competition.
- A minimum set of service standards should be legislated, in the way Insolvecy Practitioners discharge their duties to creditors. This includes the provision of tax forms as required to employee creditors.
- Insolvency Practitioners should be heavily encouraged to provide information and services using the internet. This (if done well) will go a long way to solving the frustrations many creditors feel when dealing with administrators.
- Insolvency Practitioners to maintain a public list of creditors' contact details, which can be used by creditors to contact each other. **Creditors will have absolute discretion to contribute to the list;** they do not have to publicly reveal any details about themselves unless they wish to do so.
- ASIC (in its enforcement role) should launch many more prosecutions, and significantly increase penalties, to deter against illegal behaviour.