
COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

**Reference: Australia's insolvency laws**

THURSDAY, 26 JUNE 2003

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**JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES**

**Thursday, 26 June 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, Murray and Wong and Mr Byrne and Mr Hunt

**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**

**Committee met at 4.37 p.m.**

**SELLARS, Mr Andrew Newell, Manager, Governance and Insolvency Unit, Corporations and Financial Services Division, Department of the Treasury**

**CHAIRMAN**—Today the committee continues its public hearing program into its inquiry into Australia's insolvency laws. The intention of the committee is to examine Australia's insolvency laws with a view to identifying strengths and weaknesses and to make recommendations to government on ways to improve the current legislation. The committee relies heavily on the contribution of people such as academics and lawyers specialising in insolvency law, businesspeople and government officials who understand or have experience with the operation of the law, and insolvency practitioners. Their knowledge and expertise is invaluable to the inquiry process. The committee expresses its gratitude to all of those who have assisted it so far in its inquiry.

Before we commence taking evidence, may I reinforce for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to the evidence that they provide. Parliamentary privilege refers to the special rights and immunities attached to the parliament or its members and others necessary for the 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 should decide otherwise, this is a public hearing and, as such, all members of the public are welcome to attend.

I now welcome Mr Sellars from the Department of the Treasury. This is a public hearing and so the committee prefers all evidence to be given in public, but if at any stage you wish to give part of your evidence in private, you may request that of the committee and we would consider such a request to move into camera. We have before us a written submission from the Treasury which we have numbered 14. Are there any alterations or additions that you would like to make to that?

**Mr Sellars**—No, Mr Chairman.

**CHAIRMAN**—I invite you to make a brief opening statement and then I am sure the committee will have some questions.

**Mr Sellars**—Thank you, Mr Chairman. Part of my unit's role is to provide policy advice to ministers on issues involving corporate insolvency. The importance of a sound insolvency framework has been recognised by numerous international bodies—including the Group of 22, the IMF, the World Bank and the OECD, all of whom have devoted resources to promoting sound insolvency systems. A robust and transparent system is needed to deal effectively and speedily with commercial difficulties before they spill over into the payment system and create a systemic crisis. It is also an important factor in preventing the difficulties occurring in the first place.

On Australia's initiative, the United Nations Commission on International Trade Law, UNCITRAL, has recognised the importance of sound insolvency systems in the context of

international trade and has been developing a model domestic insolvency framework. This work is now close to completion. The commission is considering a draft at its forthcoming meeting. This builds on the work done by UNCITRAL in relation to cross-border insolvency that the government is currently considering as part of the CLERP 8 project. Australia's own insolvency framework has not substantially changed since the implementation of the Harmer report. That legislation took effect in about 1993, so we have roughly a decade of experience under the new insolvency scheme.

From where we sit in Treasury, the general position is that the framework is producing good results in comparison to alternative systems adopted elsewhere. In that regard I note that New Zealand has recently completed its own survey of rehabilitation systems, including examining systems in the United States, the United Kingdom, Canada and Australia. It recently announced that it was going to adopt a model similar to Australia's.

Although we think the fundamental settings are quite good, there are a number of lesser order issues which are worthy of review. Our written submission to the committee identified a number of areas that have been considered already. I note that the commission's own issues paper identifies a number of other issues and, of course, submissions to the committee do also. I would like to add some further input to the process as best I can today and I look forward to questions from the committee.

**CHAIRMAN**—Thank you very much, Mr Sellars. In relation to the government's announcement on 14 September 2001 of the so-called 'maximum priority proposal' in which certain employee entitlements rank ahead of all other creditors including secured creditors, what is the status of that proposal given that no legislation has yet been forthcoming?

**Mr Sellars**—The Treasury produced a draft proposal. It was not a government position; it was a draft proposal that went out to consultees. The consultees have responded to that, and the government is currently considering its position in light of those representations. I think the submissions to this committee give a fair indication of the kinds of things that the consultees were saying to the Treasury.

**CHAIRMAN**—That was leading to my next question: could you advise the committee on the state of the consultations of the Treasurer after announcing the proposal. There would be extensive consultation prior to the introduction of the legislation. Can you give us an update on what stage the consultation process has reached?

**Mr Sellars**—The consultation process on the policy is complete. What is happening now is that the policy is being refined and decisions will need to be made by government on the policy. The draft legislation would then be produced and further consultations would take place at that point, but at this stage it is still a matter of settling the policy.

**CHAIRMAN**—Can you give any sort of time frame for the likely introduction of the legislation—even a ballpark date?

**Mr Sellars**—I think Senator Campbell at budget estimates said that the policy was expected to be bedded down in the next three months. I think that was the time.

**CHAIRMAN**—So, might we see legislation this year or not until next year?

**Mr Sellars**—Possibly this year.

**Senator WONG**—Has the legislation been drafted?

**Mr Sellars**—No. Some drafting work was done but, in light of the responses from the consultees, more work needs to be done.

**CHAIRMAN**—The Corporations Law Amendment (Employee Entitlements) Act 2000 was intended to discourage companies from avoiding their liability to pay employee entitlements. That legislation includes prohibiting directors from entering into arrangements that prevent them from having to pay employee entitlements and also enhances the protection against insolvent trading. That has been in operation for a little while now. Can you give us any advice as to how that law is operating in terms of any actions taken under the legislation or outcomes from court proceedings that might have resulted from the legislation?

**Mr Sellars**—I am not aware of any court proceedings that have been taken to date, but I am happy to get in contact with the Australian Securities and Investments Commission and confirm that in writing.

**CHAIRMAN**—The committee has a submission from Mr David Kerr which we have numbered 6. In that submission he expressed his view that:

> … the Object of Part 5.3A should be amended to clearly state that the continuation of the company's business is a secondary objective to providing a better return to the company's creditors than an immediate winding up of the company.

Can you give us your interpretation of part 5.3A and whether that objective is already incorporated in that clause?

**Mr Sellars**—Part 5.3A is essentially about two things. Preserving the business is an important objective but not at any cost. If a business is not viable, I think the general opinion is that a better outcome is that the resources be directed elsewhere. Part 5.3A gives an opportunity for a business to be rehabilitated but the final decision is really one for the creditors to make. In the operation of that part of the law, the experience has very often been that creditors will support a rehabilitation plan, so I think the objectives in that sense are being met. It was never envisaged that part 5.3A would be a panacea so that anybody who goes into voluntary administration would somehow, by virtue of the legislation, come out the other side being a viable organisation—some are just not viable.

**CHAIRMAN**—Another issue that has been raised with us is directors waiting until the last minute before a winding up application is heard to appoint an administrator. Some of the submissions that we have received have suggested that the appointment of an administrator in those circumstances should be prohibited or only be allowed with the permission of the court. If the law were altered, can you foresee any difficulties in making the provision that, once a winding up application has been filed, the voluntary administrator could only commence with the leave of the court?

**Mr Sellars**—A voluntary administration allows a period of 30 days et cetera and then the company can go into winding up from there if the creditors so decide. In relation to the ability of companies to commence a voluntary administration after an application has been filed, that was an issue that was looked at quite carefully in the general insolvency inquiry known as the Harmer report. I accept what Mr Kerr says in his submission, but it is not something that has been raised as a major problem with the operation of the scheme that I am aware of.

**CHAIRMAN**—The tax office has expressed concern that public confidence in the voluntary administration process may be being undermined by a perceived absence of impartiality. It is suggested that consideration be given to a roster system under which administrators would be appointed on a random basis. Are you aware of any problems—or perceived problems—with the independence of administrators?

**Mr Sellars**—Yes, that has been raised. In fact, the Corporations and Markets Advisory Committee, formerly known as CASAC, produced a report on the voluntary administration scheme. I do not have the year of that report—I think it was a couple of years ago now—but I do have a copy. Independence was something that they looked at and made some recommendations on.

As to the roster system, I would just note for the committee's benefit that at one point a roster system was used for the appointment of official liquidators in various jurisdictions around Australia. In the report on the regulation of corporate insolvency practitioners, it was recommended for various reasons, including competition, cost and so forth, that a roster system is not the most appropriate way to go. I just note that for the committee's information. The CASAC recommendations regarding independence include things like statements of independence being made and enhancing the ability of people to change administrators. There is already a facility for creditors to change administrators on the first meeting of creditors, which is at five days from the appointment. The purpose of that meeting was to address concerns on the part of major creditors about independence. That is really the only purpose of that meeting.

**Senator MURRAY**—As you are probably well aware, Mr Sellars, with the corporate governance debate, independence used to be taken as a sort of adjective. You need people with independence and people should be independent directors, but there was never a definition of independence. The Joint Committee of Public Accounts and Audit had a look at this area and said it is the starting point which is a problem—if you are going to talk about independence, you need to define what independence means. I have noted that the various associations, professions and organisations are looking at the issue of independent directors, for instance, and independent auditors and are starting to define what independence means. I am not familiar with the CAMAC report and the work they did, but have they actually specified what it means to be independent in this area?

**Mr Sellars**—No is the short answer. Defining independence in any area is difficult. But I think what could be done is to give an indicative list of issues that could be addressed in a statement.

**Senator MURRAY**—What is emerging is an interest in those dealing with this not to prescribe it precisely in black-letter law but to allow the regulator—which in the case I am talking about is ASIC and sometimes the ASX routes regarding disclosure rules and so on—to

give indications as to what constitutes independence in particular circumstances. But you have to be careful with a tick the box approach. At least the black-letter law needs to lay the essential foundations. My interest in this in our report is that we would choose to do such a thing.

**Mr Sellars**—My recollection—and I think I will need to go back and check—is that the Insolvency Practitioners Association of Australia may have released some kind of a practice note or guidance note in relation to independence. I am afraid I did not bring a copy of that with me.

**Senator MURRAY**—Just staying on this point for a moment, who is their oversight body?

**Mr Sellars**—They really sit underneath—if I could put it that way—the major accounting bodies.

**Senator MURRAY**—But who is the regulator that has regard to what they do? Is there a regulator that has regard to what they do?

**Mr Sellars**—The Australian Securities and Investments Commission are what we would describe as the regulator in relation to corporate insolvency matters. They would have an interest in what the IPAA is doing.

**Senator MURRAY**—If, for instance, this committee were to recommend—and I am not presuming they will because we have to discuss it—that there is a bedrock of attention in the act to the issue of independence which ASIC should substantiate more—and they can change it with experience and they would develop it in conjunction with the industry or the industry would develop it and have it ticked off by ASIC—would Treasury have an instinctive revulsion from that approach, or would you think that would be a helpful way to go?

**Mr Sellars**—I think the general approach would be mainly along the lines of what you were saying before, that the tick-a-box approach in this area is not really appropriate—so long as the general approach is that, as in other issues, the decision should be ultimately one for those who are affected.

**Senator MURRAY**—What worries me with proposals like roster proposals and so on is that they do not suit every occasion, particularly where you need specialist expertise for particularly difficult businesses to run or manage. You might not be able to find the appropriate people around. Therefore, it seems to me that you need a flexible system but one which has a very clear set of guidelines which determine what independence is and how you must conduct yourself independently. I cannot see an act doing that, but I can see a regulator being able to do that with a practice note, guidelines note or whatever it is.

**Mr Sellars**—The approach that has been used on similar issues is one of relying primarily on disclosure—to regulate what must be disclosed and maybe listing the types of issues that one would want creditors to find out about, rather than have a list of relationships that are prohibited and then take a range of administrators out of the potential market.

**Senator MURRAY**—I do not think they are going the route you are suggesting in the corporate governance debate, because they are actually indicating the circumstances in which you are not independent. If you look at the ASX material, the ASIC material, IFSA and the

various people looking at it, they said, 'In these circumstances you would be best not to be part of it.' So there are genuine examples given of cases which could be lineball and they indicate on what basis you would not be independent.

**Mr Sellars**—Certainly, but I think the point I was getting at was slightly different in that those guidelines are not a prohibition. They are identifying areas of potential concern and making recommendations, but they do not go so far as to say, 'If you are a person with this kind of relationship, you are prohibited from doing this kind of activity.'

**Senator WONG**—Mr Sellars, what could you point to in the current legislative and regulatory framework which ensures the independence of administrators?

**Mr Sellars**—The main device is the first meeting of creditors. But as CAMAC has recommended, with respect to the information getting to creditors about the administrator that has recently been appointed, there is not much information getting to them.

**Senator WONG**—That assumes a certain level of knowledge of the person appointed in the creditors, doesn't it?

**Mr Sellars**—Indeed.

**Senator WONG**—And assumes a certain disclosure from the administrators.

**Mr Sellars**—Yes. It relies on the creditors concerned knowing a bit about the background of the person who has been appointed. Recommendations for reform include things like statements of independence being signed off by the person appointed and that kind of approach.

**Senator WONG**—In one of the submissions—and I think this has been referred to—there has been a suggestion that there should be a statement of personal interest tabled at the first meeting of creditors to deal with the issue you flagged. What is your view about that?

**Mr Sellars**—I think that is a suggestion worthy of consideration.

**Senator WONG**—What about entry requirements or qualification requirements for registered liquidators? We have had some suggestions from the IPAA—whom you referred to earlier—that there should be some entry requirements before one could be registered as a liquidator.

**Mr Sellars**—There already are entry requirements.

**Senator WONG**—I suspect that they are arguing for slightly more exacting requirements.

**Mr Sellars**—To raise the bar, yes. I suppose that the considerations with that would include whether, by doing that, the cost of restricting the market is going to outweigh the benefit or not.

**Senator WONG**—When were these current requirements first developed and when were they last reviewed?

**Mr Sellars**—They were developed when the scheme came into effect, and I think the actual bill was introduced in 1992. They were reviewed as part of the 1997 review that I mentioned before—the Review of the Regulation of Corporate Insolvency Practitioners.

**Senator WONG**—Those recommendations have not been picked up yet, have they?

**Mr Sellars**—Those recommendations have not been implemented yet, no.

**Senator WONG**—Have any of the recommendations in relation to entry requirements for registered liquidators been implemented?

**Mr Sellars**—No.

**Senator WONG**—None at all, from 1997?

**Mr Sellars**—No.

**CHAIRMAN**—Are there provisions in the current legislation to ensure that administrators are not placed in a conflict of interest situation? For instance, the Law Council have suggested that administrators should table a statement of personal interest at the first meeting.

**Mr Sellars**—There is nothing equivalent to that in the current law.

**CHAIRMAN**—Would there be any difficulties with that requirement being part of the law?

**Mr Sellars**—I think the only consideration would be issues like compliance costs and so forth. It is a disclosure tool.

**CHAIRMAN**—Another issue that has been raised that also relates to independence is another suggestion from Mr Kerr's submission about the inclusion of a code of ethics for administrators in the corporations regulation similar to what applies in Canada's bankruptcy and insolvency legislation.

**Mr Sellars**—I am afraid that I am not familiar with the Canadian code. I do know that the IPAA does release various guidance notes and so forth, but they are not linked to the law in any way. I gather that what he is suggesting is to somehow have them brought up into the law and become legally binding. With things like ethics, it could be problematic to make them in a legally binding form.

**CHAIRMAN**—We have also had suggestions that the circumstances in which creditors can replace an administrator are too restricted. Are you aware of criticism from creditors in that regard?

**Mr Sellars**—Yes. That is also something that was considered by the CASAC report.

**CHAIRMAN**—Would you accept that there are difficulties in creditors being able to effectively use the avenues currently open to them to appoint an administrator who is one of their choice?

**Mr Sellars**—The criticism of the first meeting is that the time frame is very short—it occurs five days after the appointment and many creditors may not have the opportunity to assess the merits of the appointee in that time. There is an opportunity to reassess but only at the end of the administration period. The suggestion that there should be more opportunity has been considered by CAMAC and I think it is worthy of consideration. The only consideration that I would note is that, if administrators are allowed to be changed too often, there is a concern about the repeating or doubling up of work and costs.

**CHAIRMAN**—There is also the issue of whether the creditors should have the opportunity to appoint a liquidator when a company moves from an administration into liquidation if they are not happy with the performance of the administrator. Do you think that is a change that could be made efficaciously?

**Mr Sellars**—I think that is the sort of thing that is certainly worthy of consideration, yes.

**CHAIRMAN**—That is all the questions I have in terms of the independent appointment of administrators.

**Senator WONG**—I just want to clarify that—I thought there was a provision in the legislation, once you move into liquidation, for the creditors to agree to a change of person from the administrator to liquidator.

**Mr Sellars**—That is at the end of the administration period, yes.

**Senator WONG**—I just misunderstood your answer.

**Mr BYRNE**—In terms of the administrators, have Treasury looked at the costs that administrators are charging as a rule? Have they looked at whether or not those costs—when it is in the period of administration—may actually affect the future running of the company or the potential salvaging of the company?

**Mr Sellars**—Cost was one of the key considerations when the Review of the Regulation of Corporate Insolvency Practitioners was conducted. In terms of what can be done about the costs, it is a difficult issue and involves consideration of things like the market for the services of insolvency practitioners generally.

**CHAIRMAN**—Do you agree with the Law Council's suggestion that:

Administrators should disclose the "past and projected fees" at the first meeting and provide details of fees (present and future) with the notice of the second meeting.

**Mr Sellars**—The recommendation of the review I mentioned before was along the lines of encouraging innovative approaches to fee setting, including things almost like a tender process rather than the traditional approach of an hourly charge. The criticism has been that the hourly charges are not all that informative if the creditors do not know how many hours are going to be charged. So the approach taken in that review was to encourage different methods of fee setting. The difficulty in this area is that the claim by the administrators is that you do not know what the job is until you are well into the job. That is something that is a problem.

**Senator WONG**—Legal practitioners say that too, and they have had to try to become a little bit more precise about what a particular thing might cost at different stages of litigation.

**CHAIRMAN**—Another issue that has been raised is the time frame. I think we have already had some reference to that this afternoon, particularly in regard to the meetings and reporting obligations of the administrators. There has been concern expressed that administrators may not properly examine and report in the time frame that is allowed, thus defeating the purpose of the independent examination. Are you aware of these concerns about time frame?

**Mr Sellars**—Yes. The countervailing concern is that the job expands to suit the time available. In general, I am aware of those issues but I am also aware of senior practitioners saying that it is very difficult—especially in a large, complex administration—but there is an opportunity to go to the court and seek an extension of time in appropriate circumstances, and it can be done. That is not to say that there is no case for extending the time period by some extent, but it was a key objective of the voluntary administration to set deadlines and have fairly short deadlines so that the procedure did not blow out into a costly and lengthy exercise.

**CHAIRMAN**—Would the suggestion from the Ernst and Young submission be helpful—that creditors should be allowed to decide the length of the convening period at the first meeting of creditors or subsequently by resolution, rather than going through the court process to do that?

**Mr Sellars**—One of the key objectives was to have some kind of firm deadline. So, if the suggestion is that there is no limit to what the creditors can decide, that may be a concern from the point of view of having some certainty on the part of all parties going into the regime. That is one big advantage of the voluntary administration scheme over alternatives—at least the parties, particularly secured creditors, have some certainty as to when the process is going to end.

**CHAIRMAN**—The ATO has suggested that administrators and liquidators faced with incomplete records are prevented from providing creditors with a full and complete assessment of the company's financial position and potential recovery of preferential payments. The tax office has suggested that administrators and liquidators should be required, if necessary, to reconstruct company accounts to a standard sufficient to facilitate the performance of their duties under the act. Can you perhaps explain for us the extent of the obligation placed on administrators and liquidators to furnish a full and complete assessment of the company's financial position?

**Mr Sellars**—The obligation as set out in the law is to advise creditors at the end of the administration period whether the company should be placed back in the hands of the directors because there is no problem—that rarely happens—or whether it should be wound up or go into a deed of company agreement. There are reporting obligations that go along with that. I cannot give you the exact details of those reporting obligations right now, but I am happy to go back and highlight them.

**CHAIRMAN**—I do not think we need to do that. Who deems such a report to be adequate?

**Mr Sellars**—If the creditors think that it is inadequate then they would be able to approach the court. The situation would arise most often I suspect that, where a deed is recommended on the basis of perhaps information that is inadequate and one or more creditors feels that the

information was inadequate, there is provision in the law to approach the court and challenge the deed.

**CHAIRMAN**—So it is at the creditor's initiative but is determined by the court.

**Mr Sellars**—Indeed. So the creditor has to take the initiative.

**CHAIRMAN**—Again looking at time frames, I think it is the Bankers Association which, in their submission, suggested an amendment to confer an express power on the court to extend the time in which the administrator could convene the first meeting.

**Mr Sellars**—Yes. As I said, a number of concerns have been raised about the convening of the first meeting. It is probably fair to say that it was never envisaged that every creditor would be able to attend that first meeting. Its purpose was really to allow an opportunity for a choice which was clearly inappropriate to be reversed at an early stage. The early stage was important to minimise the amount of work that needed to be redone.

**Senator WONG**—Going back to the maximum priority proposal, I may have a poor recollection of your answers but I think you indicated that it was not government policy; it was a Treasury paper. Is that right?

**Mr Sellars**—It was a Treasury paper based on—

**Senator WONG**—It was a policy announced at the election, wasn't it?

**Mr Sellars**—Yes.

**Senator WONG**—So is it still official government policy?

**Mr Sellars**—Yes.

**Senator WONG**—Who precisely has carriage of it? Is it the parliamentary secretary or the Treasurer?

**Mr Sellars**—It is the Treasurer, and the parliamentary secretary is involved.

**Senator WONG**—You indicated that you did have a round of consultations. What sorts of organisations were consulted about that?

**Mr Sellars**—In summary, employer groups, employee groups, lenders and professional organisations such as the Law Council and the Insolvency Practitioners Association.

**Senator WONG**—Which sorts of employee groups?

**Mr Sellars**—The Australian Council of Trade Unions.

**Senator WONG**—Is it the case that the parliamentary secretary was not satisfied with the first round of consultations and commissioned a second round?

**Mr Sellars**—That is correct.

**Senator WONG**—When did that occur?

**Mr Sellars**—Early this year.

**Senator WONG**—What was the concern?

**Mr Sellars**—The concern was that the first round of consultations raised a number of concerns. It was felt that there should be more input.

**Senator WONG**—What sorts of concerns were raised?

**Mr Sellars**—About the proposal?

**Senator WONG**—Yes. That resulted in the need to commission a second round of consultations.

**Mr Sellars**—I think the concerns are reflected in the submissions that this committee has received from people like the Australian Bankers Association and so forth.

**Senator WONG**—Are you able to give me a thumbnail sketch of some of them?

**Mr Sellars**—The nub of the concerns was the possible impact of maximum priority on the price of credit and the accessibility of credit.

**Senator WONG**—So investment certainty issues—that secure creditors are not going to want to lend?

**Mr Sellars**—That is the nub of the concern.

**Senator WONG**—Do you think there is merit in that?

**Mr Sellars**—I think that is really a question of policy.

**Senator WONG**—Is it your section in Treasury that has got carriage of the second round of consultations?

**Mr Sellars**—Yes.

**Senator WONG**—Are they currently under way or have they been concluded? What has happened?

**Mr Sellars**—They have been concluded.

**Senator WONG**—Who was consulted in the second round?

**Mr Sellars**—The same group.

**Senator WONG**—But did the questions differ?

**Mr Sellars**—No, it was more seeking some further input.

**Senator WONG**—What further input was there that you did not get in the first round?

**Mr Sellars**—When the first round of consultations was conducted, we had round table discussions. A second round was convened where groups were invited to make further submissions and so forth.

**Senator WONG**—Independently of each other?

**Mr Sellars**—Yes.

**Senator WONG**—Is the proposal that was circulated for consultation the second time round the same as the first time, or has that been altered as well?

**Mr Sellars**—There was only ever one proposal paper.

**Senator WONG**—I think you said those consultations have concluded. Is that right?

**Mr Sellars**—Yes.

**Senator WONG**—And has a further report gone to the parliamentary secretary?

**Mr Sellars**—The parliamentary secretary and the relevant ministers are considering the results.

**Senator WONG**—But the reports are there?

**Mr Sellars**—Yes.

**Senator WONG**—From Treasury?

**Mr Sellars**—Not the final report. A report on the consultations has been provided.

**Senator WONG**—The second round of consultations.

**Mr Sellars**—Yes.

**Senator WONG**—Is any other department involved in these consultations? Is DEWR involved?

**Mr Sellars**—Yes, DEWR and the Office of Small Business.

**Senator WONG**—I understand that there was a bill in relation to this issue that appeared on the government's legislative program in the autumn sittings but that it has been removed from the list. Can you indicate why that occurred?

**Mr Sellars**—It became clear that further policy work needed to be done and that the bill would not be ready for the winter session.

**Senator WONG**—So is it still government policy to proceed with the maximum priority proposal?

**Mr Sellars**—I think Senator Campbell said as much in the budget estimates session.

**Senator WONG**—Has Treasury been asked to do any costings of any alternative arrangements, than this proposal, for ensuring or maximising employee entitlements?

**Mr Sellars**—We are not doing any detailed costings on other arrangements at the moment.

**Senator WONG**—You have not explored, for example, the possibility of trust funds or insurance schemes?

**Mr Sellars**—My recollection is that a discussion paper on those sorts of issues was released some time ago, but it is not a Treasury discussion paper.

**Senator WONG**—Were you involved in preparing the DEWR discussion paper?

**Mr Sellars**—We received it.

**Senator WONG**—You were not involved in preparing it?

**Mr Sellars**—No.

**Senator WONG**—Have you made a response to it?

**Mr Sellars**—I am pretty sure that we would have given comments, but that was some time ago now.

**Senator WONG**—When are we talking about?

**Mr Sellars**—I think those questions should be directed to DEWR.

**Senator WONG**—I am asking about the Treasury end of it. I am trying to work out when you might have responded to this position paper.

**Mr Sellars**—It would have been after it was released, but I am afraid that I am not sure of the dates. I am happy to take the question on notice.

**Senator WONG**—Yes, if you could. Was it before or after these consultations in relation to the maximum priority proposal?

**Mr Sellars**—Before.

**Senator WONG**—We are probably talking about last year.

**Mr Sellars**—Yes.

**Senator WONG**—Does Treasury have a view about the viability of, for example, a trust fund arrangement as opposed to a maximum priority approach?

**Mr Sellars**—Again, I think these are now questions requiring comments on policy matters.

**Senator WONG**—You do not have a view on that?

**Mr Sellars**—I think that is a question of policy.

**Senator WONG**—As I understand it, the GEERS scheme is funded out of consolidated revenue, isn't it?

**Mr Sellars**—Yes.

**Senator WONG**—What would occur if we had another very large corporate insolvency such as the Ansett collapse?

**Mr Sellars**—I am not sure that I understand the question.

**Senator WONG**—The point is that, if you had another major corporate insolvency in Australia, under the GEERS scheme you would have to fund that out of consolidated revenue, wouldn't you?

**Mr Sellars**—Yes.

**Senator WONG**—Or, alternatively, impose another levy on something.

**Mr Sellars**—I am sorry, I am afraid that the question is unclear.

**Senator WONG**—Now that we have had the Ansett insolvency, have Treasury looked at what the liability would be for government if we had another major national corporate insolvency—given that the GEERS scheme exists now?

**Mr Sellars**—Not that I am aware of.

**Senator WONG**—In regard to CAMAC, I understand that in the estimates process there was some discussion about CAMAC's consideration of chapter 11 in the United States?

**Mr Sellars**—Yes.

**Senator WONG**—And there is a discussion paper that is due out. Is that right?

**Mr Sellars**—Yes. CAMAC is about to release a discussion paper, but I am not sure of the timing.

**Senator WONG**—Is Treasury involved in preparing that?

**Mr Sellars**—We are not involved in preparing that, no. CAMAC is an independent agency.

**Senator WONG**—Do you make submissions or consult with them or do they consult with you?

**Mr Sellars**—We have had discussions with the secretariat, and an officer of Treasury attends meetings as an observer.

**Senator WONG**—Is there a proposal to import some of the chapter 11 approach?

**Mr Sellars**—As I understand CAMAC's current approach, there is no proposal to import chapter 11 wholesale, but it is looking at some elements of chapter 11 with a view to determining whether any of those elements might enhance the Australian system.

**Senator WONG**—Would that include the directors of the particular company remaining in control of the company?

**Mr Sellars**—I am not sure of the details of their considerations.

**Senator WONG**—Going back to the independence of administrators, in an answer to a question from Senator Murray you said that it is not an area where you would consider a ticking the box approach to be appropriate, but I think you did express that there was some benefit in trying to have some sort of legislative mechanism to ensure the independence of administrators.

**Mr Sellars**—That is certainly a view that has been expressed by a number of parties.

**Senator WONG**—Yes. How would we go about doing that?

**Mr Sellars**—I think the CAMAC recommendation talked about a statement of interest, something along the lines of the Law Council suggestion, to mandate that being provided to creditors so that they can then make an assessment about whether they are happy enough to continue with that administrator, notwithstanding their other interests.

**Senator WONG**—Do you have a view about the benefit of having a regulatory body policing some sort of broad requirement as to independence being inserted in the act?

**Mr Sellars**—When you say policing—

**Senator WONG**—For example, one option might be to actually have some sort of broad statutory requirement for independence and have ASIC as the regulatory body that ensures that is the case.

**Mr Sellars**—I think that what goes with a requirement for independence is some kind of prescriptive rule that says, if you are in this kind of relationship, then you cannot be an administrator for this type of company. As I understand the CAMAC recommendations, they are not going that far. What they are saying is, you must disclose all of your potential conflicts but then the decision is left to creditors, so in terms of the policing role—

**Senator WONG**—You are still left with the creditors, then, aren't you?

**Mr Sellars**—It then becomes the creditors' decision.

**Senator WONG**—They may not have the wherewithal to actually police it, to use the term.

**Mr Sellars**—Well, they have the choice of whether to continue with the administrator or not.

**Senator WONG**—What about if you had a requirement that ASIC be satisfied as to the independence of the administrator and left it at that and then Senator Murray's suggestion of having some sorts of guidelines developed with industry?

**Mr Sellars**—I think requiring ASIC to be satisfied of the independence of every administrator in every appointment would raise issues in terms of costs and such.

**Senator WONG**—But you would agree that leaving it totally in the hands of the creditors to determine independence has some limitations, wouldn't you?

**Mr Sellars**—If the disclosure is adequate—

**Senator WONG**—You don't see any limitations, provided disclosure is adequate?

**Mr Sellars**—One of the options would be to allow creditors who were dissatisfied to take some action or make some representations to a court or the regulator. I think an up-front kind of independence vetting may be problematic.

**Senator WONG**—Thank you.

**CHAIRMAN**—CPA Australia has raised the issue that one of the primary functions of a liquidation is to investigate the financial affairs of the company and to examine the conduct of its officers and to report to ASIC. It states:

There are many instances where the report and examination is constrained because the company is bereft of funds.

CPA Australia states:

In the current climate where ASIC has limited resources and the incidence of assetless companies is quite high the absence of a fund for this purpose—

that is, a proper examination of company affairs and conduct of its officers—

leaves the system open to abuse by unscrupulous parties.

Can you explain how the examination of the affairs of assetless companies is funded? Is there a danger that, because of a lack of funds, the affairs of such companies and the conduct of their officers may escape proper scrutiny?

**Mr Sellars**—This is an issue that has been around for quite some time. It was considered in the Harmer report in 1988 and I think it is an issue that most countries face. We do not currently have any fund for funding assetless administrations. The system some years ago depended on the roster system, so it was based on the idea that insolvency practitioners take the good with the bad and that they will be appointed on a roster basis and then they may get one profitable administration but also accept unprofitable administrations.

For various reasons that system has now been abandoned in favour of a system which allows, primarily, creditors to choose the external administrator that they feel will do the best job in the circumstances, based on things like costs and so forth. The suggestion that a fund be established was also brought up in the review conducted in 1997, titled the *Review of the regulation of corporate insolvency practitioners,* but to date that has not been implemented.

**CHAIRMAN**—The tax office has suggested that the voluntary administration scheme is open to abuse and that too many non-viable deeds of company arrangement are being accepted. Do deeds of company arrangement provide a loophole for the avoidance of debt?

**Mr Sellars**—For the avoidance of debt?

**CHAIRMAN**—Avoidance of paying debt.

**Mr Sellars**—I think the short answer is that deeds of company arrangement in themselves do not do that. But I note the tax office's concern that perhaps in some cases deeds are entered into when really there should be a liquidation entered into, because the company is simply not viable. In that regard, I think the issue comes back to some of those issues we mentioned before in relation to the quality of the information provided to creditors at the end of the administration.

It is interesting to note that the proportion of companies entering deeds of company arrangement is actually declining, which may reflect a greater scrutiny by creditors—giving more rigorous consideration to the actual viability of a deed of company arrangement. From the numbers, it appears as if the number of deeds being accepted is actually declining from the position it was when the scheme was first introduced, when roughly half of companies found themselves in a deed. It has now declined—according to the ASIC numbers—to around the 20 to 30 per cent mark.

**CHAIRMAN**—In the provisions dealing with inappropriate transfer of property before liquidation, is it necessary for there to be a finding of insolvency before property can be

recovered—for example, for uncommercial transactions? If that is the case, could you remove that requirement from the law without injustice to the parties involved?

**Mr Sellars**—It is a requirement that there is insolvency. To remove it, I think there would be a prospect of injustice to some parties.

**Senator WONG**—Uncommercial transactions, you are talking about?

**CHAIRMAN**—In relation to uncommercial transactions?

**Senator WONG**—Yes. Are you suggesting that, even in relation to uncommercial transactions, you think that there would be unfairness?

**Mr Sellars**—The uncommercial transaction rule requires a number of factors to be met, including insolvency. There are a number of options in this regard in terms of time frames and so forth. But one of the key issues—or one of the key policy drivers—has always been that companies should be free to deal with its property until the point is reached where the company could do damage to its creditors by taking those steps.

**Senator WONG**—I understand that, but isn't that an issue of judgment? Surely, if a transaction falls within the general definition of 'uncommercial transaction', an administrator could come to that view prior to insolvency being arrived at. The fact that you could deal with it earlier might give some justice to other creditors. Isn't that a possibility?

**Mr Sellars**—I think you are right; it is matter of judgment. You are making judgments about up-front certainty versus the interests of creditors at the end of the day. I am just explaining that the policy to date has been that there needs to be insolvency.

**Senator WONG**—As I understood it, Senator Chapman's question is: do you think there would be circumstances in which you could remove the requirement for a finding of insolvency without injustice to the parties?

**Mr Sellars**—I am sure that in some cases, arguably, that would be just. But in some cases, arguably, it may not be.

**Senator WONG**—To define that line, would you need the administrator to come to a certain view about the transaction at a point in time prior to the insolvency?

**Mr Sellars**—There would be issues about how to define 'uncommercial'.

**Senator WONG**—There are now.

**Mr Sellars**—I am suggesting that if you take the insolvency requirement away there may be a need to consider what you would use to replace it.

**Senator WONG**—To replace the definition of uncommercial transaction or to replace the definition of insolvency?

**Mr Sellars**—No. If you take the element of insolvency out of 'uncommercial transaction', it becomes a very broad provision.

**CHAIRMAN**—Would it improve the law on directors' duties if the law explicitly recognised a general duty on directors to have regard to the interests of creditors and employees when a company is in financial stress?

**Mr Sellars**—The general position at the moment is that, as a company approaches insolvency, directors need to have regard to those things. You would be aware that there was an amendment in 2000, I think, in relation to employees, which could potentially give rise to liability on the part of directors where they fail to have regard to those interests. I am not sure about an explicit law that they must have regard to them. I think it would be more in the nature of a codification of what the general common law position is.

**CHAIRMAN**—Can you tell us what stage the government is at in regard to the Cole royal commission recommendations on fraudulent phoenix companies?

**Mr Sellars**—The response is still being finalised.

**CHAIRMAN**—My other question is in relation to adopting a 'debtor in possession' business rescue regime similar to America's chapter 11 provisions. On 6 June at the budget estimates the executive director of the advisory committee indicated that he was looking at possibly adopting some of the features of chapter 11 either as an alternative to part 5.3A or as an addition to it. Subsequent media reports have indicated that the Treasurer has decided to introduce a 'debtor in possession' business rescue regime. Has a decision been made on that issue?

**Mr Sellars**—I am not aware of any decision having been made on that issue.

**CHAIRMAN**—There are a number of issues that were raised in the ATO submission. Would you be happy to take those on notice?

**Mr Sellars**—Certainly.

**CHAIRMAN**—Thank you for giving evidence before the committee today.

[5.40 p.m.]

**CONNELL, Ms Jenet, Group Manager, Workplace Relations Services, Department of Employment and Workplace Relations**

**LLOYD, Mr John, Deputy Secretary, Department of Employment and Workplace Relations**

**MAYNARD, Mr Michael Charles, Assistant Secretary, Employee Entitlements Branch, Department of Employment and Workplace Relations**

**CHAIRMAN**—I welcome officers from the Department of Employment and Workplace Relations. The committee prefers that all evidence be given in public as this is a public hearing. If at any stage you wish to give part of your evidence in private, you may request that of the committee and we will consider such a request to move in camera. I invite you to make an opening statement, at the conclusion of which we will move to some questions.

**Mr Lloyd**—The department welcomes the opportunity to address the matters raised in the committee's issues paper relating to the government's employee entitlements safety net schemes. Prior to the implementation of its employee entitlement safety net arrangements the government considered alternative approaches, issued a discussion paper in August 1999 and called for submissions. The government's safety net arrangements were implemented following that process.

It is government policy that employers are and must remain responsible for meeting the costs of their employee entitlements. The means by which employers provide such protection for employee entitlements is a matter for the employer. However, as part of its social safety net the Commonwealth government has implemented employee entitlements safety net schemes to compensate eligible employees for specific entitlements left unpaid due to their former employer's insolvency. The GEERS scheme provides financial assistance equivalent to all unpaid wages, annual leave, long service leave, pay in lieu of notice and up to eight weeks redundancy pay.

As at 25 June 2003 in excess of $124 million had been advanced under GEERS and its predecessor EESS in respect of approximately 23,000 recipients. The experience of the department is mainly with businesses that employ less than 20 staff at the insolvency date. This comprises approximately 90 per cent of all cases. The median number of employees per case is three. Under GEERS, employers remain liable for the payment of their employees' full entitlements. However, taxpayer funded payments can be made under these schemes as an advance where there are insufficient funds available from an insolvent employer.

The terms under which GEERS will be advanced are set out in the scheme's operational arrangements. This document is available on the Australian Workplace Internet site and also on request. The department's experience in insolvency matters is based on operations of the employer entitlement safety net schemes over the past 2½ years. During that time the department has advanced funds to approximately 2,250 cases, representing about 15 per cent of all

insolvencies during the same period. That concludes my opening statement. I trust it will assist in further consideration.

**CHAIRMAN**—A number of the submissions that we have received in relation to this inquiry have expressed concern that employees can be severely disadvantaged by deeds of company arrangement and that some employers have lodged claims under GEERS but, because of the wording of the deed of company arrangement, they are not able to be paid because GEERS advances to former employees must be recoverable by the Commonwealth. Can you clarify for us the rights of employees to GEERS entitlements in these circumstances?

**Mr Maynard**—The rights of the employees to GEERS is set out in the operational arrangements. The taxpayer funds will be advanced under the terms such that, under a deed of company arrangement, the rights of recovery must be consistent with section 556 of the Corporations Act.

**CHAIRMAN**—Can you enlarge on that?

**Mr Maynard**—It would be the same as what the employees would normally receive in the event of a liquidation.

**CHAIRMAN**—Okay.

**Mr HUNT**—I have three questions to follow through on. The first is to help me understand the effective ranking of employee entitlements as it fits within the scheme. Where do they qualify in a practical sense—at what point does their entitlement to an advance from the government crystallise—and, prior to that, where do they sit within the ranking scheme for the paying out of creditors?

**Mr Maynard**—Your correction that GEERS is not an entitlement, it is an assistance payment which is made for the amounts owed by the insolvent employer, is quite a valid one.

**Mr HUNT**—But, effectively as creditors, they have an entitlement.

**Mr Maynard**—Certainly. As a creditor of the company they have an entitlement and they stand in the order that is prescribed under the Corporations Act. First and foremost, you have the insolvency practitioner's fees. Secondly, you would have the secured creditors. Thirdly, you would then have employees, whose rights would be set out in terms of wages and superannuation; workers compensation payments; annual leave; long service leave; severance pay, which would be pay in lieu of notice; and redundancy payments. Underneath employees would be unsecured creditors.

**Mr HUNT**—Following through on the point the chairman was raising about deeds of company arrangement, (1) is it a widespread problem that you have deeds of company arrangement which are effectively placing employees' entitlements out of reach of the insolvency work or effectively deferring employees entitlements; and (2) is there a way that we can combat that type of action?

**Mr Maynard**—The experience of GEERS, as Mr Lloyd made clear at the start, has been a limited one in the past 2½ years.

**Mr HUNT**—Sure, I understand.

**Mr Maynard**—In that time, there would have been a tiny number of cases where deeds of company arrangement would have altered the normal creditors' standing. The rights of the employees and, for that matter, any other creditor are defined such that they may seek, through the courts, to have the deed of company arrangement overturned as it is prejudicial to their rights. That is an action which they may take through the courts, and the processes are defined under the Corporations Act.

**Senator WONG**—Can I clarify something? I did not quite understand I think it was Mr Maynard's answer to Senator Chapman's question about the circumstances where the deeds of company arrangement have got in the way of claims under GEERS. I have not read the submissions but I understand that we have had a couple of submissions which have expressed concerns because the DCAs do not permit recovery by the Commonwealth; therefore, that has interfered with the employees being able to access their GEERS entitlement because the requirement to do that means that you can then stand in their shoes to recover moneys owed to them by the company.

**Mr Maynard**—That is correct. To pick up on one of the things that the previous witness said, the deed of company arrangement is a method by which companies may trade their way out of their insolvency. It is important from a Commonwealth viewpoint, if we are advancing taxpayer funds, that we have the rights to recover those funds in as much as the company is being handed back to the directors of the company. Consequently, the terms of the operational arrangement—the terms under which we would advance GEERS funding—require that they would be distributed in the normal method that they would be in the event of liquidation. Therefore, the employees would have access to their full rights under that deed of company arrangement. I can think of one incidence of a difficulty with a deed of company arrangement, and that is the one that you have the submission on.

**Senator WONG**—We have two submissions at least.

**Mr Maynard**—You have two submissions, both from the one case.

**Senator WONG**—I do not think that is right.

**Mr Maynard**—That is as I understand it. I am of course not privy to the confidential submissions that you have.

**Senator WONG**—Let us not get into an argument now. Perhaps you could take this on notice: could you give us some indication of the circumstances where a particular deed of company arrangement has impacted on an employee's entitlement to receive GEERS? It would be useful for us if you could do that. Is that possible?

**Mr Maynard**—Yes.

**Senator WONG**—Is the problem that the deed changes the priority of payments or is it that the deed does not permit the Commonwealth to recover moneys paid, or both?

**Mr Maynard**—In the circumstance that I can think of, it is both.

**Senator WONG**—Is it right that either circumstance would lead to a nonpayment of GEERS? Suppose a deed of arrangement either altered a priority of payments, in so far as it can—I cannot recall precisely to what extent it can—or prevented the Commonwealth from then suing or standing in the shoes of the employee to recover those entitlements. In both of those circumstances, you would have difficulty paying out of the GEERS scheme.

**Mr Maynard**—That is the government policy, yes.

**Senator WONG**—How could we regulate deeds of company arrangements to ensure that would not be the case?

**Mr Maynard**—I am not certain that that is necessarily an issue that needs to be regulated. I think the access to the safety net arrangement has been promoted now for a number of years on this basis, and that is known to insolvency practitioners and to other industry figures.

**Senator WONG**—Is it known to employees, though, Mr Maynard?

**Mr Maynard**—Certainly we give the advice to insolvency practitioners and they are then requested to provide that information at the creditors' meetings where a deed of company arrangement would be voted upon. The issue then is whether or not they wish to put forward a deed of company arrangement which is contrary to the terms under which GEERS would be advanced.

**Senator WONG**—Are they under an obligation to advise employees that the particular deed they are proposing would have the effect of limiting or preventing their access to the GEERS scheme?

**Mr Maynard**—There is no legal obligation for them to do so.

**Senator WONG**—That is ridiculous.

**CHAIRMAN**—In September 2001, the federal government announced its intention to amend the Corporations Act to elevate the priority of employee entitlements above those of secured creditors. If that legislation is enacted, does that mean that the department will stand in the shoes of employees as creditors in having already advanced their entitlements and will therefore assume that priority position?

**Mr Maynard**—In any advances that we make, we stand in the shoes of the employees for whom we have advanced funds. Should the maximum priority legislation be enacted, whether or not it was prospective or retrospective would be dependent upon the terms of any such legislation.

**CHAIRMAN**—What has been the general reaction to that proposal among other potential creditors?

**Mr Maynard**—I think the previous witness from Treasury would be better placed to answer that than I am. I read the submissions and I get the sense that our Treasury colleague is the one who should answer that question.

**Senator WONG**—I guess we will have him back at some stage.

**Mr HUNT**—I understand that it is difficult to give an opinion, but, in your relations with different organisations, whether they are employer organisations or employee representatives, has much been put to DEWR about their approach to placing priority above the secured creditors? I know there is lots of material with Treasury, but I am interested in pushing Senator Chapman's question a little further to see whether or not there has been much comment or many views expressed to DEWR about the priority for employees over secured creditors.

**Mr Maynard**—I am not aware of any such submissions.

**Mr Lloyd**—I too am not aware of any such submissions to us. As I think the Treasury witness indicated, we have been involved in some of those consultations that Treasury has been conducting, but to my knowledge there have been no major submissions, interactions or views put forward to us.

**CHAIRMAN**—Can I refer you to the report of the Auditor-General No. 20, which is on the performance audit on the Employee Entitlements Support Scheme. The Auditor-General reports that the Commonwealth has begun to receive significant amounts of recovered funds only during 2002. The Auditor-General found that this was consistent with industry advice on the time it takes to realise business assets after insolvency. However, the Auditor-General concluded that effective recovery would require the Department of Employment and Workplace Relations to become a more active creditor, including following up insolvency practitioners with more rigour to ensure that they are taking all appropriate action. Is there anything in the Corporations Act that is impeding a more efficient and effective recovery process of the advances made by the department?

**Mr Maynard**—No, I do not believe there is.

**CHAIRMAN**—So there should not be, for instance, more onus on insolvency practitioners to recover the debts?

**Mr Maynard**—As a creditor to a number of companies to which we advance funds, we seek that they provide the same information to us that they provide to other creditors and we seek that they do their commercial duty as insolvency practitioners, including following up debts.

**CHAIRMAN**—Would you like to respond to the observations of the Auditor-General that the department does not pursue insolvency practitioners as actively as employees who have a strong personal interest in recovering their own pay and entitlements might?

**Mr Maynard**—I think that observation was one based on the history of the scheme as a whole. We have a recoveries unit at the moment which is very active. All funds that we advance are actively followed up, both in the request and the recovery of information about how things are going, in the distribution for each of the companies that we have advanced funds to. We are also mindful of the need at times to attend creditors' meetings, sit on creditors' committees and, if it were necessary, take legal action to ensure that our rights of recovery are protected.

**Mr HUNT**—You can only judge it on those cases where the distributions have been completed and all of the assets are exhausted. Where those distributions have been completed, do you have any approximate figures as to the difference between the advances and the rates of recovery?

**Mr Maynard**—No, I am sorry, I do not have that detail.

**Mr HUNT**—That can be in proportionate or in absolute terms—could we ask for that on notice? I do not mean to create a lot of work.

**Mr Maynard**—I think it would be better to take that on notice, otherwise I would not be able to give you a useful sense.

**Mr HUNT**—It would be very useful for us to understand what the difference is—to understand the level of subsidy, effectively.

**Mr Maynard**—Certainly. So, just to make it clear in my own mind, for those cases where the distributions have ceased, the level of return relative to the level of outlay?

**Mr HUNT**—On the advances—the net government transfer to employees under the GEERS scheme, both as a proportion and as an absolute, on completed distributions.

**Mr Maynard**—Certainly, we will get that for you on the GEERS scheme.

**Senator WONG**—I assume that the $124 million is a straight cash outlay figure?

**Mr Maynard**—That is correct.

**CHAIRMAN**—The Insolvency Practitioners Association of Australia have suggested that the department's position should be clarified so it can be an active participant in the insolvency process. Their submission says:

> Where DEWR makes a payment to an employee under either EESS or GEERS, it is entitled to "step into the shoes" of the employee for dividend purposes pursuant to section 560 of the Corporations Act. It is arguable whether they have any other rights as a creditor as they are a post insolvency creditor.
>
> The IPAA is concerned that this situation may have an adverse impact on insolvency administrations due to the fact that the original creditor (the employee) has largely been paid and as such has little interest in the matter, and DEWR is powerless to be active as a creditor and to help in the process (ie. fund litigation, receive reports, approve fees, sit on committees, vote at meetings).

What is the department's response to that submission?

**Mr Maynard**—I cannot say I agree with that particular observation. We are on creditor committees and we are an active creditor. In terms of the issue of funding litigation, most employee creditors would not be in a situation where they could fund litigation, and we would consider each and every case on a case-by-case basis to determine whether it would be appropriate for the Commonwealth to fund litigation. I note that the industry has a series of companies who set themselves up solely for that purpose.

**Senator WONG**—I accept your evidence that you consider you are an active creditor. Are you able to perhaps cast some light for us on why your view seems to be somewhat different from the IPAA's? You said earlier that it might be an observation of the operation of the scheme over quite a long period and that perhaps your practices have changed since then, but certainly their views are somewhat different.

**Mr Maynard**—Most definitely. I am certainly aware that in their submission—and in discussions with officers from the IPAA—they note that this is a view based on their experiences for the life of the employee entitlement safety net schemes. We certainly believe that the work we have been performing in the last nine months has made a significant difference to our role as active creditors, and we will continue to perform that work. Their opinion is valid as their opinion.

**Senator WONG**—Was there a policy decision taken nine months ago to ramp up your creditor activity?

**Mr Maynard**—Certainly we actively chose to enhance that particular aspect of our work.

**CHAIRMAN**—As you are aware, GEERS is established under administrative arrangements under ministerial authority rather than under legislation. The Auditor-General noted that this means there is a relatively high degree of ministerial discretion. Could you explore for us the major differences which occur as a consequence of it being established under administrative arrangements rather than by statute. For instance, are the parliamentary and public accountability obligations the same? Would they be subject to the same degree of parliamentary scrutiny?

**Mr Maynard**—We are subject to the same level of parliamentary scrutiny. We report though the department's annual report. We are subject to scrutiny at Senate estimates or in any of the other appropriate committees. We have defined the terms and conditions of the scheme, and they are publicly available. That includes an appeal process, which would be normal under a legislative process. I believe it to be comparable.

**Senator MURRAY**—I should remark in passing that I have always been gratified that this government was the first government to actually do something about paying employee entitlements, even if it is not a Rolls Royce model. As you know, the Cole royal commission's recommendations covered tax law, the Corporations Law, insolvency law, workplace relations law and probably a few other types of law as well. Mr Lloyd or anyone else, are you attending as a department to the Cole royal commission recommendations on insolvency matters; and are you pursuing those with any energy with Treasury?

**Mr Lloyd**—The government's response to the Cole royal commission is under consideration, and I do not think I can really answer the question any more than that.

**Senator MURRAY**—There is the need, though, to recognise that Cole dealt with issues that were not new, such as phoenix companies and the ways in which administration and insolvency are manipulated. It simply focused on their effects in a particular industry. As they are not new issues—and taking it away from the specific recommendations of the Cole royal commission; as you may have noted, in my questions I have not referred to specifics—are you discussing these matters with Treasury in their present examination of insolvency?

**Mr Lloyd**—The Cole report in its entirety is being considered. I really cannot add much more than that. The government's position is not finalised.

**Senator MURRAY**—Would you be alert to the possibility that the Senate could want the Cole report to be dealt with as a whole? In other words, the Senate might refuse to deal with anything from Cole unless it is a package—employee entitlements, insolvency, Corporations Law changes, tax law changes and anything else. In considering these matters, are you alert to that possibility?

**Mr Lloyd**—How the Senate might deal with the response is a matter in the future. We will have to wait and see what approach is taken.

**Senator MURRAY**—I appreciate your care in answering and I will try to avoid stepping on any areas of policy. I have deliberately put these questions to you because this committee is examining insolvency and Treasury have a lead role in that. I believe you cannot consider the insolvency issues without bearing in mind the very high profile that the Cole commission gave them. The commission made very particular remarks about the effects of the manipulation of insolvency laws, such as the terrible consequences for employees and creditors. Therefore, my intention in my question is to establish whether, in a general sense, the department is alert to this being much more than just a normal review—that it is integrated into an immediate issue which is before the government and will in due course be before the Senate.

**Mr Lloyd**—The Cole royal commission report is getting thorough and careful consideration, I can assure you of that. It is being considered, as I say, thoroughly and carefully, but the government position is not yet finalised.

**Senator MURRAY**—But in your preparation for today's hearing did you review the generic or general issues that Cole identified—the specific examples of the abuse of insolvency laws represented by what is known as the phoenix company system?

**Mr Lloyd**—I am aware of the Cole report. It is some time since I read that particular volume. We are aware of those recommendations and his views on that. Predominantly phoenix companies are a matter for Treasury, and it is getting careful consideration. I really cannot add anything to that.

**Senator MURRAY**—Mr Maynard, I see that your title is employee entitlements branch. I gather from your replies that you are the principal officer with policy responsibility for insolvency. Are you conscious of the Cole examples of phoenix companies and entitlements?

Has it influenced at all the way in which you are able to progress your understanding of law changes or process changes that are needed?

**Mr Maynard**—My responsibility is for the administration of the employee entitlements safety net schemes rather than for employee entitlement policy. That particular question would be better handled by Mr Lloyd.

**Senator MURRAY**—Have you read the Cole report?

**Mr Maynard**—Yes, Senator, I have.

**Senator WONG**—I want to go back to a question that the chair asked trying to elicit some comparison by you, Mr Maynard, between the GEERS scheme being essentially a scheme established by ministerial authority and a scheme that might be established by statute. I accept there are mechanisms that ensure accountability, but would you agree that there is a significant difference between a scheme set up under statute whereby there is a clear definition of the statutory purpose, the purpose for which funds must be expended, and a scheme such as this one?

**Mr Maynard**—The accountability requirement for this particular scheme is that there is a separate appropriation through the budget uniquely identified as being funding for this purpose and this purpose alone. The department is obliged to report on that in its annual report. I am not sure whether that would support your assertion that it is not.

**Senator WONG**—It is not my assertion. What is your response to the Auditor-General's report in which he notes that there is a relatively high degree of discretion residing in the minister and the department?

**Mr Maynard**—In the operational arrangements there is reference solely to one area of discretion and the rest of the scheme rules are defined and applied very clearly.

**Senator WONG**—So you disagree with his assessment?

**Mr Maynard**—I disagree that there is a high degree of discretion.

**Senator WONG**—Was GEERS based on a comparable model in another jurisdiction?

**Mr Maynard**—Not that I am aware of.

**Senator WONG**—And superannuation, of course, is not covered.

**Mr Maynard**—No, employer superannuation contributions are not covered by GEERS.

**Senator WONG**—Other than funding issues, do you see any impediment to them being included?

**Mr Maynard**—That is really a policy decision.

**Senator WONG**—But there is no technical issue associated with that, is there?

**Mr Maynard**—I am not aware of any, but then again I would not consider myself familiar enough with all of the possible statutes to be able to give you a comprehensive answer on that.

**Senator WONG**—Mr Lloyd, would you be able to assist us with this?

**Mr Lloyd**—Superannuation is predominantly the responsibility of the Treasury. It would be inappropriate for us to proffer views about what could be done.

**Senator WONG**—I appreciate that it is the responsibility of Treasury, but I am asking whether or not you see any technical difficulties in including superannuation payments in the employee entitlements scheme.

**Mr Lloyd**—Firstly, the issue of including it is a policy matter—

**Senator WONG**—That is why I am not asking you about whether you think it is a good idea.

**Mr Lloyd**—No, but I do not feel it is appropriate for me to give an opinion about whether it could be included because I am not involved in the regulation or administration of the superannuation arrangements or laws. Therefore, I feel I am not competent in my knowledge to give advice on that point.

**Senator WONG**—From your knowledge, are you able to point to any technical difficulties of including super in the GEER Scheme?

**Mr Lloyd**—I have not had to direct my mind to that particular point. Superannuation is covered by a different act administered by another portfolio. It has not been an issue which we have had to turn our minds to.

**Senator WONG**—If you did, could you either—

**Mr Lloyd**—I think it would be inappropriate for me to proffer a view that would probably be poorly informed conjecture on my part.

**Senator WONG**—Are you happy to take it on notice? I accept that you have not had an opportunity to turn your mind to it. I am not asking you about the policy; I understand that it is a policy issue as to whether or not it should be included. I am interested to know whether you consider there would be any technical difficulties with its inclusion. I am happy for you to take it on notice.

**Mr Lloyd**—Again, I think that is asking us a question on an issue that is beyond our portfolio responsibility. I would be happy to take a question on notice which was within the responsibilities of workplace relations.

**Senator WONG**—I am not asking you something that is beyond your portfolio. I am not asking a question about super. I am asking whether you see any technical difficulties with superannuation being included within GEERS.

**Mr Lloyd**—Superannuation is not included in GEERS, and therefore I believe it is—

**Senator WONG**—We can go down to the Senate and put it on notice there. I am asking if there is a possibility you could provide some answers to this question after you have had the opportunity to consider it.

**Mr Lloyd**—We will take it on notice, but I am not confident I will be able to advance the matter beyond what I have said tonight.

**Senator WONG**—Has DEWR investigated any alternative mechanisms for dealing with employee entitlements, such as trust funds?

**Mr Maynard**—There have been two papers released by the government on protecting employee entitlements. Then Minister Reith produced a discussion paper in August 1999 which considered alternatives, and Minister Abbott released a discussion paper in January 2001 which also considered alternatives.

**Senator WONG**—Has there been any further work since the release of the 2001 paper?

**Mr Maynard**—Not that I am aware of.

**CHAIRMAN**—There being no further questions, I thank the officers from the department for your appearance before the committee tonight and the answers you have given to our questions. They will certainly be very helpful in our investigations.

[6.18 p.m.]

**CHARLES, Mr Robert, Assistant Commissioner, Operations, Australian Taxation Office**

**HOLLAND, Ms Erin, Deputy Commissioner, Operations, Australian Taxation Office**

**TOPPING, Mr Gregory, Assistant Deputy Commissioner, Operations, Australian Taxation Office**

**CHAIRMAN**—Welcome. The committee prefers all evidence to be given in public, this being a public hearing, but if at any stage of your evidence or answers to questions you wish to give evidence in private you may request that of the committee, and we will consider such a request to move into camera. We have before us a submission from the Australian Taxation Office which we have numbered No. 25. Are there any alterations or additions that you want to make to the written submission at this stage?

**Mr Charles**—Yes, there is one amendment. On page 5 of 34 at paragraph 23, the case cited—Re: Solfire Pty Ltd (in liq.) 15 ACLC 1487—should actually read: Lam Soon Australia Pty Ltd (Administrator Appointed) v. Molit (No. 55) Pty. Ltd. [1996] 899 FCA 1.

**CHAIRMAN**—Thank you. I invite you to make an opening statement, at the conclusion of which we will have some questions.

**Ms Holland**—The ATO welcomes the opportunity to appear this evening. As highlighted in our submission, the tax office is a creditor in a number of voluntary administrations and liquidations. We are generally an unsecured creditor and rely on the effectiveness of the corporate law. Our submission highlights our concerns about the behaviour of a small number of individuals and how they operate within the regulatory regime as opposed to the regime itself. As outlined in our submission, we have some concerns about some practices of a small number of individuals which my colleague Mr Charles will refer to.

**Mr Charles**—There are two main areas we are particularly concerned about. Firstly, in relation to phoenix activity we have identified directors who have been managing and administering certain entities and when the business folds leaving creditors with liabilities. Just prior to them going into liquidation the entities' assets have been disbursed. At the same time, if not soon after, virtually the same business starts again and continues to trade, to the detriment of creditors, including the tax office.

Secondly, in relation to concerns regarding friendly creditors, as we have referred to in our submission, we have identified deeds of company arrangement proposals where there have been creditors listed as related parties. They have put forward a deed of company arrangement through the normal manner, and those related parties—on a number of occasions—forgo their right to a dividend under the deed of company arrangement but do not forgo their right to vote. In some cases we have seen instances where the related parties can have liabilities tenfold in excess of tax office liabilities, and clearly that gives them a position to vote against that proposal. These are two of the main areas that we have had concerns about.

**CHAIRMAN**—Have you considered ways by which these two problems might be overcome?

**Mr Charles**—We have made a number of suggestions in our submission to the committee in relation to the behaviour of directors, in particular, where they have been managing insolvent entities. We are of the view that the focus should be on the individual behaviour of directors, which has been the focus of our submission. We are not overly concerned about the general regime in relation to insolvencies. We are concerned about identifying those behaviours as outlined by the proposals in our submission. The question that arises is whether or not related creditors should be entitled to vote at those meetings, particularly where they are putting forward proposals that have significant distribution to creditors below a hundred cents in the dollar.

**CHAIRMAN**—I note also in your submission that you say there are opportunities to improve the quality of reporting by voluntary administrators. Could you outline what the deficiencies are currently in reporting obligations and how they could be improved?

**Mr Charles**—In a number of cases we see poor records, which clearly reflects on the quality of information being provided to creditors in those cases. In voluntary administrations we would like to see clearer reporting in relation to related transactions that might have occurred in the past that might be available for preferential claims by the administrator. It is the completeness of the record that we are often concerned with. But, again, we rely on the quality and the independence of the administrator or the liquidator that that is the best they can do at the time with the resources they have available. To a certain extent we have to rely on that.

**CHAIRMAN**—How is it that the situation of poor records can arise in the first instance? Is that because of inadequacies in auditing rules or monitoring procedures? What is the issue there that creates that problem?

**Mr Charles**—I would suggest that might be a matter for other regulatory authorities in that respect. We certainly have that focus in terms of records that we require to be maintained for the purpose of tax legislation. But in terms of the general record keeping, that is the main issue that we focus on.

**Senator MURRAY**—You would know a lot more about effects than causes—is that what you are telling us?

**Mr Charles**—Possibly, Senator, yes.

**CHAIRMAN**—You suggested in your submission that the administrators and liquidators should be required to reconstruct company accounts to a standard sufficient to facilitate the performance of their duties under the act. What is your view of the extent of the obligation placed on administrators and liquidators to furnish a full and complete assessment of a company's financial position? Who actually deems whether a report is indeed adequate?

**Mr Charles**—I would probably have to defer again to other regulatory agencies in terms of deeming if they have met the requirements that they have to as administrators. Our concern here is in respect of where we do see examples where there are insufficient funds. What we would see an administrator has to do is bring the records up to date to a reasonable standard. They will recognise quite early in some cases that it is an assetless company—there are no assets there—

and the amount of work that they are willing to put into that effort reflects that and their return to meet their costs. That is where our concern has been expressed. That is a reasonable concern from the point of view that, if the records have not been kept up to date before the liquidation or administration, then that should be a matter, we believe, the director should have greater accountability for.

**CHAIRMAN**—Are you aware of any objections to your proposal that directors should be liable for the shortcomings particularly in relation to any costs incurred in making up the shortcomings in the company's records?

**Mr Charles**—I am not aware of particular objections.

**Senator MURRAY**—I was pleased that you raised the phoenix company issue in your submission. Have you as a tax office had a look through the Cole report's remarks on phoenix companies?

**Mr Charles**—Yes, Senator.

**Senator MURRAY**—Has it altered or sharpened up or changed your views on what could be done about it?

**Mr Charles**—From an administrative perspective or policy?

**Senator MURRAY**—From a law change and process perspective. The evidence we are getting from a number of people is that the insolvency laws are in pretty good shape but there are areas where there could be legislative improvements. Cole certainly goes down that path—because Cole deals with causes as well as effects, hence my remark—and I wonder whether it influenced the sorts of suggestions or recommendations you make to Treasury when they are looking at this area.

**Mr Charles**—That report is with government and I am not in a position to make comment on that.

**Senator MURRAY**—It was a worth a try. I refer to the issue of the superannuation guarantee charge. Just remind me: are payments from this year on going to be quarterly? Is that what is going to happen?

**Mr Charles**—Yes.

**Senator MURRAY**—My view has always been that that will take away many of the problems in that simply payments have to be made in a shorter period and you do not get the accumulated debts. Do you think it might also have the effect of accelerating insolvency or voluntary administration? In other words, people will come up against their cash flow problems a lot earlier because they will have to recognise them.

**Mr Charles**—I have not specifically turned my mind to that.

**Senator MURRAY**—I ask you the question really based on your experience—not yours personally, Mr Charles, but the experience of the tax office—with GST, because the GST was supposed to have precisely that effect. If you remember, there was the 13-month rule adjustment and GST required payments on specific dates and the fear was that it would produce quite major problems. In fact, there were some very exaggerated claims made about the number of insolvencies that would result. But what did result was that a number of companies which were cash poor suddenly realised that they were likely to become cash stressed and had to sort themselves out. I just wonder if, based on that experience, you would have had a feel for the effects.

**Mr Charles**—I can only say that it is not a matter that we specifically looked at. I would say, in response, that I would expect that quarterly payments would be likely to improve the level of payments by those entities. They are identifying their liability within a shorter period.

**Senator MURRAY**—Is it anecdotal or do you have linkage analysis which tells you that somebody is late putting in their tax return, that they are behind in meeting their debts to you and that they are also likely to be weak in other areas and therefore are potential candidates for insolvency? Do you have that sort of in-built risk assessment format?

**Mr Topping**—There certainly will be in some instances, based on the criteria, that you will see. In other words, if someone has a difficulty or is not compliant in relation to meeting their lodgment obligations, then it may well be that they are driven by the fact that they do not have the capacity to pay. It might also be, however, that they simply are, for a host of reasons perhaps related to their business, not inclined to comply in the first instance.

**Senator MURRAY**—Hidden in our considerations is a view we are exploring that in many circumstances voluntary administration comes too late and the time is not found for proper recovery programs to be developed and so people who otherwise might have been rescued fall over. There is a consideration of whether chapter 11 type things would actually help and reinforce or not. It is people like you who actually see the early warning signs, as probably do major suppliers; you suddenly find people stretching out and so on. But there is no mechanism whereby the tax office can say, 'Hang on! We're picking up early warning signs. Based on our experience, we want to tell you, friend, that we think you are going to get into trouble. Why don't you get some professional advice?' You do not do that and I am wondering whether it is ever possible that the market knowledge that you effectively get can translate itself into earlier advice to companies to start getting professional advice which would enable them to hold their ground or get back on their feet.

**Mr Topping**—I think it is generally the case that the tax office has moved increasingly to try to deal with these emerging patterns at the front end, to cut them off at the front end—hence these systems which see more regular payment and more regular opportunities to meet liabilities or requirements to meet liabilities. We find generally that if you can get to the front end and deal with an emerging situation earlier then it is more likely to be handled by the business in question. You are dealing with smaller amounts of money and it is more likely that we are able to get a payment arrangement in place so that people can actually recover from that situation.

**Senator MURRAY**—Let us assume that you are getting nervous about somebody's payment patterns and you call them in for a chat. Is the chat directed at enforcement? In other words, do

you say, 'We want to bring you back into line of paying on time. If you are stressed we will work out a payment pattern for you.' Does it also include the advice, 'If this is reflecting business difficulties of a more general kind, are you taking professional advice? Have you consulted your financial advisers, bank, accountant, lawyer and so on?' Or do you just look at them complying with your needs?

**Mr Topping**—In the first instance we tend to look at the issue of their compliance with the tax laws. We generally do not stray into that area of making suggestions. It may come up generally in conversation but we do not instruct our staff generally to offer those sorts of suggestions.

**Senator MURRAY**—One of the things we found in discourse with you in other areas—for instance, both Senator Chapman and I were involved in the intensive Senate investigation into the mass marketing tax effective schemes problem—is that people who start to get into difficulties are ashamed to seek advice or fear the consequences of seeking the advice—namely, the bank will foreclose, the tax office will get tougher than necessary and so on. In the discussions the Senate had with the tax office, the tax office indicated that it was going to try to pursue a 'We're here to help and get you out of this jam' approach, rather than a 'We want every dollar immediately' approach. In some cases that worked and in some cases it did not.

There are two prime intentions of insolvency laws. One is to enable people to get out of their mess, recover their businesses, meet their debts and go on in life happily ever after. The other is to ensure that the maximum payment is made in the dollar. Prevention, as you know, is better than cure. The nub of my question is whether as an institution you are capable of contributing more to the prevention side because you get the early warning signals from the various payments that have to be made to you through the tax system.

**Mr Topping**—There are two things. The strong tenor of ATO receivables policy has a message that runs through it that says, 'If you are having difficulty at all come and talk to us and we'll put something in place.' We are always encouraging people. We are saying to people, 'You need to comply with your requirements but if you are having difficulty and that is the reason you are not able to comply then come and talk to us.' It would be a matter of last resort that we would take legal action against people. We would rather come to some sort of arrangement with them.

**Senator MURRAY**—Right there is the nub of the problem. They might come and talk to you but earlier in answer to a question you said you were unlikely to say to them, 'You should perhaps consider taking professional advice because there are problems here which we are not equipped to help you with.' The tax office cannot restructure somebody's business or redo their accounts. It is in that area that I think the problem is. I recognise the tax office has tried to change its culture and be more flexible and more accommodating and meet the charter's requirements of looking after people's individual circumstances. But you cannot do the job that has to be done, and unless that person will go and get help you will end up with a consequence which inquiries like this are trying to minimise.

**Mr Topping**—Any answer I can give you will be quite a general one. The fact that we make those statements in our policy, in media releases and in campaigns—for instance, when we want to let people know that a quarterly due date for the lodgement of an activity statement is coming

up—does not in itself change the behaviour of the taxpayer. At the end of the day, it really requires them to make the decision about whether they would seek that advice.

**Senator MURRAY**—We are talking about two things here: one is the general invitation—which, by your answer, I assume relatively few take up—but the other is that you call people in and say, 'I want to see you because this is what is happening and I want to talk to you about it face to face.' I think that is proactive and is to be encouraged.

**Mr Topping**—Or we may ring them. We contact taxpayers in a number of ways. With high volume businesses, we get quite a bit of success simply by sending people letters.

**Senator MURRAY**—At the nub of my question is whether you are a partner in prevention at the moment—and I think you are not. The next question I have to ask, which is one the committee may want to consider, is whether the tax office could be a partner in prevention later, which would mean having additional steps in your interactive relationships with taxpayers. That is really what is behind my line of questioning. That is all I have, Mr Chairman.

**Senator WONG**—I want to go back to the SGC and the implementation of quarterly payments. Does that therefore mean that your powers to commence collection and recovery of superannuation moneys would only require the failure to pay one quarter?

**Mr Charles**—Yes.

**Senator WONG**—Your submission makes the suggestion that there is an automatic disqualification from holding a directorship if you have been involved in two or more corporate insolvencies. Has that been the subject of discussion with any particular constituencies outside of the ATO?

**Mr Charles**—No, not specifically.

**Senator WONG**—Would you foresee significant problems with that?

**Mr Charles**—The suggestion we have made in our paper provides an avenue for directors to approach the appropriate regulator—which, in that case, would generally be ASIC—to show cause. At the moment the onus is on ASIC to show cause. All we are referring to there is that it would refocus director's minds when they are managing a company in the future that there are consequence if they are managing a company which, on two or more occasions, has been found to be insolvent.

**Senator WONG**—Implicit in your submission is therefore the view that the current situation which requires ASIC action has been not as successful in promoting that sort of behaviour as you would like. I am not being critical of ASIC.

**Mr Charles**—I understand that. Our submission is based on a recognition that we believe it would improve the regime if there were increased clarity of the obligations of directors and of the consequences of managing companies of that nature. I mentioned at the beginning of this hearing that part of our suggestion in relation to phoenix companies is in recognition of addressing that behaviour before it becomes phoenix type activity. That alone does not mean that

it is always the same directors that are involved in phoenix type activity, but that suggestion is to address that.

**Senator WONG**—Why do you say the current provisions are not achieving this outcome?

**Mr Charles**—We say that on the basis that we see instances of the same directors managing companies into the future without being disqualified, and we believe the system may be improved with increased clarity in terms of the consequences of being directors of insolvent companies.

**Senator WONG**—In circumstances where you become aware of that, do you have discussions with ASIC about that or is that not appropriate?

**Mr Charles**—No, not in that case. Our secrecy provisions restrict us in terms of that.

**Senator WONG**—How would ASIC become aware of that?

**Mr Charles**—That might be a question for ASIC.

**Senator WONG**—I go now to deeds of company arrangements and your concern regarding what you have described as discriminatory deeds. Do you mean deeds which favour creditors whose relationship with a company might be deemed necessary to continue trading and so forth?

**Mr Charles**—It can be related to creditors and it can be creditors they wish to have an ongoing relationship with in the future.

**Senator WONG**—How should that be regulated? It is an amendment to particular provisions of the act that deal with deeds of arrangement, is it?

**Mr Charles**—If the company was to be liquidated, the general principle under the Corporations Act for insolvencies is that there is even distribution to unsecured creditors. That same principle is not there in deeds of company arrangement provisions.

**Senator WONG**—Which would seem inconsistent.

**Mr Charles**—That is right.

**Senator WONG**—You were present earlier when we were having a discussion about the possibility of deeds of arrangements which might impact on employee entitlements.

**Mr Charles**—Yes.

**Senator WONG**—Would you think that that is an appropriate area for regulation as well or is that outside your purview?

**Mr Charles**—The question of specific payments would be a matter for policy.

**CHAIRMAN**—In your submission, you refer to public confidence in the voluntary administration process being undermined by perceived absence of impartiality on the part of some voluntary administrators. You suggest that a roster system for the appointment of administrators on a random basis might be one solution to that. I do not know whether you were here earlier when we raised that possibility with Treasury and heard their response.

**Mr Charles**—I did not hear that part of the conversation.

**CHAIRMAN**—I think it is fair to characterise their response as negative. They said it would raise competition issues and also they raised the issue of an administrator appointed on a rostered basis might not be the appropriate administrator for a particular type of business. What is your reaction to Treasury's response to your suggestion?

**Mr Charles**—Our suggestion, as you correctly pointed out in your question, is one possible proposal. I note there have been a number of other suggestions made to the committee through other submissions. That is one. We have also recognised that there would need to be some recognition in a regime such as that as to the experience and capacity of different administrators to deal with the profile of different corporations.

**CHAIRMAN**—How serious a problem do you believe the issue of impartiality of voluntary administrators is?

**Mr Charles**—As we stated in our submission, our concern is predominantly based on a perceived level of independence. If the directors are choosing the administrator, they are effectively choosing who is going to take up that position and the level of independence that that administrator may have when they are representing the interests of creditors. The extent of our concern is probably reflected in our submission and it is a perception. We believe that the ongoing integrity of the system would be maintained and improved by ensuring that there is that level of independence.

**CHAIRMAN**—Another issue that you raise concern about is what you say is the increasing use of deed of company arrangements by companies to avoid paying their creditors. You say there are very few DCAs that yield dividends to creditors, in your experience. Can you enlarge on how that mechanism is being used in avoiding the payment of creditors and how it happens? Have you any suggestions as to how it might be prevented?

**Mr Charles**—The main area of our concern, as I expressed at the beginning, is the voting power of friendly creditors. We have seen instances where they are reflected as unsecured loans to the company by the directors and, in some cases, shareholders. They make significant claims against the company, as part of the deed of company arrangement, and it significantly reduces the available distribution to other unsecured creditors. Also associated with that is our concerns that, if they are inappropriately being proposed and there is not a real chance of future success, whether the creditors would be in a better position if the company went into liquidation, where a liquidator has broader powers of investigation, particularly in looking at past preferential payments and transactions that might come into question.

**CHAIRMAN**—We have a submission from Mr Tony McLean in relation to the interests of shareholders in liquidation. He says:

Almost invariably a shareholder's most important residual interest—

in relation to insolvency—

is the crystallisation of a capital loss …

Further, he says:

But until a determination is made by a liquidator that it is unlikely there will be a return to shareholders … shareholders have a legitimate interest … in the company. In those circumstances shareholders have a right to information about its financial position and arguably a right to an annual meeting …

Is the tax office aware of any difficulties faced by shareholders with regard to their obtaining information about their losses in insolvent companies?

**Mr Charles**—I am at a loss to be able to answer that. I do not have any information in that respect at all.

**CHAIRMAN**—From your experience, do you think there are any deficiencies in the system for reporting and communicating the fate of a company to shareholders, at least until the point at which a liquidator determines that there will be no distribution to shareholders and issues the declaration?

**Mr Charles**—Again, I would have to say that I have no information that I could present to the committee on that.

**CHAIRMAN**—One of the issues that arises on the part of shareholders—as Mr McLean says—wanting to crystallise a loss is that sometimes there is quite a time lapse between when it becomes clear that there will be no return to the shareholders, and a loss will be realised, and the official declaration of that loss. Do you think there is any way that that can be more efficaciously dealt with in terms of the shareholders' interests?

**Mr Charles**—I would suggest that would have to be a matter for ASIC specifically. It is not a matter that would come within our province. It is an issue of the timing of when an administrator concludes that there is no distribution likely.

**CHAIRMAN**—But the issue of when a shareholder can crystallise a loss obviously has tax implications?

**Mr Charles**—Going into that area would be a policy issue. The legislation is as it is today in terms of crystallising that.

**CHAIRMAN**—One suggestion that Mr McLean makes is that receivers, administrators and deed administrators should be vested with the authority to make a declaration that there is no likelihood of a distribution to shareholders, pursuant to section 104 and section 105 of the tax act, which currently can only be made by a liquidator. Do you have any reaction to that suggestion from Mr McLean?

**Mr Charles**—Again, I would say that is a matter of policy.

**Senator WONG**—One of the things your submission suggests is that phoenix type activity, in your view, would be potentially reduced if your restrictions on directors that we discussed earlier were implemented. Is that because the same sorts of people keep doing the same sorts of things? Is that based on your views and your experience about the profile of persons involved in phoenix companies?

**Mr Charles**—Yes, it is based on that experience.

**CHAIRMAN**—If a similar provision to the part 4A provision in the tax act were put into the Corporations Act, in relation to people who promote phoenix companies and serially make use of phoenix companies, would that be an effective way of deterring a phoenix company's operation?

**Mr Charles**—That is getting clearly into the policy area.

**CHAIRMAN**—I am having a lot of trouble with policy!

**Senator MURRAY**—That is exactly where I wanted to go. I do not want to talk to you about the policy area; I want to talk to you about the practical effect. In your tax act, part 4A has that wonderful overriding provision that, if the purpose of something is to avoid the payment of tax, you can take action. If the purpose of constructing, say, a deed of arrangement, a particular related entity relationship or a phoenix company situation and so on were for the purpose of avoiding your legitimate obligations to creditors, technically speaking a part 4A type provision would enable someone like ASIC to get behind the veil and determine the reason that it has been done. I assume it would have to be ASIC as the regulator to address the core issue; it would not be the tax office. If I understand your answers correctly, you do not have a problem with the concept of a deed of arrangement providing it is a legitimate one.

**Mr Charles**—That is correct.

**Senator MURRAY**—Your problem is with an illegitimate one. In a similar way, you do not have a problem with people's arrangements against the tax act provided that there is not a specific design to avoid their obligations and therefore you use part 4A. Returning to the chairman's question and putting it in my own words, a part 4A type provision in the Corporations Law with respect to the matters that we are discussing would allow those circumstances to be broken open, wouldn't it?

**Mr Charles**—Senator, that is the same issue of policy. I really cannot comment on that.

**CHAIRMAN**—I beg to differ, Mr Charles. I do not think that the question that Senator Murray has asked is a policy matter. We are not asking whether it is something that should or should not be implemented. We are asking what the technical consequences would be.

**Senator MURRAY**—I am asking if it could work in different circumstances. It could work in your circumstance. I am asking, technically, could it work with another regulator in their circumstances?

**Ms Holland**—It is something that we have not given any thought to in relation to this.

**Mr Charles**—If it were to work, it would be an assessment that ASIC would have to make.

**Senator MURRAY**—ASIC would be the proper people to do it, wouldn't they?

**Mr Charles**—Possibly, but that is not a matter that we could comment on.

**Senator MURRAY**—They have prime responsibility under the Corporations Law.

**Mr Charles**—Yes.

**Senator MURRAY**—I want to make it absolutely clear. On a superficial examination of the issue—respecting Ms Holland's statement that you have not turned your mind to it—there is no obvious reason why such a device could not work in Corporations Law to deal with issues like phoenix companies or deeds of arrangements which are constructed for the specific purpose of people avoiding their legal obligations?

**Mr Charles**—I am finding it difficult to vary from my previous answer from the point of view that to say one way or the other would assume that I have turned my mind to it to some extent. Nevertheless, I think it would also be a policy matter.

**Senator MURRAY**—At some stage I should put on the record for the benefit of all public servants—sorry, I do not like the word 'servants'—for the benefit of all Commonwealth employees that this policy distinction is kind of a permission, a licence, given by the parliament. There is actually no standing order or statute which says that the parliament cannot get out of you any information they want. Frankly, when we are asking questions like this to try and advance our understanding of policy, I would expect you to be more cooperative. I think that the kind of answer you gave goes too far in terms of being afraid of offending people. Nobody is going to be offended if you said, 'In theory, it could work because it works in the tax act.' In a generic sense, I am getting a bit irritated with officers in various committees pulling this policy thing a bit too far.

**CHAIRMAN**—I thank each of you for your appearance before the committee and for your answers to our questions and the information that you provided which will be of benefit to our inquiry.

**Committee adjourned at 7.00 p.m.**