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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Australia's insolvency laws

FRIDAY, 23 MAY 2003

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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Friday, 23 May 2003

Members: Senator Chapman *(Chair)*, Senator Wong *(Deputy Chair)*, Senators Brandis, Conroy and Murray and Mr Byrne, Mr Ciobo, Mr Griffin, Mr Hunt and Mr McArthur

Senators and members in attendance: Senators Chapman and Murray and Mr Ciobo and Mr Griffin

Terms of reference for the inquiry:

To inquire into and report on:

The operation of Australia's insolvency and voluntary administration laws, including:

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

(b) the duties of directors;

(c) the rights of creditors;

(d) the cost of external administrations;

(e) the treatment of employee entitlements;

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

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

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

WITNESSES

MASON, Associate Professor Rosalind Foote (Private capacity).....1

Committee met at 10.13 a.m.

MASON, Associate Professor Rosalind Foote (Private capacity)

CHAIRMAN—I call the committee to order. This is our first public hearing in our inquiry into Australia's insolvency laws. The inquiry is to consider matters including the appointment, removal and functions of administrators and liquidators, duties of directors, rights of creditors, cost of external administrations, treatment of employee entitlements, reporting and consequences of suspected breaches of the Corporations Act, compliance with and effectiveness of deeds of company arrangements and whether special provision should be made regarding the use of phoenix companies. The committee announced its decision to inquire into these matters on 24 November last year and called for submissions to be lodged by 31 January this year. We have advertised widely in the national press. We also contacted many individuals and organisations, drawing their attention to the inquiry and inviting submissions. The closing date, as I said, was originally 31 January, but this was subsequently extended to the end of May 2003. Thus far we have received some 30 submissions, and I want to express the gratitude of the committee to all those who have assisted so far in its inquiry.

Before we commence taking evidence this morning, may I reinforce that all witnesses who appear before parliamentary committees are protected by parliamentary privilege with respect to the evidence they provide. Parliamentary privilege refers to the special rights and immunities attached to the parliament or its members and others necessary for discharge of parliamentary functions without obstruction or fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of evidence given by him or her before the parliament or any of its committees is treated as a breach of privilege. May I also state that, unless the committee decides otherwise, this is a public hearing, so members of the public are welcome to attend.

I now welcome Associate Professor Mason to our hearing. Could you please state the capacity in which you appear before the committee today?

Prof. Mason—I am from the University of Southern Queensland. I am appearing as an academic who specialises in the area of insolvency. I have not put in a written submission to the inquiry at this stage.

CHAIRMAN—As I indicated, this is a public hearing, but if at any stage you wish to give any of your evidence in private you may request that of the committee and we will consider a request to move in camera. I invite you to make an opening statement, and I am sure following that we will have some questions.

Prof. Mason—Thank you very much. As an opening statement, my comments today will be reflections upon the issues paper which was released this week. There are a number of aspects of that in which I have particular interest. It is a very wide-ranging inquiry, and I would not profess to have expertise in all the areas that are being examined by this committee.

What I would like to say as an opening statement is that insolvency is a particular area of regulation which reflects a number of interests. Typically, when an insolvency becomes public knowledge people consider creditors and those who may be the obvious ones who the press may

wish to comment upon, such as the employees, but the interests are much broader than that. In an insolvency there may be voluntary creditors, such as suppliers of the insolvent business, but there can also be involuntary creditors. I suppose that is where some of the concern for employees may arise—they are working for a business that has become insolvent and now suddenly there are entitlements owing to them which they may not receive. Creditors may be involuntary because they could, for example, have a tort claim against the particular business and that is not an obligation or an arrangement which they chose to enter into with the debtor.

Another interest, obviously, is the debtor's interest. In that, one hears quite a lot about the directors and the management, but there are also the shareholders. For example, if it is a listed company there may be a little more publicity about the concerns of the shareholders. There are third parties who will be affected, such as landlords. They may not be creditors at that point in time—all the liabilities of the business are being met—but once the company or the business goes into insolvency then their position changes.

Other interests in the insolvency are public interests. There are issues of commercial morality. Often the way in which a business has been operating has not necessarily been scrutinised by anybody external to that business until there is a liquidation, and often that is where issues of commercial morality arise and the actions of boards of directors or management come under the spotlight.

The public interest in insolvency is also one of public confidence, in that we operate in an economy in which credit is extended. There needs to be a sense that that credit will be repaid and that, if it is not, there will be an interest taken in why it is not repaid and inquiries made into that and a sense that the funds will in some way be repaid. Perhaps some of that confidence has been affected by the insolvency of insurance companies. There has been a sense that there may at least be insurance or something, but if it is an insurance company which is insolvent there may not be that sense of sense of comfort that people may have that an insurance policy will cover the situation.

In the interests in an insolvency, one should not forget the intermediaries, such as the insolvency practitioners and also the regulators. So, really, it is very much a multifaceted area of the law. That is the first point, about the interests that become apparent once an insolvency strikes.

The second point is that often the corporate and commercial concerns that have been in place while the business has been a going concern change once the business goes into an insolvency administration. Once a business is eclipsed with insolvency a lot of the assumptions made about it being a going concern get replaced. The values that are placed upon the assets et cetera then need to be seen in a different sense. The way you would try and manage that business may change. It could well have been controlled from wherever the board of directors used to make decisions or where the headquarters of the business may be. But, once it goes into insolvency, the issue of control becomes control of assets and control of access to those assets in a different sense, in which self-interest in those assets takes on a different meaning. The possibility of fraud comes into play. Often the insolvency means that there will not be enough assets to meet all the liabilities. Then it becomes a matter of placing oneself in the priority of the distribution of those assets. These factors really do change the dynamics of normal regulation of corporate and commercial behaviour once there is an insolvency.

The third point is that, because it is a situation in which there will not be enough assets to meet the liabilities and it becomes a concern as to the priority in which those assets will be distributed, insolvency is really about choice. It is about the choice of values, the choice that underpins the priorities that will be put in place. Fundamental to insolvency is that it is a collective administration. It is there for pari passu distribution—that all creditors should be treated equally—but in fact that is not the case. For example, obviously, meeting the costs of the insolvency administration needs to be a priority, or there will not be people putting themselves forward to be administrators of an insolvency. But, beyond that, most jurisdictions in the world have had at various times varying types of special priorities that are given to particular interest groups. Employees is an obvious one. Revenue has been one, but not quite so much in so many jurisdictions now. So the choices reflect the values of a particular society.

Insolvency law is embedded in the culture of a particular community, because it reflects social concerns, it reflects economic concerns and it reflects commercial concerns. It is very much integrated with other areas of law. So insolvency law cannot necessarily sit on its own. When an insolvency administration is in place, the insolvency administrator and the lawyers advising would be consulting in the context of corporate insolvency law; general corporate law, on directors' duties; property law; in a personal insolvency, perhaps family law. So many areas of law are integrated. So one of the things that should perhaps be said when looking at the insolvency laws of a particular society, and here we are looking at Australia, is that it is embedded in all of that. It is not necessarily an area where it is easy to just translate a particular response to insolvency in another jurisdiction into our jurisdiction, because of this embedding in the local culture and the integration with the other laws.

CHAIRMAN—With all of the interests that are involved in insolvency, I put to you a case of a supplier to a business that goes insolvent, where the supplier has supplied perhaps goods for use in the business or perhaps goods supplied to a trading business that is going to on sell those goods or whatever but at the time the business goes insolvent those goods have not been used and are just sitting as stock. Do you have a view on whether the ownership of those goods ought to reside with the company going insolvent or whether ownership should revert to the supplier, if they have not been paid for them?

Prof. Mason—There you have a good example of the competing interests between that particular creditor and the general creditors of that business. You would probably need to then go back to the question of how will the business be carried on and then, should insolvency come into play, the way that should be handled. It is really a of matter of how people will protect themselves. People will act in self-interest, and they will act to protect their interests in the case of insolvency. That is why insolvency law is often seen as underpinning commercial law; it is the bottom line. People will negotiate in good faith and be confident while everything is a going concern. But, depending on the advice or the care they take, they should also perhaps be considering, 'If the business does go insolvent, how can I best protect my position?' If you are talking there about goods that have been supplied then perhaps the best way—depending on the type of goods involved, obviously—would be to take back the goods themselves. That has become quite a well-known way to protect interests for suppliers—to have, say, retention of title. But a concern that I would have—

Senator MURRAY—Is that known as a 'Romalda' clause?

Prof. Mason—Romalpa clause. It is named after a case. The concern with that, however, is that that is in the contractual relationship between the business and the supplier and, if that is not in the public arena, then other people may carry on business with the firm and not be aware that, while it looks as though it is well stocked and would have assets, in fact those assets are owned by somebody else.

In 1993 the Australian Law Reform Commission issued an interim report, report No. 64, on personal property securities. One of the issues raised there was the registration of securities over personal property. Within Australia such things as retention of title clauses are not registered as such, and so other people may not have notice, or constructive notice, of their existence to be able to search; whereas, for example, in New Zealand they introduced in 2001, from recollection, personal property securities legislation. From memory, Canada may have something along those lines as well. It is because of this transparency and people being able to make an assessment about a firm that there is perhaps a concern underpinning what would otherwise be quite an appropriate thing to do, which is to negotiate the terms of one's contract with a freedom of contract. But there is an issue about whether other people are aware of that. Another issue with those sorts of clauses is that something which can take up quite a lot of time in an insolvency administration is trying to find the position of the firm as far as retention of title clauses is concerned, from what I understand.

CHAIRMAN—In the lead-up to commencing our hearings, the issue that seems to have generated most interest from a media point of view, to the extent the media has focused on this inquiry, has been the suggestion that Australia move to a chapter 11 type situation. Do you have a view on the efficacy of that approach, the United States' approach, compared with our current approach?

Prof. Mason—It is not an area of special research of mine to look into voluntary administration. My colleague Colin Anderson at the University of Southern Queensland researches in that area. But I have looked at cross-border insolvency, because an interest of mine is the CLERP 8 area. It links back, once again, to saying that one's insolvency laws are embedded in the culture of one's society and are integrated with other areas of law.

There has been comment made in the past that the English tradition—and Australia's laws have evolved from English insolvency law—and the American tradition have diverged somewhat. While not being an expert—but with some references to writers in this area who have looked at comparative approaches, which I can subsequently refer to in a written submission—it seems, to simplify the story a little, that in England the position of the banks was seen somewhat differently to the position of banks in America. In the City of London, the banks et cetera were held in high esteem; in America, for example, the banks would be much smaller organisations, state based et cetera.

Within England quite an important aspect of insolvency administration has been the appointment of receivers. So secured creditors have come in and appointed a receiver to act in their interests, and a lot of expertise has built up with the accountants, who would typically have been appointed to come in and to run the business. So there would be accountants employed as independent administrators but in that case acting in the interests of the secured creditors. So within the English tradition the insolvency practitioners have typically come from the accounting profession, and they have engaged lawyers to give them the expert advice where the law has

effect. Insolvency, a little like taxation, is an area where the accounting and the law professions very much work together, because there is so much regulation. That is one aspect.

Whereas in America it seemed that the tradition arose that the lawyers would have a much stronger role to play, because there, once you have a chapter 11, instead of needing an accountant to come in as an independent administrator to run the business, they would instead perhaps leave the debtor in possession and leave existing management in or in certain circumstances, such as in the Maxwell case, they would have brought in a person to then oversee that sort of situation. So they do not necessarily in the same way need a businessperson as an insolvency practitioner, as an accountant who has become an expert, to come into a new situation, assess it and assist with knowing the best way forward. They have been able to leave the managers in place to do that aspect, just continuing to run the business while there is negotiation, while there are discussions with creditors, while there is talk about compromises with debt et cetera.

There may be cultural differences. Wood, in a book in 1995, talked about the different approaches to insolvency. You might have some jurisdictions that are more pro-creditor and some that would be more pro-debtor. It has been said, for example, that America, with its enthusiasm for entrepreneurship et cetera, has been much more pro-debtor. If somebody has had a misfortune and a financial failure, then perhaps that goes more to bad luck and we should give the person more of an opportunity and encourage that spirit of entrepreneurship; whereas perhaps one who is more pro-creditor is more concerned with, say, the secured creditors being repaid and an appropriate realisation of assets and distribution to creditors.

Having said that, throughout a number of jurisdictions in the world in the last 10 to 20 years there has been much more of a focus on trying to rescue business rather than immediately going to liquidation, and for very good reasons. There could be within a firm some aspects that would be viable but other aspects that are not. So to go in and at least try to save that which can be saved can then continue confidence in credit. The suppliers would perhaps otherwise go into liquidation themselves or into some sort of insolvency administration if an important organisation with which they dealt went into liquidation. The employees may be able to retain their employment.

The push towards trying to rehabilitate where appropriate is, I think, to be applauded. But to necessarily go down the chapter 11 route—for the reasons I said earlier, about the fact that that it is a different culture with a lot of different and connected laws—is something which I would myself not necessarily support. My impression is that our voluntary administration scheme in Australia has been working well. There are some areas which can be finetuned, no doubt, and some of these matters are raised in the issues paper. The situation where one has independent administrators come in who are expert in the field, who are officers of the court et cetera, who are liquidators and so on, and who act in the collective interest is, I think, working well, and I would not necessarily see a reason to move down the chapter 11 track myself.

Senator MURRAY—But the core weakness in our system is the short time frame—

Prof. Mason—Yes.

Senator MURRAY—within which judgments have to be made, and the core strength of the chapter 11 approach is the longer time frame during which judgments have to be made, and when you get to very large, very complex corporations, a short time frame, in my view, cannot work in the interests of all the creditors.

Prof. Mason—Yes. As I said, there are aspects which I think could be finetuned. I think also that one cannot necessarily see that one insolvency administration fits all. Aspects of the voluntary administration scheme could perhaps work quite differently for a small enterprise, but for a large enterprise I think, yes, there are concerns, and I think the reference to CAMAC for the restructuring of large enterprises will hopefully bring forward some recommendations looking at those particular issues with large administrations such as you describe. I think that is an issue of procedure, of timing, rather than a fundamental shift away from bringing in an independent administrator to take charge of the assets, to protect the current position, to have a moratorium, to find out the situation, to make investigations and to make recommendations to creditors.

Senator MURRAY—What would happen if it were a two-stage process—in other words, you stayed with the current situation but an option was developed within it whereby a voluntary administrator could recommend then a chapter 11 type process which would then be approved? In other words, part of that early assessment would be an assessment as to whether that is the right course of action.

Prof. Mason—I am not a sufficient expert as to how chapter 11 operates, so I am operating from generalisations to a certain extent. Chapter 11 means that the business can continue on without having to have the independent insolvency administrator in place and operating it, and the current situation we have, which is the voluntary administration while the options are being assessed, can often be replaced by the deed of company arrangement in which perhaps management may once more be in charge of the business, so I do not necessarily see the difference there. I do not see that I could add to that.

CHAIRMAN—Do you think there is a need to further strengthen the independence of administrators?

Prof. Mason—I think the independence of administrators is critical to public confidence in our insolvency system and therefore also in our system of credit underpinning that. I think that there is a high degree of confidence in our administrators generally. I think the public perception after, say, the Patrick's case and the Ansett case was that these people were seen to be independent, they presented to the press as independent, they were coming in as people who would take care of the interests of everybody, and their role was to inform people. So I think generally there is quite a good perception. But it is so important to the way the system operates that if there are any concerns about the regulation of insolvency administrators that should be reviewed. I am not sufficiently an expert. I had a look at the matters raised in the issues paper, and I cannot today give any advice one way or the other on that, except to affirm that it is important and that it should be reviewed. I think there should be disciplinary procedures there for insolvency administrators that underpin a sense that they are regulated.

CHAIRMAN—In that context, are there changes that ought to be made to the provisions for removing an administrator?

Prof. Mason—I do not feel that I am sufficiently expert in that to comment on that today.

CHAIRMAN—What about the procedures for appointing administrators? Do you have any views on potential improvements there?

Prof. Mason—I think the way in which an administrator can be readily appointed by a resolution of the board of directors is a good thing. In some jurisdictions one needs to go to court to commence certain types of administrations. Here, action can be taken quickly once there is a resolution that a company is insolvent or is about to become insolvent, and I think that should remain.

As to whether there should be any additional aspects to that, I think the forces that are in play at the moment probably well balance the situation. There could be sometimes a perception that an administrator who has been appointed, though, by the board of directors is seen as siding with the directors. That is a difficulty that could arise in that situation. The directors in charge of governing a company can be in that twilight zone where the judgment about whether in fact the firm is solvent or insolvent is so difficult. It goes to whether we are talking about a going concern, where there is confidence et cetera, or about a situation where the confidence has gone and people are starting to withdraw services and to take action under contracts they have with the company. They are in a situation where the issues are so complex that they would be needing professional advice. That sense that the administrators appointed are in the interests of the collective body becomes an issue then about the quality of the insolvency administrators appointed. If they, albeit because of the system, are appointed by resolution of the board of directors yet are seen as being independent, that just emphasises how important it is that they are seen to be independent.

CHAIRMAN—What about the capacity of directors to appoint an administrator and thereby circumvent the winding up of a company?

Prof. Mason—I have seen it reported that a number of voluntary administrations do result in creditors voluntary liquidation. That says that there is something wrong with the voluntary administration scheme, that in fact it is a way of going into a liquidation other than through some of the other methods available. However, I have also heard that some of the reasons for that are that there are obligations placed upon directors under certain legislation, such as the income tax act, which require them to act promptly to protect their own personal positions so they do not become personally liable. But some of the time lines are such that if they had wanted to go straight into a voluntary liquidation, I understand, they would not have been able to do so within the terms of the statute. So the best way to protect their own personal interests is to go into creditors voluntary administration, which in itself is an insolvency administration and brings somebody in independently anyway. If it then goes into creditors voluntary liquidation, well, so be it. Perhaps that becomes an issue of looking at creditors voluntary liquidation and the procedures for entering into creditors voluntary liquidation, which, from memory, I think CASAC looked at in the past in one of its reports when it was looking at voluntary administrations a couple of years ago.

CHAIRMAN—Do you believe there is a tendency for some administrators to recommend deeds of company arrangement that have little chance of success? If so, what changes should be made to overcome that?

Prof. Mason—I could not comment on that. I guess it comes back to those interests in insolvency again: is it the debtors, is it the creditors, is there a public interest as well? There has been some debate that says that some of the arrangements that have been agreed upon really should not be agreed upon—so few cents in the dollar are being agreed upon to be repaid that one questions whether or not that is an appropriate agreement—and that somebody should do something about it. But the other side of that is that it is the creditors' money. They are the ones who have lost the funds; they are the ones who can make the commercial judgment as to whether to agree to that deed of company arrangement that is being forward. To what extent should one interfere with the creditors' ability to make those sorts of judgments for themselves in a commercial sense? I guess if there were any concerns about a public interest in a situation, the regulators may have a role in putting that position in some sense in the procedure. But I really have not given enough thought to how that would work in practice.

CHAIRMAN—Do you believe that the current method of determining fees for administrators is appropriate? Is there a better way of determining fees? Also, should there be improvement in disclosure of fees and, if so, in what way would it be appropriate for fee disclosure to take place?

Prof. Mason—There is a lack of clarity about fees. There were recommendations from the Insolvency Practitioners Association a number of years ago which have been replaced by a more general statement, so this area is a little open-ended. Once again, one could say there are procedures in place for approval of fees and that, as long as there is transparent disclosure of the basis upon which fees have been assessed et cetera, it is really up to the creditors to agree with that. But I do not consider that I know enough in that area to be able to make a comment. There have been a number of articles, references to which I could include in a written submission.

Senator MURRAY—I am glad you have a particular interest in cross-border insolvency, because I think it is an area that our inquiry may move into. The effects of globalisation and of increasing Australian exposure to overseas risk must mean greater attention to those areas. I want to start by sketching an environment for you, if I may. In the Senate there are two committees which see all bills. One is the Selection of Bills Committee, which is just a postbox through which it is determined whether the bills go to committees for examination or not. The other is called the Scrutiny of Bills Committee, and I have sat on that committee for the last seven years. I have observed that two streams of law are developing: a stream of traditional law attached to the rights of the individual, and a second stream, which I would call the law of entities, which really removes many of the rights of the individual—you have to disclose things, you may not be silent in a number of areas, there is a reverse onus of proof, and so on and so forth; all designed to get behind the corporate veil and to prevent officers of entities using corporate resources to shield the company and themselves from liability. There has also been a development of that in non-corporate law to deal with criminal organisations—conspiracy type law, law related to people like bikies, confiscation of assets and so on—and trying to get behind cohesive organisations which prevent you accessing material.

One of the real problems for us in Australia is, of course, when those types of arrangements are external to Australia. I took a particular interest in the Bond matter. I thought that Alan Bond's lies—in my view, the man is a criminal—and the way in which those lies were supported by the lies of Jurg Bollag in Switzerland, supported by Swiss law, were unconscionable. It occurred to me that we may need laws in this country whereby if somebody will not answer questions which are legitimately put to them by an administration and so on they will be deemed

to be guilty. As you know, in criminal law in certain circumstances somebody can be tried in their absence. So you would take that a step further. But these are not characteristics of our law, and Alan Bond got away with his lies and the protection afforded to him by that Swiss gentleman and his country. So I would hope that you would put a submission to us focusing on the globalisation aspects, the cross-border aspects and how in the fraudulent area of insolvency we can improve our law to get at those kinds of circumstances. So, with that broad brush stroke of my own prejudices and anxieties, perhaps you would respond.

Prof. Mason—Perhaps one of my opening statements might be something that I say to my students, which is that one cannot legislate for morality. It seems to me that often we have quite adequate laws in place; however, it could be a matter of the regulation, it could be a matter of the funding of the regulators to be able to regulate, it could be matters of laws of evidence, as you suggest. It then becomes a debate about the interests of individuals in drafting laws. In one circumstance the law may assist, because one is trying to investigate fraud and one has a sense that there is something wrong here and if only we could establish it, yet those laws may well be used against people. In fact, it could well be that, if one becomes too black letter in the drafting of laws and too specific, people who would wish to avoid the impact of that law may well, unfortunately, have 'professional' advisers who could advise them on how best to place themselves so that the law does not impact upon them and yet the law will still be on the statute books to hit the people who are in the middle, who would not have perhaps been the people for whom that would have been intended to have that ramification.

I support the UNCITRAL model law for cross-border insolvency, which is the subject of CLERP 8. The reason for that is that it really does aim at procedural matters to try and facilitate swift action, to facilitate cooperation and communication between jurisdictions, and yet it does not necessarily interfere with the rights of sovereign nations to have their laws in place which are suitable for their jurisdiction, which underpins some of the comments that I am making. Yet if there is a sense of confidence between the foreign representatives and the local representatives, between the various legal systems et cetera, it does enable action to be taken much more quickly to be able to address situations, because often it is those procedural issues that become the concern—being able to act quickly, being able to take action to protect assets which are otherwise disappearing and which can disappear so much more quickly now with e-commerce, with the click of a mouse on a computer.

Senator MURRAY—I aim not so much at legislating for morality as at trying to find better means to recover assets. The difficulty, of course, is that the assets are frequently overseas.

Prof. Mason—Yes.

Senator MURRAY—Even if you say they are yours, how are you going to get your hands on them?

Prof. Mason—Yes.

Senator MURRAY—But the Australian precedents are there. The confiscation of assets laws, which are generally state laws, I think—I do not think there is a Commonwealth equivalent—do exactly that. They say, 'Prove that you got those asset lawfully, and if you can't prove that we are going to take them away, because we think you have got them unlawfully.' That might be

quite hard on the occasional person who falls into the trap, but the community thoroughly supports that because it is principally aimed at criminals who have been able to conceal the ways in which they have unlawfully acquired assets. So we have that precedent in our law. You made the point that it is our legal and institutional culture which determines our laws. We have those precedents. My interest is how far we can go in turning those existing precedents in our law, which is why I have also indicated what I have called entity law to you, into such areas, of which the Bond example is a very good one. I would ask you if you could give some thought to that sort of proposition and, if you would find the time to make a submission on it, it would be of interest, if that is an area of your expertise.

Prof. Mason—Thank you.

Senator MURRAY—Moving on, we have insolvency laws in this country which are split. The committee are looking at corporate insolvency laws, because that is our principal interest. But the mesh between corporate insolvency and personal insolvency is often very close. I have wondered simply why there is not a single insolvency law perhaps with chapters dedicated to individuals and itinerant debtors and so on as opposed to corporates. You might even—and you perhaps implied this in your answer—look differently at major corporates and small business and medium business people. So there would be almost three grades: personal, small and medium business, and large corporate. What do you think of those sorts of comments?

Prof. Mason—I believe that the issues of insolvency are such that there is merit in having a piece of legislation which deals with insolvency. Insolvency underpins so much, and there should not necessarily be a different outcome if the business is being conducted—and we will talk here about business insolvency—as a sole trader or individuals in partnership as opposed to insolvency through a corporate entity and then typically, say, through corporate groups, which is yet another whole issue.

Section 51(xvii) of the Constitution refers to the Commonwealth having power to legislate for bankruptcy and insolvency. The corporate insolvency law really evolved much later than bankruptcy. So, in fact personal insolvency was there for the ways in which businesses operated to begin with anyway. Laws for traders were in place since the 1500s, and then the corporate insolvency law came into place in the mid to late 1800s. A lot of the early laws were actually based on and included reference back to the bankruptcy law.

So really there are, as far as I am concerned, cohesive policy reasons underpinning both. That tradition of it being in two pieces of legislation (the bankruptcy laws and then the corporate laws, and being part of company law) and the way our Constitution was drafted and our laws have evolved—the fact that bankruptcy, from the 1924 act, was a federal matter and then the others were part of state laws, with all the issues that that has brought about—I think have actually skewed things away from it being seen as, really, one fundamental issue to do with insolvency.

So I would be in favour of looking at a unified act. They have it in the United Kingdom and the United States. They have it in South Africa, where there was quite a lot of research done, and people at the University of Pretoria assisted in that process. I think that it also takes those issues of insolvency law for corporate insolvency out of the companies act, and they can be seen in a

much more holistic sense. Obviously, it is integrated with other aspects of company law, in any event, but I can see benefits in that.

Also, just looking at the culture and the ways in which it has evolved, you get behind the policy and the institutions that are in place behind insolvency within Australia. You now have personal insolvency as a matter for the Insolvency and Trustee Service Australia, which is now a senior executive service but answerable to the Attorney-General, and corporate insolvency is now within Treasury, and there is the Australian Securities and Investments Commission.

You have reasons for perhaps things happening differently, because there are different bodies involved. Creditors may be in one corporate collapse—where the company is in, say, liquidation and then you have also got trustees acting for the directors, who are bankrupt by now, for whatever reasons—yet with those professional people who would be assisting, say as a registered trustee in bankruptcy or liquidators, there may be different rules for meetings and so on. There may be lots of differences there that do not necessarily make sense and seem to be inefficient. There could be thought given to something being treated holistically as an insolvency matter, then some of those matters could be looked at differently and perhaps finetuned. But there are big issues involved in that, obviously.

Senator MURRAY—The University of Southern Queensland is said to possess particular expertise in the area of insolvency. Does that rest in you? Does it or rest in the department? Where does it rest?

Prof. Mason—We are a Department of Law in a Faculty of Business. We are also a distance education provider. We have had expertise in the area of insolvency law. Professor Andrew Keay, who is now in the United Kingdom, is a former staff member. I have been there for a number of years and have an interest in this area. Colin Anderson joined us a number of years ago and has expertise in, for example, the voluntary administration area. So you have in the one university expertise in a particular area, and once you have two people together a lot more synergies can result, and there have been other people within the faculty with whom we have worked.

The other benefit is that we are a distance education university, so we have been able to provide education within Australia, and with the population that we have and people involved in insolvency practice throughout Australia we have been able to provide a course to students around Australia. At the moment our masters courses are accredited by a professional body. We are involved with the profession, because students who are taking our courses are coming forward from the accounting profession, the law profession, banking et cetera. That is how it has evolved.

Senator MURRAY—The reason I ask that question is—apart from my hopefully successful imposition on you for a submission—I have an interest in the structure and framework that underpin the way in which we approach insolvency laws, as opposed to the content of them. Although the committee inquiry is into just corporate insolvency, it is open to us in passing to comment on whether we would be interested in recommending that the government examine the feasibility of approaching this more holistically and reforming the structure and framework along the lines that you and I have been briefly discussing. So, once again, if your mob would be at all interested in putting something forward to us on that side of things, I would be grateful.

Prof. Mason—Thank you; noted.

CHAIRMAN—We are probably going to need to wind up fairly shortly to get to Boonah on schedule. Do you have any further questions?

Senator MURRAY—No, that is all for now.

Mr CIOBO—I missed your opening comments and initial questions. I was interested, though, if it has not already been explored, to get your views on the relationship between the audit function and insolvency, to the extent that you, as an observer, are able to make comments about that. Obviously, whilst that does not have a direct impact on the mechanics of insolvency, it is very much a large precursor to insolvency down the track. I am interested in your comments on that.

Prof. Mason—I have just a couple of comments on that. The relationship between law and accounting is interesting, because one of the big issues in an insolvency matter is when was the company insolvent and, for that, one needs specialist accounting advice. So the lawyers will rely on expert accountants. Then within the expert accountants you will have accounting used for different reasons, though. You will have accounting used for external reporting, and you will have the auditors involved in that, and then you would have, say, the management accounting function, in which there is the internal accounting information. So some of the issues involved there—and perhaps you should speak with accountants about this—include the perception of the use of the information that is being gathered. I am quite interested in trying to support businesses who may be suffering some financial difficulty without necessarily being insolvent, during that twilight zone where they are trying to decide whether or not they are insolvent. They should take action, for their own personal reasons as well as for the business. So they will be operating using management accounting information. If later on the liquidator is trying to establish that the company was insolvent, that management accounting information—if it exists—may be available to put before the court in reconstructing that, yes, the company was insolvent.

That can be quite different to, say, the external reporting. From what I understand from talking with accounting colleagues, that is done for different reasons. The auditors are in doing things for a different reason and their role is a different one. Yet once insolvency strikes there is the self-interest of trying to establish as many assets as possible, because there is not going to be enough to meet everybody's claims. There is almost a sense of looking for deep pockets. The company takes action, and the liquidator comes in, and the running of this becomes quite a different scenario than the one prior to insolvency. This is one of the issues. Once insolvency strikes, a whole lot of values and things change. The emphasis changes. Not being an expert in the area, I am hesitant to say too much, but one should really be looking at the role of the auditors, at what they can be doing and what is a reasonable expectation of auditors and the audit aspect of establishing solvency, or insolvency, of a company for external reasons, as opposed to for internal management reasons.

One of the big issues that I can pick up from my students is that proving insolvency is not easy. Proof of solvency, or insolvency—which is important for insolvent trading, issues to do with directors' duties, issues to do with voidable transactions—is quite important, and yet when it comes to the actual point of establishing it before a court it becomes quite a vexed issue. One of the recommendations in the Harmer report that was not taken up, and which I believe Andrew

Keay is in support of, is a presumption about insolvency for a certain period of time back from the time of, say, the liquidation of the company. That may assist. That is a little to one side of what you are asking about with auditors, but I just wish to make that point about proving that something is insolvent. It is very important—it is very important for the liability of directors—and yet it is a grey area.

Mr CIOBO—Is there much collaboration between insolvency practitioners and, for example, the AASB when it comes to the provision of standards and those types of things that would make that retrospective, forensic type approach easier, or is that not within the confines of your interests?

Prof. Mason—I cannot comment on that, because I do not know specifically. There was a paper that an accounting colleague, Dr Anne Wyatt, and I wrote back in 1998—she is now at the University of Melbourne—in which we tried to talk about, in a corporate group context, the accounting context of proving insolvency and the legal approach to proving insolvency. Even as just an accounting academic and a legal academic talking together, we would use terms that meant one thing for her and one thing for me, and we had to clarify what we meant. In that paper we referred to some work that was being done by Loftus and Miller in looking at accounting where the issue is insolvency, as opposed to solvency. I can include those references in a submission.

Mr CIOBO—Thank you. The temptation is to focus on the high-profile insolvency actions, whereas it would seem to me that the vast majority of Australians are affected more often than not by small companies becoming insolvent and so on. Again, I would be interested in some general comments about the extent to which there is adequate education in place when it comes to directors' responsibilities. I am talking now about local schools and corporations that are set up as vehicles for those types of processes where you have, if one falls over, as regularly occurs, debtors of maybe $50,000 to $100,000, something that has a huge impact on a small business cash flow. Is there enough out there from an insolvency point of view? Again, it does not go to the mechanics, but I am interested in your perspective, because I am sure you must see errors that are repeated time and again. From a precaution point of view, I am interested in what more could be done.

Prof. Mason—Being an educator, I have an interest in these sorts of matters, and an area of research interest is consumer bankruptcy, which actually, if one is looking holistically at insolvency should be seen as a social issue as much as it is seen as an insolvency issue. But the issue with that is financial literacy. At what point should one be going back into the schools? What are the ways in which one should look at trying to educate people about the use of money? That is in a personal sense.

In a corporate sense, yes, there is the issue of perhaps looking through the corporate veil to try and make some individuals personally liable for an insolvency, and where people's claims cannot be met then they are looking perhaps to the directors. But often a director may be a director of a company only because they were given advice by their accountant that for tax reasons it may be good for them to operate their business through a company. So they are doing it for those sorts of reasons, and yet they will not necessarily have an appreciation of the legal complexities, the fiduciary obligations and all of those other things that are in place. Something that could be considered is the education of people who are going to take on being directors—

and there would be different levels, because you are talking here about small enterprises and corporate groups; there is a whole range. Nevertheless, for those people who are taking on those obligations, who we presume to know the law but do not necessarily, there should be available, accessible ways for them to have education about the ramifications, the dimensions of what it is that they are taking on.

Mr CIOBO—So that does not exist at present?

Prof. Mason—I am not aware specifically of what is in place as far as education for directors goes. There are obviously professional bodies—the Australian Institute of Company Directors et cetera—who would be looking at that. But then the people they are talking to may be those who are interested in it in a much more structured and businesslike way than a person who may be operating a small family business, who will not necessarily be tapping into that sort of resource that is available, may be.

CHAIRMAN—There being no further questions, thank you very much, Professor Mason, for your appearance before the committee this morning and for your evidence. We look forward to receiving your written submission and also perhaps following that up with a telephone link-up later in our inquiry. Thank you very much for your effort this morning.

Prof. Mason—Thank you.

Committee adjourned at 11.08 a.m.