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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Australia's insolvency laws

THURSDAY, 7 AUGUST 2003

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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Thursday, 7 August 2003

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

Senators and members in attendance: Senators Chapman and Wong and Mr Griffin

Terms of reference for the inquiry:

To inquire into and report on:

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

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

(b) the duties of directors;

(c) the rights of creditors;

(d) the cost of external administrations;

(e) the treatment of employee entitlements;

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

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

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

WITNESSES

Committee met at 9.37 a.m.

ANDERSON, Mr Peter Christian, Director, Workplace Policy, Australian Chamber of Commerce and Industry

CHAIRMAN—Welcome. Today we continue the Joint Committee on Corporations and Financial Services' public hearing program for its inquiry into Australia's insolvency laws. 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 they give. Parliamentary privilege refers to the special rights and immunities attached to the parliament, 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. I also wish to state, that unless the committee should decide otherwise, this is a public hearing. As such, all members of the public are welcome to attend.

The committee prefers that all evidence be given in public, but should you at any stage wish to give part of your evidence in private the committee will consider a request to move in camera. The committee has before it a written submission from the Australian Chamber of Commerce and Industry, which we have numbered 13. Are there any alterations or additions that you wish to make to the written submission at this stage?

Mr Anderson—There are no alterations.

CHAIRMAN—I invite you to make an opening statement, at the conclusion of which I am sure the committee members will have some questions for you.

Mr Anderson—The Australian Chamber of Commerce and Industry welcomes the opportunity to provide a submission and evidence to this joint parliamentary committee. The role of insolvency systems and insolvency law is an important component of the operation of our economy and our society, and it is appropriate that these laws be kept under ongoing review by the Australian parliament. The issues paper released by the committee in conjunction with its terms of reference is a good and sound basis for consideration of the policy issues which arise. In an overall sense, the Australian Chamber of Commerce and Industry generally regards the operation of Australian insolvency laws as satisfactory, bearing in mind that they deal with an entirely unsatisfactory business situation—that is, the insolvency of what had been a trading commercial undertaking.

Although it could be argued at the margin that some changes could be made to provisions relating to administration and phoenix companies, the focus of the ACCI submission is on paragraph (e) of the terms of reference of the joint parliamentary committee—that is, the treatment of employee entitlements. Our submission was lodged with the committee in January this year. At the moment, we do not see the need to supplement that submission with further material, but if there are specific issues that arise, particularly in relation to other terms of reference on which the committee seeks a specific view, I am happy to take those issues forward and raise them with the relevant corporate policy directors in the organisation.

In broad terms, a summary of our submission on the issue of employee entitlements can be found at paragraph 7 of our submission. This is a genuinely difficult issue. Moneys owed but moneys not paid is a wrong and an injustice. The key points raised in our submission on this topic are as follows. It is important that employers accept the full responsibility they individually have to pay moneys owed to their employees on time and in full. In addressing the issue of how that principle is applied as a consequence of insolvency, our submission identifies a number of key issues.

Firstly, it is important to keep the policy responses to the issue of unpaid entitlements on insolvency in perspective to the magnitude of the problem. Our analysis of the issue is that there is no ideal policy response to what is an imperfect situation. In considering policy responses and the way in which the Corporations Law currently deals with the question, it is important to consider not only the position of employees who are owed unpaid entitlements but also the position of other creditors, including unsecured creditors, many of whom themselves may be small or even self-employed independent contractors. Governments of both political persuasions, over the past decade, have been relatively cautious in invoking large-scale policy responses to this question. That caution, identified in paragraph 7.18 of our submission, is not necessarily a failure in public administration. It may reflect the inherent difficulties in arriving at a policy remedy that does less damage than the problem itself.

In general terms, our submission indicates support for the operation of the General Employee Entitlements and Redundancy Scheme, known as GEERS. We have also supported amendments to the Corporations Law which have related to the duties of directors, particularly amendments which have more recently been made in relation to the duties of directors as they relate to avoidance of obligations to pay employee entitlements. Our submission also outlines the reasons why we do not support a government proposal that is foreshadowed to raise the priority level of employee entitlements in the ranking provisions of the Corporations Law above those of secured creditors.

Since the lodgment of our submission, there have been four other significant developments which I simply indicate and am happy take questions from the committee on. Firstly, proceedings in the Australian Industrial Relations Commission by way of a national test case have commenced, dealing with redundancy entitlements for Australian employees, and consequently redundancy obligations of Australian employers. Those proceedings, before a five-member full bench of the commission, are continuing. In fact, not far from here they are continuing today. Those proceedings concern a number of issues which have some potential implications for the work of this committee, including the level of the community standard redundancy payments which are prescribed by the Australian Industrial Relations Commission through the award system, and also whether or not community standards by way of award provision should differ according to the circumstances of a business making employees redundant whilst they are solvent, as compared with whether a business ought to have different obligations with redundancy upon insolvency.

The second issue that has arisen since our submission is that a number of these issues have arisen more actively in the process of bargaining in the industrial relations environment through unions, particularly raising these issues with employers in the bargaining rounds that have occurred during the course of 2003. Thirdly, the Cole royal commission has reported to the Australian parliament and government. That commission made a number of recommendations

which touched on aspects of the matters before this committee, including the issues of Phoenix companies.

Fourthly, since 1 July this year as a result of legislation passed by the parliament last year, quarterly superannuation obligations have been introduced on Australian industry. One of the aspects behind the introduction of quarterly superannuation obligations has been the desire to achieve high levels of compliance, accountability and transparency in respect of the employer superannuation obligations. In part, that legislation is based on the premise that quarterly superannuation, once introduced, may lead to higher levels of compliance and therefore less scope for unpaid entitlements of superannuation upon insolvency. With those few remarks I conclude my opening statement.

CHAIRMAN—Thank you very much, Mr Anderson. In your submission you referred to the Commonwealth government's announcement in September 2001 of what might be described as extending the existing provisions of GEERS through the Corporations Act by elevating the priority of employees' entitlements above secured creditors. You are critical of that, and in your submission you refer to earlier statements by the Commonwealth government, which were also critical of that proposal. Have you done any analysis of why the government changed its position on that issue? What are your views on the change of position?

Mr Anderson—It seems that the government has been searching for some policy responses to the issue, and that is an entirely right thing. I think all of the major political parties in the parliament, and even the minor parties, have this issue very much in their consciousness of political debate and policy thought. As we understand it, the government announced that it intended to amend the Corporations Law to heighten the priority of employees above those of secured creditors and it was at around that time or shortly after that the government also enhanced the operation of GEERS. Our analysis of that decision is that it would have been much preferable for the government to examine the way in which the enhancements of GEERS have operated before making a supplementary or additional policy response.

Our analysis of the way in which GEERS is now operating, which is different to the way in which the original employee entitlements support scheme operated, is that GEERS has by and large operated well and, in the overwhelming majority of cases, it is providing relief to persons who are employees of businesses where there is insolvency and where there are unpaid entitlements. There are always issues with a scheme such as GEERS in terms of the timing of payments and the importance of trying to get payments promptly to employees. That requires a process of checking and certification, and accountability and cooperation from insolvency practitioners. Whilst some issues of timing of payments still arise with GEERS, our analysis is that GEERS, as it has been enhanced from EESS, is a superior policy response and one which has really rendered unnecessary the need to take further steps by way of the secured creditors option.

To look at the secured creditors option and the super-priority that is proposed: there are broader implications that arise if you rank employee entitlements, which are unsecured, ahead of secured creditors. This is not just an issue of principle, from our perspective. There is a very important principle here of not undermining security and secured lending, but our analysis of it goes beyond the issue of principle to what are likely to be some of the practical implications for business as a consequence of that sort of change.

Our submission makes the point that the design of any super-priority will regulate the extent to which there are broader impacts. So, without seeing the legislation that government ultimately brings forward, we are talking today to some degree in the abstract. At the very least, one can say that ranking unsecured entitlements ahead of secured lenders is creating a more risky environment that the lenders will identify. If they identify a more risky environment, there are a number of consequences.

One consequence is that they may raise the cost of lending in order to cover the heightened risk. So there is some potential that lenders will seek to raise interest costs, at least in respect of some businesses. Secondly, it is possible that secured lenders will seek to move more quickly on business foreclosure in order to protect their exposure at an earlier point. So it is possible that, if they identify a potential risk and see the likelihood of their exposure to that risk being greater, they could move in and foreclose on a business more quickly. As we know from experience, some businesses that move into financial difficulties are able to trade out of those difficulties, salvage some employment and restructure, whereas some businesses are a basket case once they move into financial difficulties, and are identified as such by banks, administrators and liquidators. But it would not be generally a desirable outcome for the economy if you had early foreclosure on businesses as a result of banks identifying heightened risk.

The issue of a super-ranking for employee entitlements I think is capable of creating these broader implications for the economy. You then ask the question of whether or not those broader implications, which would apply in respect of businesses that may not be in any sense unable to pay employee entitlements, are a fair and proper policy response. Our preliminary discussions with the financial industry on this question indicate that they see themselves as being in a position to move forward that added risk that they face, onto the business community. They may not like the government's proposal either, but they are in a position to move that risk forward, whereas we as business providers and basically the consumers of their financial services products would in the end bear the risk.

CHAIRMAN—With one or two notable exceptions, most instances of unpaid employee entitlements relating to insolvencies occur in relation to small businesses. The government announced that its proposed amendments to the Corporations Act would exclude small businesses from the breadth of the legislation. Therefore, the legislation would apply only to large companies. Given that, how significant do you think the risk is of those possible detrimental consequences that you mentioned?

Mr Anderson—As I mentioned, the design of the legislation will regulate just how extreme those risks are or are not. I certainly do not want to be seen as putting forward an exaggerated view of the risk. Exempting small business, as is proposed, certainly minimises the risk of these adverse consequences, because you have a category of businesses which are substantial in our economy but which, on the face of it, would not be subject to that obligation. In those circumstances, the banks and the lenders would not be able to sensibly identify them as in the high risk category.

There is also another design issue which is very significant. The proposal announced by the government, as we understand it, is that the super-priority would apply to wages, leave entitlements and notice obligations but not to redundancy payments. Our knowledge of GEERS and also our knowledge of this issue from industry itself is that the largest issue in the unpaid

employee entitlements debate is redundancy payments. If redundancy payments are not included in the super-priority, that very significantly diminishes the risk profile that the banks would need to reassess. So, whilst there is risk associated with the proposal, those two design features diminish the risk. Nonetheless, it does still exist.

On the small business aspect there is one other issue which also has to be borne in mind and should, I think, cause policy makers some deep thought. When you exempt small business from something like this, you are creating boundaries which require definition. Even irrespective of how you define small business for those purposes, it is always possible for a business to move from being a smaller business at the time it may have borrowed some money to being over that line of small business by the time it moves into trading difficulties or into insolvency. Equally, it is possible that a business was a medium size business at the time of borrowing money but at the time of insolvency it is a smaller business that has already restructured itself downward.

As a result of that reality, there is something abstract about a definition which is always going to cause some anomalies. Whilst exempting small business from that proposal is definitely a beneficial element of the design feature, we have to be prepared to recognise that there are some anomalies created as a result of definitions.

CHAIRMAN—The government, when it announced the proposals in relation to the Corporations Act, said also that it would consult with the finance industry and business generally on those proposals. Has there been consultation with ACCI in regard to the proposals?

Mr Anderson—Yes, there has been. The government consulted with us and, we understand, other business organisations in the course of last year and also into this year. I think the most recent round of discussions we had was in March this year, with officials from Treasury.

CHAIRMAN—Among the submissions we have received from the trade union movement have been several suggesting a tightening of reporting requirements. For instance, the Australian Workers Union has suggested that employers should provide to the union and employees, on a regular basis, reports about the financial position of the company and, in particular, its ability to meet its obligations in relation to employee entitlements. The ACTU has put forward a similar proposal. What are your views, particularly of regular financial audits being supplied by companies to employees and unions?

Mr Anderson—I think it is an issue that is worthy of some consideration, at least in the context of workplace bargaining. I do not think that it is a proposal which ought to be mandated across all industry or all employers. There are certain reporting obligations for public companies and those obligations are very important. It is crucial that industry takes those obligations seriously and applies them fully. It is a little more difficult, when you get to smaller proprietary companies, to impose those same standards of reporting obligation. I think that it is a generally good thing that the Australian Workers Union have been looking around for some different solutions or options. I know that they have raised that issue in the context of bargaining with a number of specific companies. It is really a matter for them and those companies to assess whether or not they can agree on terms for that purpose.

One can look at the risk profile of companies and make some judgments about whether or not one needs to go so far as to put in place specific reporting and auditing obligations which are

designed just to address the issue of employee entitlements. One can look at companies that may be in higher risk categories of unpaid entitlements. You could certainly say that companies that have very high redundancy obligations, particularly if they do not have a large dollar value of fixed assets, may be in a risk profile of unpaid employee entitlements. Companies that do not have very high redundancy obligations would not have very high contingent liabilities in the event of insolvency and it may not be appropriate that they have more onerous reporting obligations. It is generally a good thing that different ideas are being put forward, particularly in cases where a union sees a particular risk profile that they want addressed.

Senator WONG—Before we move on, I am not sure that I accept the implication in your answer that this would be such an onerous obligation. I would have thought that, given that this is a contingent liability, one would have thought good corporate governance and good accounting practices would be such that that would be something an employer should take account of in assessing their financial situation. Why do you say it is such an onerous obligation to require at least an explicit financial reporting of what those contingent liabilities are? One would assume companies would do their accounts—major companies quite often I suppose—at least once a year to assess tax and all that. What is the difficulty with requiring companies to properly record and report contingent liabilities, including employee entitlements?

Mr Anderson—It is not difficult for a company to identify and record accrued liabilities. That happens as a matter of course in the processes that you have mentioned, so what is outstanding by way of leave entitlements and what is outstanding in the way of any unpaid wages can be readily identified.

Senator WONG—So in relation to the accrued liabilities you would say the imposition of a reporting requirement as to those would not be onerous?

Mr Anderson—If companies are already providing that detail, it is not an additional burden and so there is not an additional onerous burden.

Senator WONG—Before you move on to the rest of that answer I want to finish with this. Would you not agree that it would be good accounting practice and good corporate governance practice for companies to be identifying clearly their accrued liabilities—that is, leave entitlements et cetera?

Mr Anderson—I think that is good practice.

Senator WONG—What would be so onerous about requiring those to be reported?

Mr Anderson—You are creating another process inside a business. Businesses which already have processes which provide that information have mechanisms set up to do that, and providing that information to employees is unlikely to be an additional cost to them. Businesses that do not have reporting mechanisms—a smaller business or a proprietary company, for example—will have to put an additional process in place, even though they would be undertaking what is generally good practice.

Senator WONG—It is pretty standard.

Mr Anderson—It is good practice to have an idea of what your accrued liabilities may be.

Senator WONG—Isn't there a coalescence there between two good policy outcomes: one is people being aware of what their entitlements are; the second is encouraging good corporate accounting practices and requiring companies to have regard to what their accrued liabilities are?

Mr Anderson—Yes.

Senator WONG—Perhaps there may be a modicum of burden—particularly, I appreciate, on small business—but the other way of looking at it is that the policy outcomes are beneficial on two counts, because you are requiring even small businesses to have regard to what their real financial situation is and to take into account the accrued liabilities under which they are operating.

Mr Anderson—I would not disagree with that.

Senator WONG—You were moving on to contingent liabilities.

Mr Anderson—I will move on to contingent liabilities. I think there is a different issue when it comes to contingent liabilities. A contingent liability, such as redundancy payments, is not a liability that is known of. It is a liability that will only arise on the occurrence of certain events.

Senator WONG—I appreciate that.

Mr Anderson—The quantum of that liability will change according to the profile of the labour force at the time of those events.

Senator WONG—I agree with that.

Mr Anderson—Information about your contingent liability is only meaningful on the supposition that you are going to be making employees redundant, because that is the act that gives rise to the contingent liability. Even in the broad, the quantum of liability that you can identify at a given point in time by way of contingent liability will change as your labour force profile changes. So, as the work force gets older—

Senator WONG—This is self-evident, Mr Anderson.

Mr Anderson—Those of us involved in the IR system see the way in which those obligations are structured. They are based on an age profile, years of service and those sorts of things. Information about contingent liabilities requires assumptions to be made and that detracts from the value of the information you provide at the time.

Senator WONG—It may detract from the value in terms of its accounting accuracy but we are looking at what public policy is appropriate to maximise the likelihood that employees receive their minimum entitlements on redundancy and how best to facilitate good corporate governance practices. I do concede that redundancy is a slightly different situation. I frankly find it hard to see an argument against accrued liabilities being properly accounted for and reported. I think that that is a fairly reasonable proposition. In relation to redundancies, you would agree

that you could at least assess what your potential redundancy entitlement is at any particular point in time. There are certain assumptions you could make. I suppose what you are saying is that the question is: why should employers have to make assumptions about five, 10, 20 or all of their work force being made redundant, for every particular financial year—because what is the use of that information?

Mr Anderson—That is right. What the employer is being asked to do is engage in some calculations in the abstract. If you inform your employees of that information in the abstract there could be some workplace relations consequences. If a business tells their employees, 'If we make five people redundant—or if we make this division redundant—our liabilities are going to be X, and we can cover those liabilities,' that may reassure people that there is money to cover their redundancies but it may make them feel less secure in their jobs because the business have been doing some work on what their costs would be if they were to sack them. So I am not sure that that ultimately helps the operation of the business and its relationship with staff.

Senator WONG—I have some more questions but I think the chairman wanted to finish this. Before I finish on accrued liabilities: it would be normal accounting practice for a company to identify its accrued liabilities, including long service leave, annual leave and so forth in its accounts, wouldn't it?

Mr Anderson—Yes, it would.

CHAIRMAN—Another proposal from the ACTU went further than just the provision of information that we have been discussing over the last few minutes. It proposed that directors and company officers be personally liable if employee entitlements cannot be met in the case of insolvency if they had, in the provision of information, asserted that there was adequate provisioning for those entitlements. What is ACCI's view on that proposal?

Mr Anderson—Our view is that it is not a necessary change. We support the amendments that were made to the Corporations Law a couple of years ago, which in some circumstances do allow for personal liability of directors. We do not think that one needs to go further on that question. Our views on that are expressed in paragraphs 28 and 29 of our submission. I think that it is wise to let those provisions operate, see how they operate in circumstances where there are cases of unpaid entitlements and then, based on the experience of the operation of those provisions, consider any further proposals. But at the moment our position is that we would not support that proposal.

Senator WONG—Before we move off this: what would be the difficulty? I think what the ACTU is saying is that, in circumstances where there has been an assertion by a company director that there is money to cover your entitlements, he or she should be held to account for that statement. What is your philosophical problem with that? The sort of scenario I imagine that they are talking about—and there have been instances of this which you are probably aware of—is, where a company might be sailing close to the wind, there is a meeting between employees and their union and management, and employees agree to continue working under particular circumstances on the basis, amongst other things, of an assertion by representatives of the company that there is provision for redundancy entitlements. Do you not think it appropriate that directors be held responsible for such assertions if they are incorrect?

Mr Anderson—I do not think it is an issue of correctness; I think it is an issue of good faith.

Senator WONG—That is precisely right.

Mr Anderson—I think that making assertions in good faith on the best available information to you is the most you could reasonably be expected to do. It does not necessarily mean that in every case that assertion is going to be correct, though. I can imagine scenarios where an assertion may be made, in good faith, on the basis of information known at the time which is found to be incorrect or incomplete when additional information comes to light or another interpretation of the law is made about what liability a particular secured lender or lender with a floating or fixed charge may have had. That will ultimately determine the question of whether or not there is money available to pay an employee entitlement. As much as I can see the core decency in the proposition you put forward, I can also see a circumstance where, in good faith, a director could express that position but it may not actually be correct, or it may not be fully correct.

Senator WONG—That would seem to me to be an argument for a defence, not an argument against the imposition of that duty per se. One could construct a clause in the Corporations Law that made a director liable in those circumstances but then provided a defence of all reasonable care or that, as a reasonable person in those circumstances, they made the statement on the basis of the best information available. Would you not agree?

Mr Anderson—I do not think you are getting too far away from the provisions that have been put into the Corporations Law that relate to circumstances where a reasonable person has taken all reasonable steps to prevent the company from incurring the debt.

Senator WONG—I think you are talking about transactions which then can be considered as—

Mr Anderson—Uncommercial transactions.

Senator WONG—Yes. I think the ACTU are talking outside of that. There is a whole range of issues in relation to the definition of non-commercial transactions. I think they are saying that, if I employ you and you have a concern that the company is going to the wall and I say to you, 'It is fine. We've made provision for your entitlements. We just need you to keep working,' et cetera and the company goes under, I should be liable for that. I accept what you are saying: there are may be circumstances where I might not know all the information. But, as I said, that seems to be an argument for a defence rather than for the principle.

Mr Anderson—I think one does not need to legislate in the abstract here. If you have circumstances where some widespread statements are being made which are incorrect and which are not being made in good faith then you might look at something like that. But that does not seem to me to be the core of the problem here on the employee entitlements. You can have a circumstance where directors make a claim that they do not think there is enough money and then the company gets put in the hands of some administrators and the administrators actually find that the company is capable of trading, trade out, and hand the business back to the directors. You can have a range of circumstances where people can say things with the best of intention, but they may not actually turn out to be right.

I do not think you want to legislate simply because those things can happen. If we are looking here at legislative solutions, we should ask ourselves the question: is it going to make it more likely that employee entitlements are going to be paid for with the legislative response that is being made? I am not sure that that legislative response that the ACTU is putting forward, as you have described it, is going to make employee entitlements more likely to be paid for.

I think, though, there is an element in this question which is beneficial, and it is this: this public debate about employee entitlements which has occurred particularly in the last three or four years and the publicity that it has given to the high-profile cases has definitely raised the consciousness of Australian industry and directors of public companies—and, for that matter, directors of private companies—on the issue of unpaid employee entitlement obligations. I think that has been one of the benefits, a benefit that does not occur in a regulatory way but a benefit that has occurred as a result of some of the very difficult and high-profile cases that have occurred. There is a higher level of consciousness in industry about the issue of unpaid employee entitlements and, more generally, about what the community will and will not stand for in business conduct in relation to employee entitlements. That is a good thing. I am not sure that you want to legislate to make it unlawful when a director says something that ultimately does not happen for the reasons I have described.

CHAIRMAN—Other submitters have suggested some other alternatives for reducing the incidence of short falls in employee entitlements. Among those have been CPA Australia, who have suggested compelling companies to make full progressive provision for annual and long service leave payments and injury compensation payments in a separate designated trust account, that PAYG tax deductions should similarly be held in a trust account pending remittance and that designated employee entitlements should be retained in an industry trust fund or similar arrangement and be properly monitored. What is the view of ACCI with regard to those proposals?

Mr Anderson—We do not agree with any of those proposals. I think the last one of those, industry-wide trust funds, is probably one of the most undesirable policy responses here. What that is doing is trying to, effectively, create a pool of moneys which are taken out of the industry—out of the management capacity of the industry—and put into a trust fund simply on the basis that there will be future liabilities to make those payments. It carries the assumption that, unless you actually have those moneys in a trust fund, those who are contributing to the trust fund will not be making those payments.

This is where the question of the proportionate nature of the policy response is important. We are starting to see a profile of what the incidence of this in industry is. If it is correct from that profile that we start to get from GEERS and the reports of the insolvency practitioners, we have something around 99.2 or 99.5 per cent of entitlements paid to employees by the employer as required by law. The very small number of cases of unpaid entitlements has a huge impact on the individuals concerned; I accept that. But, given that overwhelmingly business pays its entitlements which are accrued, and also those which are contingent, as and when they are owed, it is not a proportionate policy response to say that all of those businesses ought to be putting moneys into a trust fund, simply on the basis that a small number—in some cases for reasons beyond their control and in some cases as a result of very poor practice—are not paying entitlements. I think that it is a well-meaning suggestion, but it is not a suggestion which operates fairly across industry.

Senator WONG—Is that your position even in relation to accrued liabilities?

Mr Anderson—Yes, it is. We do not agree with putting accrued liabilities into a trust fund.

Senator WONG—On the basis that it is taking money out of the industry?

Mr Anderson—It is taking an amount of capital out of productive use in the business, and certainly out of productive use in the industry.

Senator WONG—But there were those who would argue it is not your money to play with—

Mr Anderson—Yes, I accept that.

Senator WONG—and I would have thought, frankly, that that view was fairly widespread in the community. If we are talking here about accrued liabilities we are not talking about redundancy entitlements, are we, unless people have already been sacked. We are talking about liabilities which people are already owed.

The CPA's evidence is a bit different from yours. They make reference to the fact that there are frequent occasions on which large amounts are owing when companies become insolvent. I do not know what the statistical analysis is, but certainly, as you point out, there has been some widespread concern in the community as a result of both some high profile corporate insolvencies and also some in the small to medium size sector. The CPA made the very good point that companies, in this situation, are in effect using employee entitlements as a form of banker and using employee funds to continue operating. I would have thought that that is not a position that equates to good corporate management, if you are in a situation where you cannot operate other than by utilising capital which should otherwise be designated in respect of the accrued liabilities. What is the difficulty with requiring accrued liabilities not only to be accounted for but to be paid into a trust account?

Mr Anderson—I do not agree with the characterisations that you, or the CPAs, have put on the issue. This is not a case of using those accrued funds as a banker; it is a circumstance where there is an accrued liability but no current obligation to pay.

Senator WONG—That is semantics, though.

Mr Anderson—No, it is not.

Senator WONG—It is money that you owe them. It is money the employer owes them.

Mr Anderson—Let us take a real-life example: annual leave. I have an accrued amount of annual leave. My employer may want me to go on annual leave and I may want to accrue my annual leave. I may not want to go on annual leave at the moment; I may want to store up a bit more annual leave before I go on annual leave. My employer may have the money, want me to go on annual leave—that is, want to create the circumstance which is the obligation to pay—and I may be saying to my employer, 'No, I'd rather accrue my annual leave a bit further before I take it.' In those circumstances, it is not the employer who is saying, 'We will delay the act of payment'; it is me, the employee, saying to delay the act of payment. In those circumstances,

why should the employer have that amount of money that they are prepared to pay me right now—to take me on annual leave—remain in a trust account? I do not think it is a case of the employer using that money as a banker. I do not think that is right. That would be right only where there was an obligation to actually pay the money. It is not money where there is an obligation to pay; it is money that is an accruing liability.

To go more deeply into your question, the policy issue is really this. With every policy response to the problem there is a consequence. So we have to ask ourselves, 'What is the consequence of doing what is proposed?' It would be doing something which would change substantially what had been practice for decades. It would mean that those funds which are currently accrued but not payable would not be used for the purpose they are currently being used for. They are used for productive purposes in the business; they are part of the liquidity of the business. It would mean that they would go into a static trust fund circumstance. We have to ask ourselves what the consequences of that are for the business. I suspect the consequence is that the business are going to have to look to obtain whatever that component is from somewhere else to maintain their level of productivity or level of investment. That means higher borrowing. If there is higher borrowing, there is higher cost.

Senator WONG—I understand where you are going; I understand that.

Mr Anderson—If you are borrowing more, you are paying more in interest. It may mean that you weaken some capacity to employ. I am not sure that you end up with a net win situation for the employees in those circumstances.

Senator WONG—Do you think a business that relies on the amount equated to its accrued liabilities to such an extent that paying those into a trust fund would render its liquidity unviable is a viable business?

Mr Anderson—The answer to that question is that it probably is not, but that is where I say I do not think the characterisation is right. I do not see this as being a question of businesses hanging on to this sort of money to maintain their liquidity.

Senator WONG—I understand that is your position. I am not trying to argue. We have a different view, I suppose, about how one might characterise this, and what I was putting to you was the CPA's characterisation. I am asking you as a matter of policy: should we really be protecting businesses that are so close to the wind that payment of accrued liabilities—and that does not include redundancy—would render them unviable?

Mr Anderson—I do not think you are protecting them. I think what you are doing is allowing the operation of the current situation, which is that funds that are in the hands of the business but not actually payable are capable of being used for the productive purposes of that business.

Senator WONG—Or capable of being lost. That is the problem, isn't it?

Mr Anderson—All funds are capable of being lost, that is true. One then has to ask the question: what is the likelihood of those funds being lost? You may not agree with the percentages that the CPAs have or that we have but in relative terms it is a very small circumstance where accrued annual leave or accrued long service leave is not paid. In those

circumstances you are imposing an obligation on a much broader section of the business community to tie up those funds to address a limited problem.

Senator WONG—You have said a number of times in your evidence that this is a limited problem and that it is a very small issue. The difficulty is from a public policy perspective. It may be statistically a small issue but for the people whom it affects it is a massive issue.

Mr Anderson—I agree with that and I have acknowledged that.

Senator WONG—And for many employees some of the amounts we are talking about are the largest sums of cash or capital that these people are likely to accrue over a long period of time, particularly redundancy payments. If we are talking waged workers, these are significant entitlements for them, so one cannot measure the public policy impact of failure to pay these entitlements simply by statistical analysis.

Mr Anderson—No, I agree with that.

Senator WONG—I appreciate ACCI's position. You come from a particular perspective and that is fine, but I do note that your answer to my question, 'Do you really think a business would be viable if paying accrued entitlements into a trust fund is going to so negatively affect its liquidity?' was no. So in many ways this policy is consistent with good governance practice—that is, make sure you can at least pay out your accrued entitlements. That is not money you should be gambling with.

Mr Anderson—To make it clear so that we do not misunderstand my answer, the question was whether a business is being well managed if that amount of money is going to be the difference between liquidity or not. If the business is relying on that amount of money to maintain its liquidity, I do not think that is a sign of a business that is well managed. But equally there may be a circumstance where that amount of money is the difference between liquidity or not. If that amount of money actually keeps the business in liquidity and the business then moves into a more profitable situation and that amount of money does not become a factor on the issue of liquidity, then that is not a bad thing. If you do have a policy response that says that amount of money is in a trust fund, then obviously it cannot be the difference between liquidity or not; therefore, it could not have that positive impact that it might in that scenario that I have painted.

Senator WONG—I think we have now moved to quarterly payments for superannuation. Super is not currently included in GEERS. What would ACCI's view be about including superannuation in GEERS?

Mr Anderson—We do not see that as necessary. It is a matter that should be subject to review though. There are two steps that have been taken recently which I think should be allowed to operate and the impact of those be assessed before changes to GEERS are considered. Firstly, the quarterly introduction, as I said in my opening statement, is designed to increase compliance levels and I suspect that it will have that effect. Secondly, the Australian tax office is taking a more activist role in enforcement activities in this area—

Senator WONG—In relation to super?

Mr Anderson—In relation to super. That it is a good thing. Even though some businesses affected may not see it as good thing at the time, it is a good thing because those obligations exist and those obligations have to be complied with, and there are good social policy reasons for that, apart from the benefits to the individual employees.

Just in the last six months I think some 26,000 or so notices have gone out from the tax office into the business community. I think there are activities the tax office is undertaking with the accountants of those businesses, and I think they are better avenues to increase the level of compliance than simply including them in the GEER scheme. Putting them in GEERS does not, in itself, increase compliance. What GEERS does is to provide a level of payments, and I think we come back to the core proposition that those responsible to make the payments—that is, my members, the people I represent—ought to be making those payments.

Senator WONG—Are those notices of noncompliance or just information regarding the quarterly remittance?

Mr Anderson—I think they are information regarding quarterly remittance, which, as I understand it, could lead to issues of noncompliance. So, effectively, there is an assessment of risk profiles or judgments that have been made. The tax office is seeking information about those who they think are in a particular category where there may be non-payments or underpayments.

Senator WONG—I was just clarifying whether it is because there has been information received by the tax office that there has been a failure to remit, or whether it is more proactive than that.

Mr Anderson—I understand it is more proactive than that.

Senator WONG—I have some brief questions about voluntary administration. I do not know if you have any views about the current procedure, but there have been a number of submissions which do raise some concerns about the voluntary administration procedures. One issue that has been raised is the relative rights and remedies of secured and unsecured creditors, whether they are appropriate and whether they can be improved or not. The second issue was one of the things this committee has discussed a couple of times, debtor and possession schemes such as exist, I think, in the United States. I do not know if you are familiar with those and whether or not those would have any relevance or appropriateness.

CHAIRMAN—Chapter 11.

Senator WONG—Yes, chapter 11.

Mr Anderson—Neither of those is an area that I am personally familiar with. I am advised by our corporate policy people that, generally speaking, on the administration side we feel that the scheme operates satisfactorily. There have been some concerns about inadequate notice periods for the calling of meetings by administrators and the like. Our sense of it is that some of those concerns may be valid. But, apart from those more procedural aspects of the operation of the administration provisions of the scheme, I am advised that generally we think they are satisfactory.

CHAIRMAN—Another issue that has been raised in submissions to our inquiry, including from the tax office, is concerns about the operation of deeds of company arrangement. In instances there, employees can be disadvantaged by the deed of company arrangement providing employees and unsecured creditors with less than they would otherwise be entitled to in a winding-up—the priorities in terms of entitlements to employees being changed or ignored, or employees missing out on claims they have lodged under GEERS because the wording of the DCA does not permit the Commonwealth to recover the funds. Does ACCI have any views on the way DCAs operate?

Mr Anderson—As I understand it, those who are putting together the deeds of company arrangement and those who are authorising the deeds are having to make some very difficult judgments about the respective rights of people who are owed funds. In this whole area there is inequity for anyone who is owed moneys but who is not going to secure those moneys. We are concerned about the position of unsecured trade creditors as much as one should be concerned about the position of unsecured employee entitlements. Unsecured trade creditors, particularly small business people who are just self-account operators and the like, can be very seriously disadvantaged, in terms of their own wellbeing and their own family's wellbeing as well, by large amounts of money being owed to them and not paid.

I do not think there is a perfect solution to this. There is criticism of the terms of deed of company arrangements, but I think that is reflective of the nature of the problem. On the issue of deeds which seek to avoid the operation of the GEER scheme, we would not give any succour at all to any mechanisms that were put in place to avoid the operation of the GEER scheme. The GEER scheme should not be seen by industry as a transfer of its obligation to the governments—that is not what the scheme is. The minister wrote to us and to other business organisations earlier this year making that point absolutely clear. We agree with what the minister said in his correspondence. We have communicated throughout industry that the GEER scheme is a scheme in which the government is making some upfront payments and then standing in the shoes of the creditors. We do not think any arrangements should be put in place by companies, whether under the Corporations Law or otherwise, which would undermine that proposition.

CHAIRMAN—Does ACCI have a view on the advantages and disadvantages of insurance schemes that have been suggested as a means of protecting employee entitlements?

Mr Anderson—We have not been convinced that an insurance scheme is an appropriate policy response. Our concerns with the insurance scheme mirror some of the concerns I mentioned earlier about the trust funds—that is, whether it is a proportionate response; whether you are imposing an obligation across the whole of an industry, or across the profile of employers generally, to make payments or pay compulsory levies on the basis of seeking to protect entitlements, which the overwhelming bulk of companies would be paying and would not be giving rise to circumstances where claims on the insurance were actually required. We do not think it is a proportionate response. It is a compulsory levy and, in that sense, it is a compulsory tax. We do not think that is good for the economy or for job creation. It is effectively another compulsory tax on jobs.

CHAIRMAN—Do you have any knowledge of the international situation with regard to employee entitlements? Do some countries, and if so which ones, place employee entitlements ahead of secured creditors?

Mr Anderson—I think our submission mentions that there are two companies. We have done a bit of research on this to try and identify that. We have been able to identify two. We are not saying that there is not any more, but I would be surprised if there were many more. Our best research suggests that Mexico and one other country rank employee entitlements ahead of secured creditors. It is not general practice. When one looks at other countries, there are very different ways in which these issues are dealt with. There are pension schemes and insurance schemes in European countries which exist for a range of different purposes, which can include certain protections for entitlements. Those schemes are contributed to not just by employers but by employees as well as governments. So it is not a straightforward comparison with the insurance proposal.

CHAIRMAN—In your opening address you referred to the issue of phoenix companies, which arose out of the Cole royal commission. You indicated there may be some changes at the margin required in dealing with phoenix companies. Can you expand on your comments?

Mr Anderson—The Cole commission made probably seven or eight recommendations on phoenix companies. Generally speaking we have supported them. We have put forward a submission, which is publicly available, in response to the Cole commission's 212 recommendations. Generally we have supported the recommendations on phoenix companies, but in a couple of areas we suggested modifications. The one that we had the most difficulty with was the recommendation that ASIC be entitled to take action to disbar a director if they had on only one occasion been a director of a company which had moved into insolvency.

Our view is that that is probably going too far. If the recommendation was linked to the core issue that Cole looked at, and that was fraudulent phoenix companies, then it may be a sustainable proposition. Our response to that one is that that particular recommendation is probably framed too broadly. If it was narrower, to the issue of a director who had been involved in fraudulent phoenix companies, then it is hard to see why ASIC would not have scope to take action in those circumstances to debar. But, generally speaking, a right to debar a person and take legal action simply because they had previously been a director of a company that had gone insolvent on one occasion seems to be, in broad, going a step too far. We have generally supported the other recommendations of Cole on phoenix companies.

CHAIRMAN—Mr Anderson, thank you very much for your appearance before the committee. We appreciate what you had to say to us, particularly your answers to our questions. It has been very useful.

Mr Anderson—Thank you.

[10.47 a.m.]

FULLERTON, Ms Elizabeth, (Private Capacity)

CHAIRMAN—Welcome, Ms Fullerton. The committee prefers that all evidence be given in public but if at any stage of your evidence or answers to questions you wish to respond in private you may request that of the committee and we will consider such a request to move into camera. We have before us your written submission, which we have numbered 31. Are there any alterations or additions that you want to make to your written submission at this stage?

Ms Fullerton—No.

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

Ms Fullerton—Summarising my submission, basically I was an employee of a company that went into voluntary administration over a year ago. Since that time, a group of almost 100 ex-employees, most of whom are still in contact, have made various attempts to find out information and get things done but it has basically been impossible for us. We have had massive difficulties even in finding out our rights and in finding out the way things should work. We feel that we have been given the run around the bush by the administrator several times. We have approached ASIC, and ASIC has been less than helpful on a number of occasions. The result of all this is that I would like to bring up many points, but I will probably focus on only a few.

The administrator was able to conduct a creditors meeting which was to vote for the deed of company arrangement. This meeting was held in Sydney—the company's head office was in Sydney—and many of the Melbourne creditors were unable to vote for the deed of company arrangement because we were not delivered the details of the deed until less than one working day before the vote. So we were unable to get our proxies to Sydney, let alone take legal advice or consider what it had to say. On top of that, it appears that the deed had not been written at the time of the vote. So the deed was based upon the material being voted on, yet anything could have happened in between the vote and the actual writing of the deed.

It was very difficult for us to determine what was in the deed because it was not distributed to anybody. One copy was made available in the Sydney office and one in the Melbourne office of my company, and that copy mysteriously went missing. We were able to purchase a copy from ASIC, and we eventually found out that the administrator's Melbourne office was holding a copy that we could have purchased a photocopy of—but they did not tell us that until we pestered them a bit.

The other point about the deed of company arrangement is that it disturbs the subrogation rights under GEERS. At this moment now, almost a year after we started going through this, we have not received a penny. GEERS has not been able to make a decision on our case. In fact, our administrator has had to take legal advice on the legalities of the deed that they wrote. They are not sure about the legalities of what they have written. It really says a lot about administrators.

The next point I make is about the rights of creditors. Employee creditors are different from trade creditors. We cannot write off our losses on tax. It is not a part of our total income; it is our entire income. We need it and live off it for rent, food, school fees and things like that. Employee creditors should be placed on a different level to all other creditors. It is not something that we have any mechanism to guard against, apart from savings, and, in some cases, that is not easy. Not only are we not absolute priority creditors, but the administrators can come along and create a deed of company arrangement which practically destroys any of the rights that we are clinging to—and that should not be permitted.

The other point about employee entitlements is that we have been waiting a year. We were told that we would receive some form of payment from GEERS within one to six months of making a claim. It has now been a year and we have received nothing. We have not even received anything definite. We have received no information as to what is going on. We have one person in our group who is unofficially our contact with GEERS and he sends us a weekly report on news. For the last few weeks there has been no news at all.

That pretty much summarises my submission. I would also like to mention that, in the year since this has happened, our GEERS case manager has resigned and the two gentlemen from the administrators are now no longer with the company. Even the person I first contacted at ASIC with my complaint about the vote for the deed of company arrangement is no longer there. So, after a year of hard work, we are pretty much back at square one, except that we are a lot more tired and a bit more pissed off. That is pretty much it.

CHAIRMAN—Thank you for those comments. Is your main concern with the time line for the delivery of information and the holding of creditor's meetings in relation to your own experience?

Ms Fullerton—My main concern is about the entire organisation of it. We have heard so many conflicting reports. We found it very difficult to even understand what GEERS do. Their information was not amazingly helpful. Among the things that we have heard about GEERS from various sources in the past year—and this is not rumour mongering, it was from the administrator of our ex-company, which is still trading under administration—is that GEERS will pay all entitlements, including salary, annual leave, notice retrenchment, long service leave, and superannuation to a salary cap of $80,000. We heard that they will supplement the difference between the amount stated in the deed of company arrangement and the total amount, which is also capped, and that they will not pay more than the amount stated in the deed of company arrangement. If the company goes into liquidation before the period of the deed of company arrangement is completed then GEERS will pay employee entitlements in full, regardless of whether they were only paying to the amount in the deed. We also heard that GEERS lend the money to the company which then pays us but GEERS never actually check to see that they do pay us, and that GEERS try to finalise all payments within one month of application.

There is no clear process. This is my first time of going through an administration, and I feel that the administrators, who also claim not to know how it works, are at a distinct advantage. I think that they do this professionally and they know. I think that it is in their best interest not to help us out with these things. There needs to be some kind of process—an 'administration for dummies' kit—where we can sit down and look at it so that we can know exactly what to expect and when to expect it from all the parties involved.

We had a little high jinks from the administrators. Before the first creditors' meeting they sent out a bunch of empty envelopes, and people who received those only knew about the meeting because of their friends. Before the deed of company arrangement meeting the information was sent out drastically late. My complaint to ASIC came back saying that they had been acting under a Supreme Court order. I will state at this point that I was not in any position to take legal advice on this; I had just lost my job and the month's salary I was expecting, as had everyone else. I was trying to find money; I was trying to work. Seeking legal advice on this was really not an option for me and probably was not an option for most of the other people involved. Apparently the Supreme Court order that our administrator claimed to be working under was purely to delay the meeting. It did not say anything about sending out the material so late that nobody was able to vote—or at least the people who did not have representation in Sydney were unable to vote

I guess I am looking at two issues here: one is that the roles and responsibilities of the people involved in voluntary administrations need to be clearly defined and need to be well publicised—and in such a language that people can understand them—and the roles and responsibilities need to be watched and enforced. That sort of thing should not be allowed to happen. I have had several communications with ASIC since then. ASIC seems supremely uninterested. I can understand why: they have bigger fish to fry, but we are still a fish.

CHAIRMAN—What do you believe is a reasonable minimum time between receipt of information and the holding of a meeting and should it be specified in the law?

Ms Fullerton—I am under the impression that the law states that it should be five working days. I believe that they are supposed to give five working days. To receive materials on a Friday night—

CHAIRMAN—Five working days notice of the meeting?

Ms Fullerton—Receipt of the materials.

CHAIRMAN—Receipt of materials?

Ms Fullerton—Yes.

CHAIRMAN—So what you are saying is that in this case the—

Ms Fullerton—We received the materials on a Friday—literally, on a Friday night, because you have to get home from work. The proxies were due in Sydney on Saturday and the meeting was on Monday.

CHAIRMAN—So you are saying that the administrators were in breach of the legislation in this case?

Senator WONG—There is a suggestion, as I understand it, that there was a court order permitting an earlier meeting—you referred to that.

Ms Fullerton—The court order was for that. That meeting was delayed by a week or two weeks or something. I believe they had a court order to delay the meeting. I do not believe they had a court order to send out the material so late that small creditors would be significantly disadvantaged, which was the case.

Senator WONG—But your complaint about the meeting process does not simply relate to the time, does it? It is also the accessibility: the fact that it was in Sydney, not Melbourne where the majority of creditors were.

Ms Fullerton—With any company that has more than one office you are going to have this problem. I think I would have been quite happy to have had time to examine the materials, understand their implications and have my proxy sent to Sydney. You cannot be hideously unreasonable about these things. But I think sending out the materials less than one working day before the meeting was completely unreasonable. The only people who are capable of accessing those materials and having representation in Sydney in the event that they cannot get the proxy are the larger companies which have in-house legal departments. I do not have one of those and neither do most of the others.

CHAIRMAN—You are saying the court order did not give any permission for a delay in sending the information as far as you understand it?

Ms Fullerton—As far as I understand it, it was only for delaying the timing of the meeting. The timing is completely unreasonable. I cannot see that a court would say, 'Yes, give these people the information practically after the meeting.'

CHAIRMAN—I can understand that. What have ASIC said about this lack of information being provided in a timely fashion?

Ms Fullerton—ASIC's initial response was that the administrator had told ASIC they were acting under a court order. I am not sure if ASIC actually checked that out. I have had a bit more correspondence with ASIC. The most outstanding one was the latest thing I received from them, which was in June. I have replied to them since then but I have not received a response. This is from them:

> The minutes of the creditors meeting indicate that the issue of the late delivery of information was discussed and that the Court did not order that a Report be provided with the notice. The minutes also indicate that the effect of the proposed Deed of Company Arrangement (DOCA) on GEERS claims was discussed. Nevertheless, creditors voted in favour of the DOCA.

That is neither here nor there, as far as I am concerned. Basically, my point of view is that the people who voted for it were the people that had the most to gain from it. They were the larger creditors, who were owed more money. They had representation in Sydney—they had legal departments. And the smaller creditors, mainly the employees, were disadvantaged. We were prevented from voting. I have no idea whether our vote would have made a large difference or not, but we were prevented from voting, and it was to the benefit of the larger creditors.

CHAIRMAN—When we had evidence from the Department of Employment and Workplace Relations, they advised that, from their experience, deeds of company arrangement would have

altered the normal creditors' standing only in a tiny number of cases. Indeed, they were able to give one example—which may have been your example, although I am not sure. Are you aware of other examples of those circumstances occurring?

Ms Fullerton—No, I am not.

Senator WONG—I have got a number of questions. I will start with GEERS. I am not sure what you were reading from before.

Ms Fullerton—What I was reading from before was actually a letter I sent to a large number of politicians.

Senator WONG—What does the written response from the department in relation to your GEERS entitlement say?

Ms Fullerton—We are not sure. I am not sure what they have said, and I do not think they are sure either. We have had a large number of emails filter through—it has been email correspondence. All I have officially had from GEERS in the form of a piece of paper has been, 'We are examining your case.'

Senator WONG—When did you get that?

Ms Fullerton—A long time ago. As I said, we have had one person in our group who has been the unofficial spokesperson for us with GEERS. The information we have had from them has been that they do not know what the legalities of the situation are. I think the most recent communication we had was that they are closely examining our case, because it is going to be a test case now.

Senator WONG—Is the nature of the hold-up which appears to result from the particular provisions of the deed of company arrangement outlined anywhere, from DEWR's perspective, in any correspondence to you, to Mr Bishop or to anyone else?

Ms Fullerton—In terms of the subrogation of rights?

Senator WONG—Sorry. As I understand it, the problem with your GEERS entitlements is that there are some legal issues which arise from the nature of the deed of company arrangement. Is that right?

Ms Fullerton—Yes.

Senator WONG—Is there any correspondence from DEWR, from the GEERS administrators, which sets out the reasons for the—

Ms Fullerton—The reasons for the step-by-step problem?

Senator WONG—Yes.

Ms Fullerton—I do not have that with me here, but I think we probably have had something that says that the subrogation rights have been disturbed and they are trying to come to some decision about them. I know that the administrators were seeking legal advice. We have had nothing definite. We have had nothing that says, 'You will receive this money,' or, 'You will not receive this money.'

Senator WONG—It might be useful for this committee if you could look at finding whatever correspondence you have from DEWR which sets out what they say about why you are not being paid. As the chairman points out, we have raised this issue previously, both in this committee and also in the Senate estimates process, and DEWR's response has been that it is miniscule—there are very few people in this situation. So I am interested to see what they say about why you are not being paid.

Ms Fullerton—I am not sure we have had anything that specific from them, but I will have a look and send you what I have.

Senator WONG—I think it would be a supplementary submission, technically. But it might help if you could perhaps provide us with some correspondence from DEWR that sets out what they understand to be your entitlements under the GEER scheme. With regard to your knowledge about the fact that your entitlement to GEERS has been negatively affected by virtue of the question of subrogation of rights under the deed of company arrangement, do you know that from discussions with DEWR or from discussions with the administrator, or how?

Ms Fullerton—We have had a lot of correspondence in the past. We have one person who is sort of a self-appointed spokesperson for dealing with GEERS, and the information has come through him. Either he forwards us the email correspondence he has had from them or he has rung them up or he has been to Canberra to speak to people and he sends us a report on what the situation is. We have had no information from the administrator on that point.

Senator WONG—How long have you been waiting? It is over a year now, isn't it?

Ms Fullerton—It is over a year.

Senator WONG—Back to the deed of company arrangement in terms of the process: your employer went into voluntary administration—who is the administrator?

Ms Fullerton—Deloitte.

Senator WONG—When were you first advised of the fact of voluntary administration?

Ms Fullerton—On 12 July, at about 5.30 p.m. They made us stay back so that they could fire us.

Senator WONG—Your employment was terminated two weeks after that?

Ms Fullerton—Yes, two weeks after that, on 26 July.

Senator WONG—It was some time before the deed of company arrangement was put to creditors? You received notice on 21 October of a creditors' meeting in Sydney?

Ms Fullerton—Yes.

Senator WONG—Proxy forms were provided with that notice. Did employees submit any proxy forms?

Ms Fullerton—I do not know. There was one interesting rumour floating around. An email that came onto one of the lists that said, 'Don't quote me on this but I believe that if you abstain from the vote you will get a better payout from GEERS.'

Senator WONG—That is what I thought.

Ms Fullerton—I believe some employees did vote against it, but I am not sure of the full numbers.

Senator WONG—Were all the employee creditors based in Melbourne or were there some in Melbourne and some in Sydney?

Ms Fullerton—I think there will be some in Sydney. There are about 90 all up, I think.

Senator WONG—They are Melbourne and Sydney based?

Ms Fullerton—There will be some in Sydney but I think the majority will be in Melbourne.

Senator WONG—You have had a look at the deed of arrangement—

Ms Fullerton—Yes.

Senator WONG—What is the effect in relation to unsecured creditors.

Ms Fullerton—I am honestly not sure. I did not understand it.

Senator WONG—Has anyone explained it to you?

Ms Fullerton—I have had someone look at it for me. I have a lawyer friend who looked at it and explained it.

Senator WONG—Were any explanatory notes provided prior to or subsequent to the meeting about what the effect of the arrangement would be on your entitlements?

Ms Fullerton—No. We found that out because GEERS said, 'We cannot do this—

Senator WONG—I accept that. Did the administrators at any time give you any documents which set out what the effect of the arrangement would be on the percentage of entitlement that you were likely to get?

Ms Fullerton—Yes. That is another story as well.

Senator WONG—When did that come?

Ms Fullerton—I think it was in the materials that were sent before the vote—the ones that came late. There is an interesting interlude with that as well. They stated a percentage that they thought we would receive—

Senator WONG—In the documents?

Ms Fullerton—Yes.

Senator WONG—And what was the percentage, do you recall?

Ms Fullerton—Forty-two per cent or 43 per cent. The problem was that it was based on none of the employees receiving redundancy payments. At that point the administrators stated that they could see no evidence of our company having a policy for paying redundancy payments. There had been three rounds of redundancies before we were stood down. To the best of my knowledge every one of those people received redundancy payments. There have been redundancies since the company went into administration and while it was still trading, and I believe those people have also received redundancy pay.

Senator WONG—Where did the administrators make the assertion that there was no evidence of a policy of redundancy payments? Was that in the explanatory notes?

Ms Fullerton—They sent us out a statement that said what they thought we were owed, and it did not include redundancy money.

Senator WONG—They asserted that the deed of company arrangement made provision for around 42c in the dollar of your accrued entitlements, which is long service leave, annual leave and so forth.

Ms Fullerton—It included all that plus a four-week notice period. There was also a redundancy payment on top of that. The problem is that the amount of money they put into a pool for employee entitlements worked out at 42 per cent, assuming no redundancy payment. If we claim redundancy payment, that will shift because it is a finite pool.

Senator WONG—I see. Presumably there are award based redundancy entitlements, even if there is no enterprise bargaining agreement, that make for better redundancy entitlements.

Ms Fullerton—No, the company had signed an award agreement a few weeks before they went into administration which provided for that. In the preceding year there had been a number of redundancies.

Senator WONG—I appreciate that. So you say there was a certified agreement or something like that that set out redundancy entitlements over and above whatever the award said?

Ms Fullerton—I am not sure that it was over and above the award but a few weeks before they went into administration they signed on. I cannot remember the award; it was an IT award of some description and it is associated with APESMA.

Senator WONG—But that was not referred to in the administrator's information to you?

Ms Fullerton—No.

Senator WONG—Have you raised that with the administrator?

Ms Fullerton—I have asked them to confirm it and I have not received a reply. I think they are working on something.

Senator WONG—To your knowledge, has this disputed redundancy entitlement been discussed with the administrator?

Ms Fullerton—Yes, it has, because when we put in our GEERS application forms, as far as I know everyone included the redundancy amount—I certainly did—and that was certainly a matter of discussion between GEERS, our representative and the administrator.

Senator WONG—Have you had any response on whether or not they acknowledge the debt?

Ms Fullerton—No.

Senator WONG—So currently the only debt they acknowledge is your accrued entitlements?

Ms Fullerton—That is right.

Senator WONG—Excluding redundancy?

Ms Fullerton—Yes.

Senator WONG—It is very strange. So at this stage you do not know what the current status is of your claim under the GEER scheme?

Ms Fullerton—Apparently they are examining it.

Senator WONG—And they have been examining it for some time.

Ms Fullerton—Yes.

Senator WONG—When did you put the application in?

Ms Fullerton—It would have been fairly soon after we went into administration; I would say it was around August or something like that.

Senator WONG—So you put it in prior to the deed?

Ms Fullerton—Yes.

Senator WONG—Your group of employees are not legally represented?

Ms Fullerton—No.

Senator WONG—They are not represented by any industrial advocate or trade union?

Ms Fullerton—No. I think there may be some who have casual legal advice, as I do, but no-one does formally. I do not think that we should have to. I do not think we should be running and jumping through hoops. These things should be set out so that we do not have to go through this.

Senator WONG—It seems to me that there are a number of concerns with the process but, in terms of the actual effect of the deed, firstly, it does not appear to acknowledge all the debts you say you are owed and, secondly, you are concerned that the actual arrangement has given preference to certain creditors over yourselves.

Ms Fullerton—Yes.

Senator WONG—On what basis do you say that?

Ms Fullerton—The larger creditors, who were able to vote at the meeting, have certainly been advantaged over us. We were unable to assess the deed, obtain legal advice if we wanted to or even get our proxies to Sydney on time. If I had spent all night reading it with a legal eagle at my side and come to a decision I still would have had to run out and find a post office in order to fax my proxy, because there was not enough time for a basic postal organisation. The thing is that the larger creditors have in-house legal services: the banks—

Senator WONG—I agree that it is easier for them to participate in the process to their advantage but I am just wondering, in terms of outcome, whether you say they have been advantaged by the deed. Does the deed of arrangement make greater provision for their debts than for yours in a way that you think is unreasonable?

Ms Fullerton—Yes and no. I think I should get 100 per cent of my entitlements, obviously. In terms of the fairness of the deed, I do not know if the deed does strange things to their rights as it does to mine—I could not tell you. All I can tell you is that I lost my job a year ago and have received nothing, but I have spent a lot of time and energy trying to find out what is going on and I do not think that should be necessary.

Senator WONG—Thank you for coming today. I wish you luck.

CHAIRMAN—What do you think is a reasonable time frame for employee entitlements to be paid out where a company under administration have sufficient assets to meet their obligations?

Ms Fullerton—I would probably say within about six weeks. Sooner would be nicer, but obviously they have to do things in order to sort themselves out. It should not be more than that, really.

CHAIRMAN—If GEERS had to be brought into play, what do you think would be a reasonable time frame?

Ms Fullerton—I would like to say the same amount of time. In our case the GEERS had to wait for the deed of company arrangement, which was several more months. So I do not know if that is practical.

CHAIRMAN—Thank you very much for your appearance before the committee, Ms Fullerton.

[11.21 a.m.]

BISHOP, Mr Nicholas Robert (Private capacity)

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public but if at any stage of your evidence or answers to questions you wish to give your evidence in camera you may request that of the committee and we will consider such a request. Please state the capacity in which you appear.

Mr Bishop—I appear in a private capacity, but more particularly as an ex-employee of Open Telecommunications, which went into voluntary administration last year.

CHAIRMAN—We have before us your written submission, which we have numbered 36. Are there any specific alterations or additions you wish to make to your written submission at this stage?

Mr Bishop—There is one point: it has come to my attention that deeds of company arrangement can also be used as an alternative path to liquidation. This comes from my cursory knowledge of the M-tram and M-train administration, which occurred in December last year. I am not sure of the details of that deed proposal but it seems to me that they are liquidating that company via a deed. So the comment in my submission about the deed and my suggestions about what you can and cannot do in the deed should be restricted to deeds where the company keeps trading. Unfortunately I cannot be more specific about that. It has only come to my knowledge in the last couple of days.

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

Mr Bishop—I would firstly like to go through the events that have happened since my submission. We have appeared in the media—me plus one other person—in the *Age* and the *Sydney Morning Herald* with the storyline that the employees of my company had still not been paid after almost 12 months. The media coverage has escalated our claim and made it visible to the Minister for Employment and Workplace Relations. There was some activity within the department but we were not able to get the details of that activity. Also, to date there has been no payment. The major issue holding up our claim is the department's view that the deed of company arrangement does not meet their operational guidelines. The main specific issue is that the deed alters the priority of creditors. I therefore disagree with the ACCI's view expressed to the committee earlier this morning that GEERS is operating satisfactorily.

I believe that my former employer, Open Telecommunications, will make good profits in the future. I base my view on the fact that they sell mostly to the telecommunications industry. As you probably know, telecommunications is an essential part of the global economy. Their difficulties are only temporary. Given that they will probably make good profits in the future, I was rather disappointed that the deed of company arrangement had a limited recovery of about 43c in the dollar for employee entitlements and 20 per cent for ordinary creditors.

I have considered a number of other submissions and wish to highlight my opinions on some points raised in other submissions. Submission No. 19 was authored by Deloittes, who are acting as the voluntary administrators for my employer. They made this cheeky comment:

> We believe that the GEERS system is providing an adequate safety net to employees to satisfy social expectations.

That is very cheeky, given their role in supporting a deed which effectively closed out our GEERS claim. They also noted that creditors had the opportunity to appoint a different deed administrator if creditors chose to enter a deed. Well, they did not tell us. That relates to one of the problems that some creditors face—that is, knowing what their rights are.

The next submission for consideration is No. 14, from the Australian Taxation Office. In my view it was very well thought out. They touched a few times on an important issue, in that most creditors are unfamiliar with the insolvency process because they either do not go through it at all or they go through it only once. It is extremely important that committee members have this in the front of their minds—things like ensuring creditors are told their rights and responsibilities in more detail. It would also help if the content of deeds of company arrangement were much more tightly controlled.

I also agree with the tax office's view that phoenix company activity is a concern, and wholeheartedly agree with a small piece of submission No. 12, from Jones Condon Chartered Accountants, to automatically ban directors involved in two or three prior collapses. I think the number should be two; they expressed a view about three company failures. That is a detail that can be worked out later. There is a lot of good material in the various submissions, and I trust that the parliament will fix the many things that are wrong with the detail of insolvency law.

CHAIRMAN—Thank you very much, Mr Bishop. One of the issues that seems to be relevant in this Open Telecommunications case, and which I asked Ms Fullerton about earlier, is this timeline between the delivery of the information to creditors—in particular employees—and the holding of the meeting. I understand a minimum time frame is laid down in the legislation.

Mr Bishop—Yes.

CHAIRMAN—Ms Fullerton indicated ASIC had been contacted about that but it did not seem to have had any effect on the holding or the outcome of the meeting. Are you able to enlarge on what happened there in relation to that matter being referred to ASIC?

Mr Bishop—I guess there are two things here. The first one is that we are almost on top of it when it happens—that is, you get something on Friday and have a meeting on Monday. Of course ASIC are not going to be around to respond to the situation during the weekend. Even if they were, they are a large government department and they move slowly. So before ASIC can respond, the meeting has been held and the deed, so to speak, has been done. The second issue is the eventual response she got from ASIC, which she publicised to a group of us. It basically said that the court order that gave the extension also permitted them to send the report subsequent to the notice of meeting. I think that is simply incorrect. I have examined the court order—we have a copy of it available within our email list—and it makes no mention of the timing of handing out the report to creditors.

Since then, I have written to the one remaining administrator and got a response from him that basically says something a bit different—that the meeting was an adjournment of the second meeting of creditors, that the two meetings are in fact one and the same meeting and that the information they correctly gave out five days before that meeting still stands for the second meeting. I am of the view that that is largely incorrect, simply because the information that was given out for the first meeting has gone out of date.

CHAIRMAN—Has that been further explored with ASIC?

Mr Bishop—Yes, but it was only a couple of days ago that I posted my complaint to ASIC, so obviously I have not had a response.

CHAIRMAN—Why has it taken so long for you to take that up with ASIC again, particularly given your earlier views on the court order which obviously occurred some time ago?

Mr Bishop—It basically comes down to a case of being very busy, with the search for a replacement job, with running the email list, with renovations at home and, to some degree, with the demands of the new job I have.

CHAIRMAN—If the laws in relation to time lines for delivery of information and holding of meetings were properly adhered to and properly enforced, would you believe they were adequate at the moment?

Mr Bishop—Yes, the law is adequate.

CHAIRMAN—In your submission you also refer to the lack of control about what can be put into a deed of company arrangement. Do you advocate that there should be some restrictions on the content of deeds of company arrangement? If so, what sorts of restrictions should there be?

Mr Bishop—I refer to deeds of company arrangement, where the company keeps trading. I guess I will start with my view on one or two other deeds around the place. The tax office made a very good point that a deed could consist of handing out promissory notes or some sort of scrip to the creditors and discharge the obligations that way. Of course, the creditors still have to wait a lengthy amount of time to be able to convert that into cash, and that is quite a concern. Another concern is that the various creditors could be treated quite differently, and the tax office also made reference to that. They labelled it ‘discriminatory deeds of company arrangement’. Another concern that I have is the low recovery rates in many deeds of company arrangement. So I stick with what I have put into my submission, with the appropriate alteration that I am referring to deeds where the company keeps going, and that basically the deed continues until all the creditors have been paid out in full.

Senator WONG—You are essentially in the same situation as Ms Fullerton, aren’t you?

Mr Bishop—That is correct. I might make the comment, though, that I have examined a fairly broad range of issues in my submission.

Senator WONG—Yes. I want to go back to the issue of GEERS. Do you know of any other companies where employees are in a similar situation—that is, where the deed of arrangement creates certain legal impediments to the GEERS entitlements being paid?

Mr Bishop—No, I do not.

Senator WONG—I assume your answer to this will be no, but I could be wrong: were you ever advised, prior to the creditors' meeting where the deed was endorsed, of any implications for your employee entitlements and/or your entitlements to access the GEER scheme?

Mr Bishop—There were a couple of pieces of information, and the first one was in that report to creditors issued by Deloittes. That gave the expected percentage recovery rates. The second piece of information is an email message that was sent on an email list, which I would describe as being hearsay at best and possibly malicious at worst, and that is that voting either for or against the deed would prejudice your rights under GEERS.

Senator WONG—Just to clarify, that was not from the administrators?

Mr Bishop—No.

Senator WONG—Did they ever advise you, or did DEWR ever advise you, prior to the deed of company arrangement being entered into, that there would be any prejudice to your rights to access your GEERS entitlements?

Mr Bishop—No.

Senator WONG—When were you first aware of that?

Mr Bishop—I would say that it was in the weeks after the deed was voted in. We have received two letters in total from the department. The first one was a fairly standard form letter saying, 'We have received your claim.' The second one, which I think was issued in May, said, 'There are a number of issues with the deed of company arrangement and we are seeking advice from the administrators. We cannot proceed until we receive that information.'

Senator WONG—Are you able to provide us with a copy of those pieces of documentation, those letters?

Mr Bishop—I have only got the first one on me, but certainly I will post—

Senator WONG—Perhaps subsequently; that would be useful for us. Thank you. Obviously, one of the options is that there is provision under the Corporations Law to overturn the deed of company arrangement. Is that something that would be beyond most of the employees, in terms of financial commitment and so forth?

Mr Bishop—I think there are two different ways we could proceed. The first one is to gather 10 per cent of the creditor value and propose an alteration to the deed. Given that we have 10 per cent, we can then force the administrators into a meeting of all creditors, so that the alteration

can be voted on. We have had some difficulty in gathering together willing creditors to the value of 10 per cent.

The other thing we could do is to make an application to court that says, basically, that the deed is discriminatory or acts against the interests of creditors. But, obviously, having lost money after the collapse of the company, forking out additional money for lawyers is possibly not something that employees want to do. There does seem to be some fairly solid anecdotal evidence in this case.

CHAIRMAN—I have no further questions. Given that we heard earlier from Ms Fullerton a lot of the detail of the case, I do not think we need to explore that further with you. But the additional information and, particularly, the suggestions you have made are very useful to our inquiry. So, Mr Bishop, thank you very much for your appearance before the committee.

Mr Bishop—Thank you.

[11.43 a.m.]

GEORGAKIS, Mr John, Partner, Corporate Finance Restructuring, Ernst and Young

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public, but should you wish at any stage to give evidence in private you may request that and the committee will consider such a request to move to in camera. We have before us a written submission from Ernst and Young, which we have numbered 21. Are there any alterations or additions you want to make to the written submission at this stage?

Mr Georgakis—No.

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

Mr Georgakis—Thank you for providing the opportunity to assist the inquiry. Our short submission, in essence, reflected some issues we have encountered in our dealings as insolvency practitioners—some of my dealings and some of those of my colleagues. We considered, in providing our submission, that in conjunction with other submissions it may provide or reflect a theme or a common thread of issues that you might take up and that might require addressing to improve and finesse the current system of legislation.

The two things I wish to summarise this morning are a couple of issues with respect to the VAs and a couple of issues impacting on insolvency practitioners. On an overall basis, I consider that the VA system and process works quite well for a couple of reasons. In particular, it provides an immediate moratorium, and it provides enormous flexibility to come up with solutions and opportunities to restructure a business. It applies well in the majority of cases, if you apply the old 80-20 type rule, or a bell curve. Most cases fit quite neatly into the legislation; it is at each end of the spectrum that you might have issues that do not fit in quite neatly.

You probably have sufficient evidence on that, but one of those areas is where there is a large, complex administration. The time frames set out in the legislation do not allow sufficient time to assess the situation and come up with alternatives to report back to the second creditors' meeting. Hence, you need an extension of time and have to go off to the court to seek that extension. Going back to the court can be costly, so we have suggested maybe an alteration to, or consideration of, that legislation.

The second issue is that there are limited means for directors or companies to immediately place a company in liquidation or in an external administration. The VA process provides that mechanism to do it immediately. With other mechanisms there is typically a timelag involved, and during that timelag there is a risk that assets may be dissipated. The objective of the VA process is to try and resurrect the business or sustain some elements of that business, but there are cases where it is used as a fast track to a liquidation. Holding the various creditors' meetings gets costly and potentially affects the distribution to creditors and other parties. Hence, we are looking to make some suggestions as to whether that can be finessed in some fashion. That applies to cases, as I said, at one end of the spectrum where—before you even start the external

administration—there is no scope for restructuring; it is really a liquidation, and that is what it should be.

The second part of my summary is associated with insolvency practitioners. There are two limbs to this. Often we talk about the costs to the company, creditors and shareholders with respect to the damage that an insolvency does. I wanted to highlight the fact that there are significant costs for the administrator in taking these risks and in terms of the number of commercial decisions that have to be made. It is a costly process. Hence, the returns and the risks need to be commensurate. It is a specialty field for us.

Those commercial risks that we take in running businesses are in workplace health and safety and environmental type issues. This is the second limb of what I wanted to talk about. There is limited protection for insolvency practitioners regarding matters of workplace health and safety and environmental legislation where they could be held liable or charged with criminal offences when events have occurred prior to them being involved. That probably was not explained very clearly in the submission, but there are obviously risks and costs associated with understanding those issues, putting controls in place and so on. The risk is that we are in there running these businesses with existing issues—and we have not been involved in creating these issues—for which we could become liable when we have not been involved in the past.

There is a case that you may have been aware of, about which an article has been written. It was a Presswell Holdings matter. There was a workplace health and safety issue and a criminal charge was made against a practitioner. At the time of this case, the practitioner was not a colleague of mine, but he is now, in terms of working with me. This article is quite a useful summary of that matter. It comes from the April-June 2003 issue of the *Australian Insolvency Journal*. It is an article written by Anne Wardell, and it is useful in that it talks about the risks insolvency practitioners run when they get involved and there is an accident or an environmental issue and how they can be held liable for those things. That is all I wish to raise in trying to extract the key elements from the submission. I am happy to take any questions.

CHAIRMAN—In relation to your submission, you suggest that directors should be able to initiate a creditors' voluntary winding-up, in the same way that they can commence voluntary administration.

Mr Georgakis—In a sense with a creditors' voluntary winding-up—or in most external administrations—there is a timelag at the moment. If you want to go to court, you have to file affidavits, which takes time and it is a costly exercise to appoint a court liquidator. A provisional liquidator can be appointed fairly quickly, but again affidavits need to be prepared. With a creditors' voluntary liquidation, you need to give between seven and 14 days' notice to creditors and members for the meetings and, again, in that time frame things can shift in the assets and there can be further trading losses and further erosion, if you like, of the asset position. Because there are often cases in the VA process when really it is a liquidation, we were trying to make the suggestion that through the creditors' voluntary liquidation process there may be a mechanism for directors to appoint a creditors' voluntary liquidator immediately and then go through holding a creditors' meeting if there is the necessity to do so.

CHAIRMAN—What cost savings would be achieved through that process and what other benefits would be derived from it?

Mr Georgakis—In a VA, there are two creditors' meetings that need to be held within 21 days. In the creditors' voluntary administration you would still need to hold the first creditors' meeting but whether you would need to hold any subsequent creditors' meetings would depend on the findings of the investigations and a variety of other issues. Also, by putting the company immediately into a liquidation sense, it potentially stops the bleeding. It stops the losses being incurred and potentially takes away the risk of assets being dissipated further during that lag. They are the sorts of things that we were thinking of. They are the benefits in a sense as well, and it happens much quicker.

CHAIRMAN—Would that process take sufficient account of the rights of creditors and shareholders?

Mr Georgakis—In what sense are you referring to?

CHAIR—In terms of their involvement. In the normal process you have—

Mr Georgakis—In a voluntary administration sense at the first creditors' meeting, obviously the creditors can decide to change the appointed party. In a creditors' voluntary situation, as it stands now—and it is not used very often—the members appoint somebody at their meeting, and then the creditors have an opportunity again to change the liquidator if they consider it appropriate. Similarly, at the creditors' meeting that would be held within a short time frame they would have the opportunity to change the liquidator if they saw fit. If that is what you are getting at, there are opportunities for the creditors to express their views, if they consider it appropriate to change the liquidator. There is a reporting process in a typical liquidation sense where you have a duty to the creditors to report your findings, be it offences or be it opportunities to take action to recover moneys and the like. I do not think the duties change in that sense.

CHAIRMAN—The Insolvency Practitioners Association of Australia have suggested an alternative method of dealing with the problem that your proposal seeks to find the solution to—that is, to amend the voluntary administration procedure so that, with the administrator's consent, the creditors could resolve to place a company into liquidation at the first meeting of creditors. Do you see any merits in that approach? What would be the costs and benefits of your approach compared with that approach?

Mr Georgakis—I was not aware of that suggestion. If the company goes into voluntary administration, that has an immediate impact. It stops the losses, if you like, or immediately freezes the assets. I think what you are saying is that if, within five days, we think there is no scope to restructure the operations then we place them into liquidation. That is only a five-day period and it does not sound unreasonable; in that sense, it sounds like a useful suggestion. With a lot of these things there is always going to be finessing. Not all companies are going to fit appropriately into the box, so that sounds like a reasonable suggestion.

CHAIRMAN—Your submission also suggests placing greater responsibility on administrators to provide a proposal to rescue the business in a voluntary administration procedure. Do you believe the legislation needs to be amended to achieve that objective of the legislation; and, if so, in what way?

Mr Georgakis—It was just a high-level observation that maybe at times we wait for directors or other parties—although it is typically the directors—to come up with some sort of deed of company arrangement and if nothing is put forward then the company just goes into liquidation. It is just a sense that maybe there is a greater responsibility on practitioners to try to explore all avenues to try to extract a deed of company arrangement or a solution. I think at times there may be the situation where, if nobody has put anything forward, they just leave it at that.

Senator WONG—As I understand your submission, you are saying that the voluntary administration procedure is, more often than perhaps it should be, simply used as an easy way to take the company into liquidation. Is that right?

Mr Georgakis—Yes. There are cases where, to move very quickly to stop trading or to deal with directors' responsibilities of insolvency and trading whilst insolvent and so on, the VA process is the only way to do it immediately.

Senator WONG—And your proposal is in some ways to streamline that: to say at the first or the second meeting of creditors—I am not sure which—that, with the administrator's consent, there can be a resolution to put the company into liquidation. Is that your proposal?

Mr Georgakis—No, we were suggesting an alternative, maybe through a creditors' voluntary liquidation.

Senator WONG—I am sorry; that was the Insolvency Practitioners Association proposal.

Mr Georgakis—Yes, that was the IPAA proposal, which I think is a reasonable approach.

Senator WONG—How does that approach fit with your also saying that there should be a higher duty placed on administrators to come up with a reasonable rescue package or VA process?

Mr Georgakis—It is a case-by-case situation. It is knowing which situations warrant further investigation or exploration to try to find a solution. It is not resurrecting the whole business; it could be resurrecting, as I think the objectives of part 5.3A state, as much as possible of its business. Arguably, there are other sections of the act—section 438A and section 439A—that say that there is a responsibility for us to do that. It was just an observation that we made. Arguably, it could be deemed that there is sufficient wording in the legislation to do that.

CHAIRMAN—We have had various suggestions in the submissions regarding the timing of the second meeting of creditors. Your submission suggests that creditors should be allowed to extend the convening period at the first meeting or by resolution. How would that proposal work if creditors were not able to agree on the length of a convening period? Also, if the period of administration were left to the discretion of creditors, would that encourage secured creditors to take unilateral action to end the administration?

Mr Georgakis—I suppose again it was a high-level thought. Often you know you are not going to be able to come up with the alternatives for dealing with our requirements to present something at the second meeting within that time frame, and often you know that fairly early on. We thought, 'Instead of incurring the cost of running off to court, maybe at the first creditors

meeting you can ask their permission,' given they are obviously the beneficiaries in terms of exploring opportunities to get a better return. To finesse that if the creditors disagree, the fall-back position is: 'Well, I'll go off to court.' That is the mechanism. I suppose I am trying to take a commercial stance. If you provide sufficient commercial argument for creditors, there is merit to doing that.

On a case-by-case basis you need to be conscious of all the stakeholders—be they secured creditors or unsecured creditors—in that vein and make sure you meet the needs of all those creditors. I do not think there is any hard and fast rule. I think you need to look at these things case by case, especially when they are of a complex nature where there is no set rule. The time frame might be different for each case. You need to always have a focus and set a time to come back to creditors. I have not considered that detail, to be quite frank, but I do not think there is any simple solution for it. Because of the nature and complexity of each of these files, I think it is a case-by-case situation.

Senator WONG—Are the crime provisions in the act relating to members voluntarily winding up and creditors voluntarily winding up too onerous? Is that why the voluntary administration process is taken more often?

Mr Georgakis—A member voluntarily winding up is totally different—

Senator Wong—Sorry, I mean creditors voluntarily winding up.

Mr Georgakis—The voluntary administration, from my recollection, was introduced to try and enhance the opportunity of—

Senator WONG—Continuation.

Mr Georgakis—salvaging something of the businesses, and it is a good mechanism to do that. There was similar legislation in the UK prior to that and it took parts of that legislation, if you like—the good bits, I am imagining—from that 10 years ago when it was introduced. It freezes everything. The moratorium is the key thing that provides the opportunity to put a restructure together. Some of the other mechanisms do not provide that moratorium period to do that.

Senator WONG—Is it 497 which deals with creditors voluntarily winding up?

Mr Georgakis—The creditors voluntary liquidation is, again, a liquidation process in a sense.

Senator WONG—What is the time frame on freezing the company's assets and dealings then?

Mr Georgakis—The minute it goes into creditors voluntarily liquidation you start to realise assets. If there is a business there you try and sell the business.

Senator WONG—Is it, what, essentially seven days because you need to give seven days notice?

Mr Georgakis—Are you talking about for the creditors' meeting?

Senator WONG—Yes.

Mr Georgakis—No, you just go ahead and do it all and then you report back to the creditors over time, as you consider appropriate, as to your conduct and what the outcome will be for them in terms of a dividend potential. At the meeting you are referring to, you have not actually been appointed. In the seven to 14 days you have not done anything at that point in time. You get appointed at the time of the meetings—the meeting of the members and, immediately after that, a meeting of creditors. It happens when they confirm that appointment.

Senator WONG—I am trying to clarify why people use the voluntary administration process rather than this process set out in division 3.

Mr Georgakis—I think it is because it is quick; it is immediate. In essence, a directors' resolution is passed and an appointment document is signed immediately and has immediate effect. It is a system we have become accustomed to utilising.

Senator WONG—We have heard some evidence—and you might have been here for some of it—raising concerns about the content of some deeds of arrangement. Do you have any views about whether or not there should be any further regulation of the content of deeds of company arrangement, particularly insofar as they relate to dealing with unsecured creditors, including employees?

Mr Georgakis—Typically, my reasoning with respect to deeds of company arrangements is that employee entitlements should be treated as they are treated in the act and should be considered to have that priority. My attitude is that they should not necessarily be worse off than they would be in a normal liquidation and should therefore be afforded the same priority in any deed. That is my general comment on that; I am not aware of the details of the deed that was being discussed by the people giving evidence just prior to me.

Senator WONG—Would that obligation to maintain the status and priority of employee entitlements be inferred from other provisions of the act in relation to deeds of company arrangements? Is your attitude—which seems appropriate—actually a legal requirement as you understand it?

Mr Georgakis—No. I think that in the deed you can do anything you like. One of the benefits of the voluntary administration process is that you can come up with a restructure limited only by your imagination, in a sense, in terms of what you can do within the realms of reasonableness.

Senator WONG—What would you say to provisions which regulated the content and effect of deeds in relation to employee entitlements so as to preserve them consistent with the liquidation provisions of the act?

Mr Georgakis—That would be a reasonable approach. Again, there may be specific reasons why it is not appropriate in a specific case but I am not aware of those.

Senator WONG—In your experience, is the attitude you have taken the reality in relation to deeds of arrangement?

Mr Georgakis—Yes. My colleagues and I always endeavour to apply a reasonable man's approach. The legislation which exists in other areas provides that priority, so it makes sense to apply it consistently.

Senator WONG—Have you been aware in the course of your work of arrangements whereby that has not occurred?

Mr Georgakis—No. I was not aware of the matter that was referred to this morning.

CHAIRMAN—Your submission refers to directors using letters of comfort from related parties to avoid personal liability for insolvent trading. Can you give examples of how that has occurred?

Mr Georgakis—One of my colleagues came up with the suggestion as to where it is used. My understanding is that the Ansett situation was in the form of a letter of comfort from the holding company, if you like—Air New Zealand—to the Australian entity. That is one example. In terms of other specific examples, I do not have any. Again, there was a general comment that if it is a recurring theme it might be something for you to take up to finesse.

CHAIRMAN—Are you aware of any court consideration of letters of comfort? Do you know what the attitude of a court has been in any cases?

Mr Georgakis—No, not specifically.

CHAIRMAN—Thank you very much for appearing before the committee, for the submission from Ernst and Young and for your contribution to our hearing today. It has certainly been useful to our inquiry.

[12.11 p.m.]

WATTS, Mr Richard Keith, Senior Industrial Officer, Australian Council of Trade Unions

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public but if at any stage of your evidence or answers to our questions you wish to give evidence in private you may request that of the committee and we will consider such a request to move in camera. We have before us written a submission of the ACTU, which we have numbered 32. Are there any alterations or additions you want to make to the submission at this stage?

Mr Watts—Yes, there are a couple of typographical errors. On page 2 of the submission there is a reference to section 566AB(1). That should be 596AB(1). There is also a similar typographical error in paragraph 75 on page 14 of the submission. Other than that, there is no other change.

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

Mr Watts—My opening statement will not be too long. I think that what needs to be said is that we are not seeking to turn Mr Solomon in his grave, if you like. We recognise that there is a difference between a company and a company director and between executive directors and non-executive directors. It is really a question about who bears the risk and the burden of those risks, and whether the current state of play is such that the burden unfairly falls, in many cases, on employees. Obviously they are some of our main concerns.

What we are saying is that there should be a comprehensive approach. It is not just about employee entitlements. It is about corporate governance in general; it is about the community's expectations; it is about employee creditors, but it is also about creditors as a whole. It is about companies and how companies are run—who runs them. Obviously they should be run by the people who are in charge of those companies and take that responsibility. It is a question of what responsibilities we put on those individuals as directors of the companies, what personal liabilities they bear and in what circumstances they should be personally liable. The ACTU is not proposing that company directors should bear personal responsibility for all the actions of a company, but they should bear personal responsibilities for their own actions, especially when those actions affect others, not just their own personal wealth.

In our submission we talk about a range of issues, including early intervention. I was interested in the previous discussion with the last witness regarding VAs and how they can play a role. We believe there is a total package that needs to be looked at. It is about early intervention. It is about looking at some of the warning signs. It is about information sharing and employees having the opportunity to look at the state of play of a company and be provided with proper details of contingent and accrued liabilities and companies' steps to secure those—at least to ensure that they are in an informed position as potential creditors or creditors of the company.

We are concerned when employees have an investment in a company. If it is a company they work for, they have a personal as well as a financial investment and, in many cases, it is the only

investment they have. Their accrued liabilities are often held on trust by the company, not in a formal sense in terms of a trust account but they certainly trust the company to hold those assets on their behalf. In many cases there are substantial entitlements, particularly for employees who over many years have substantial accrued entitlements. They see that as an investment with the company. It is a nest egg for them. When the company goes under, their loss is a substantial loss. Not only do they lose their job, which is often their only means of accruing any moneys, but they lose the moneys they have invested in the company itself. So it is a substantial burden that they bear. We say that, given they are open to a substantial loss, they should be afforded increased protection, not least of which is the need to look at the priority afforded to employee entitlements. It is an issue we deal with in our submission.

We are of the view that employee entitlements should be afforded a super preference. We put that in the light of the general burden that employees bear. We understand that, if there is to be a super preference for employees, the issue of what is to be included in that preference is an issue for discussion—whether it is to be all entitlements. I think a valid debate needs to be had about that, but we believe the general concept of super preference is morally right. We see that there is no real reason why employee entitlements should not be afforded a higher priority over secured creditors when in fact those employees' entitlements are being used as working capital by the company itself and they have limited security.

That raises a number of issues. If super preference is to be provided to employee entitlements it raises the issue of pooling of assets of related companies. Of course, there is a greater incentive to separate the assets of capital of the company from those entities that might directly employ the employees, so we believe one of the things we need to look at is pooling. It is important in general. Whilst we recognise that there may be grounds for treating different companies separately, in most cases as a general concept we believe that pooling of related companies is important. A lack of appropriate pooling can lead to inequitable results in the case of liquidation or the distribution of assets. The last witness mentioned Ansett. In Ansett there are 47 different companies. Pooling has not been approved by the courts in that case, but you will find that there are people who unexpectedly will receive a 100 per cent return as unsecured creditors in certain of those companies simply because, unbeknown to them at the time, they were not contracting with the Ansett group of companies but with one particular entity in the Ansett group. So a lack of pooling in itself can result in inequitable results.

In general, the ACTU's view is that there is not a single answer to the spate of corporate collapses but we believe there is a trend that needs to be addressed. There needs to be close cooperation between the various bodies—the ATO and ASIC—to look at phoenix companies. There needs to be a greater imposition of penalties on directors who are clearly and flagrantly breaching their duties as directors. We do not believe that punishment itself, the threat of punishment or regulation is going to solve all the problems. There will always be difficulties. It is really a question of getting the balance right and, in our view, the balance is not quite right at the moment.

CHAIRMAN—A major issue in relation to employee entitlements is the announcement by the federal government to amend the Corporations Act to give them priority over secured creditors. That has raised objections from a number of industry groups who argue that it will increase the cost of finance to business and, in effect, may have a detrimental effect on a company and its employing capacity. What is your response to those objections? Also, given that

the government says it will only apply to the large business sector rather than the small business sector, how effective will it be in dealing with the problem?

Mr Watts—On the first issue, I think the government's original announcement was made immediately following the collapse of Ansett and also in association with the introduction of the GEER scheme. The GEER scheme, from our point of view, is obviously a great improvement on the previous scheme, but I think the two need to be read together. The introduction of super preference in those sorts of limited circumstances is clearly tied with the greater liability that the government has exposed itself to with the introduction of GEERS. The preference is being sought not just for larger businesses, although I guess that is a view that government generally has. We do not necessarily share it, particularly if it could lead to a deliberate distortion of businesses by people breaking up a company into different entities to avoid that obligation. That is a concern where there is no justifiable business reason for breaking up those entities, other than to avoid that preference. In terms of the liability, I guess what the government is attempting to do is to claw back the liability that it is exposed to under GEERS. That is understandable; the government is going to cover some of those losses. Clearly it wants to stand in the shoes of the employees to that extent, and one way to do that is to afford preference.

Our view is that it does not go far enough. It should be covering all employee entitlements, and there is good reason for that. We believe, particularly, that what is missing is redundancy payments in excess of eight weeks. In many cases those redundancy payments have been traded off in lieu of giving pay rises and other benefits, as part of enterprise bargaining. That has been a trend, you will find, particularly in those industries which are vulnerable, where there is structural change. In the manufacturing and textile, clothing and footwear industries you will often find more generous redundancy arrangements, but they have often been achieved by the forgoing of pay rises over the years, where the employees' higher priority is on protecting themselves in the case of redundancies. So we see no justifiable reason for limiting it to eight weeks.

In terms of the cost of capital and the availability of capital, we think that there is probably not much doubt that there will be some effect in the peripheral areas, but only in those peripheral, marginal businesses. It will not affect large corporations and it will not necessarily affect the cost to capital, we think, of smaller businesses. But for some medium sized businesses it will, we believe, marginally increase the cost of capital and it is also likely to reduce the availability of capital to some businesses—not to the extent, though, that we think that that is going to detrimentally affect business operations overall or put companies in a position where they would go under if they ordinarily would not.

For us it is really a question of who bears that burden. If cost of capital is going to marginally go up for a small section of business and if that is seen as a negative, we would say that the greater negative is that employees should bear the burden themselves. What in fact is being said is that employees should bear the burden because otherwise some businesses will. We say that employees are in a lesser position to bear that burden than those businesses themselves. The cost will be spread over a range of businesses. We accept, though, most large companies do not have secured creditors. In the case of the Ansett group as a whole, they did not have a single secured creditor. The employees effectively have super preference, because they stand ahead of the unsecured creditors in that case. For large corporations that will be the case; for smaller

businesses, the risk is tied more to the nature of the business itself. This will be an issue for medium-sized businesses, but I do not think it will be a substantial issue.

CHAIRMAN—The related issue that arises is the suggestion that employers should be required to contribute employee entitlements to some sort of trust fund arrangement. Arguments have also been raised—indeed, this morning by the representative from Australian Chamber of Commerce and Industry—that it will increase the cost of business and that, even though the entitlement is accrued, it is not actually due for payment until the person receives it and therefore it is efficacious for those funds to remain in the business until such time as they are demanded by the employee. The representative this morning gave the example of where you have accrued leave and the employer may actually want the employee to take their leave but for other reasons the employee may want to defer that leave. How do you respond to that issue?

Mr Watts—I think the trust funds are one method. Many employers are obviously opposed to tying up funds. It is a question of whether those moneys held in trust are available to the business in certain circumstances or whether they are available no matter what the state of business is. The call for trust funds is in response to many employees seeing the business, as a last resort, using funds that they would ordinarily hold back. Usually businesses will use some of the employee entitlements as working capital. But too many businesses seek to go that extra mile when things are a bit difficult and will call upon employee entitlements with the strong possibility that they may not be able to repay those moneys if they are called upon. In fact, in many cases the company will be in a position where there is probably a greater likelihood that they will be called upon.

Many other businesses will clearly be in a position where it is less likely that the company will be in difficulty. In fact, the company may argue that there is no need to put moneys in trust. Many employees, though, having seen large corporations go under often after giving assurances that they are in a solid financial position, are not in a position to properly assess the real state of play of a company without any further information being provided to them, without access to detailed information from the company or without having associate directorships or other positions on the board. A trust account or trust fund is one way of securing those resources and providing some certainty for them. In many cases, because it is of great concern for many employees, it provides a greater level of stability at that workplace.

If employers can put forward arrangements where they can ensure that employees' funds are secure—whether it be through security arrangements, fixed charges over certain assets or other arrangements where employees' moneys are secured—there may be middle grounds where arrangements can be utilised where employees, in the absence of super preference, can get first call on those resources because of those secured arrangements. There are arrangements that have been entered into in many cases where that has occurred. That has allowed employees some degree of comfort and resolved what has been on the ground a real industrial relations concern and in the broader sense allowed for greater productivity as a result. Trust funds are one way to resolve those issues. We think that it is part of the answer; it is not the full answer and it is not going to be the appropriate answer for all business. But for many businesses it is an answer which can make sense.

It is recognised that companies use employee entitlements—whether contingent or accrued liabilities—as working capital. In many cases that is not necessarily opposed. What is opposed is

using that as capital as the last resort, when there is in fact little chance that the company will be in a position to recover. The last throw of the dice is often to dive into those resources. That is where some of our other recommendations go to. They are looking at the process of providing information to employees about what arrangements are in place to provide for employee entitlements should and if they fall due.

CHAIRMAN—With regard to your proposal that employees and unions should be entitled to request audited financial reports on a regular basis which include details of accrued and contingent employee liabilities and the provisions made for their payment, this morning the ACCI representative did not have any problem with the reporting provision in relation to accrued entitlements but indicated that contingent entitlements can be a bit of a moving feast. He indicated that to provide any meaningful report on those would be relatively costly and might be meaningless because of changing number of employees and that sort of thing.

Mr Watts—I take that point. It is a question, though, of what is actually reported. In some senses we are talking about a moving feast; we are talking about a range. It may well be that a company reports that it has in fact made no provision for contingent liabilities and that it intends to make no provision for contingent liabilities because over the next 12 months it intends to employ additional staff, not to make staff redundant, for instance. It may well be that it is a proper reporting process where in fact they say, 'We have an expectation of some turnover of staff at this level over the next 12 months and we've made provision for that and we intend to make provision.' We would say that if a company had an expectation that there was going to be a substantial and unusual turnover of staff, they would be required in their annual report under Australian accounting standards to detail what provisions they have made for that turnover of staff if that calls into account substantial amounts of capital that would ordinarily need to be put aside for contingent liabilities. So we would say that Australian accounting standards already allow for that if a substantial amount of extraordinary payments need to be made.

It is a moving feast. We do not necessarily need to pinpoint it with great accuracy; it is the direction and what general arrangements have been made that people are interested in. It may well be that the company has made very little provision. What we say is that there should be a requirement for them to say when they have made very little provision and why. If you look at many of the large companies that have collapsed which made very little or no provision for contingent liabilities you will find that the year before they would have said, 'There is no requirement for us to make provision because there is no expectation we will go under.' We would prefer people to be up front and say that. Later, it might well be that they would need to justify that comment.

Senator WONG—Just on that, the reporting issue in relation to accrued entitlements—or accrued liabilities, from the company's perspective—is reasonably clear. It would not be a difficult thing to require companies to report, 'This is the amount of our accrued liabilities in respect of long service leave, annual leave et cetera, and we have made provision for it in this way.' But for contingent liabilities—such as redundancy, which is contingent upon a company making a decision to dismiss people—how would you frame a reporting requirement that would be meaningful? Because, as you say, if you went to One.Tel the year before it fell apart, they would probably have said, 'We're not going to be making people redundant, so we don't have to make provision for it.' So how would imposing an additional legislative requirement or another

regulatory requirement that they report the provisions they have made for accrued and contingent liabilities actually assist employees in those circumstances?

Mr Watts—I think that it is tied up with some of the other changes we are seeking. What we are in fact saying is that—

Senator WONG—It is tied up with your changes to directors' obligations?

Mr Watts—That is correct. What we are in fact saying is that, if the directors of a company do not believe they need to make such a provision, they should say that they do not believe they need to make such a provision. It may well be that they need to justify that position in relation to their directors' duties not to trade whilst insolvent and to take into account their fiduciary duties as company directors. We would say that they have a fiduciary duty to employees as well as shareholders and creditors in general and that if they are in fact exercising that duty correctly then there must be a conscious decision not to make provision for contingent liabilities. That must be a conscious decision at some stage of a company.

We say that it should be a conscious decision that they make and that when they provide their annual reports they should justify it. It may not assist the employees directly. It may be that they use actuarial advice—for example, 'We expect that in the next 12 months the level of contingent liabilities that are paid out will not be any different to what it was in the previous 12 months, and it was this level,' or they may say something different. But they certainly would need to justify their position subsequently if the company did collapse as to why they formed the view that they would not be calling on that capital to make provision for contingent liabilities.

Senator WONG—So we should read paragraphs 63 and 64 of your submission as conjunctive? On the one hand, you want reporting and, on the other hand, you want directors to be personally liable in the event that statements made about provisioning for contingent liabilities or contingent entitlements are incorrect.

Mr Watts—If company directors are making conscious decisions to either make provision or not make provision for contingent liabilities, we would hope that with what is at stake the decision had some foundation. If in fact the decision had no foundation and there was an expectation that there might be a significant call upon those entitlements but they made no provision for them, then we would see that as a breach of their duties as directors of the company.

Senator WONG—ACCI oppose that, but one of the points they made was that directors should not be personally liable unless there had been some bad faith dealing. In other words, a director might make the statement about what provision has or has not been made on the basis of reasonable information which subsequently turns out to be incorrect, whether that it is internal to the company or some external market driven issues. Where does the level or weight of the duty sit? How high a bar are you proposing?

Mr Watts—I think that 'reasonable' is not a bad term; it is one that is bandied about, though. Company directors have an obligation to make their own inquiries, and proper inquiries, rather than simply rely upon the advice given to them, though obviously they can and should rely on advice. But they are required to make their own proper inquiries and to make decisions which

are reasonably and properly founded on those inquiries. We think that 'good faith' is not a bad term to use and we do not necessarily disagree with ACCI's position in relation to good faith. If someone makes a decision in good faith—having made proper inquiries and having made all efforts, as a company director, to take into account the interests of others as well as of the company—and something occurs that is different from what a reasonable person would expect then it is unfortunate but that goes with the territory of any business. Issues like that will arise. We do not say that there is necessarily any liability that flows from that.

Senator WONG—Briefly, because we are running out of time: are you responding to any particular events or experience in your suggestion that if a director makes a statement regarding the provisioning for employee entitlements they ought to be held to that? Has it been the ACTU's experience that there has been a difficulty in that regard?

Mr Watts—It certainly has been. There have been many cases of positions that have been put to company directors—in many cases these are small businesses where the directors are the largest shareholders in the company, and family businesses in particular—where clear assurances have been made to the employees. Those assurances have been made to ensure that the employees do not panic, that absenteeism levels do not go up and that employees continue working while the company is obviously in some difficulty. Those assurances have turned out to be clearly untrue. There are, we think, real concerns where the employees are required to rely on assurances.

Senator WONG—And those statements have not been actionable under any other provision of the act or under common law?

Mr Watts—No, they would not be actionable under the provisions of the act. If statements are made in various forms as part of voluntary or other insolvency processes it may well be that there can be action there. But we do not believe that statements such as: 'Don't worry, everything's okay; we're just going through a bit of a problem at the moment. It'll all be fixed,' that are made by an employer to groups of employees are necessarily actionable. Of course you have to take into account that employees, as creditors, are very rarely in a position to take action as individuals against a company.

Senator WONG—Thank you.

CHAIRMAN—One of your criticisms of the GEER Scheme is that it does not include superannuation among the entitlements that are covered.

Mr Watts—Yes.

CHAIRMAN—Do you think the recent changes to the superannuation guarantee legislation, requiring quarterly contributions to be made, lessen the need for superannuation to be included in GEERS? And does it provide adequate security for employee superannuation?

Mr Watts—We think it lessens the need. Our experience is that in some instances superannuation has been many years behind. If there is a requirement for that issue to be addressed every three months it is likely that if the company goes into insolvency there will still

be substantial periods which are unpaid beyond three months. A month would be preferable. It lessens the concern, but we believe there is still a substantial concern there.

CHAIRMAN—Do you have any concerns about deeds of company arrangements in relation to employee entitlements?

Mr Watts—Yes, we do, because deeds of company arrangements can change the preference arrangements. We have experienced arrangements where employees have been unaware of what in some cases have been complex deeds of company arrangements which have altered the priority arrangements. In fact in many cases they have voted for those deeds of company arrangements, although unbeknown to them there has been a change in priority, because of the complex nature of the documents that have been put before them.

I have certainly been involved in liquidations or deeds of company arrangements where that fact has occurred or I have come in after that has occurred. It has been of grave concern to the employees that their options, other than arguing that they have been deliberately misled, are very limited once those arrangements are entered into. So we believe that those arrangements, prima facie, should not alter the preference arrangements. There may well be circumstances where it is in the employees' interests or other creditors' interests to change the preference arrangements so that a restructure can take place. That may well be as part of their investment in that restructure. It should be a conscious decision that they make and they should be properly informed.

There should be an obligation—we think primarily on those proposing the deed of company arrangement but also on the administrator or liquidator of a company—to advise all the creditors, including the employee creditors, what the ramifications or implications of the deed of company agreement are. This needs to be done clearly, particularly in cases where employees are from a non-English-speaking background or their involvement in the financial affairs of businesses is such that they are very much taking advice from others as to what is best for the company. In many cases they are voting away certain rights and are clearly unaware that they are doing so. So we think they should be made clearly aware of the implications of a deed of company arrangement if any rights are being removed or preferences altered. If they then make a conscious decision to vote to do so, so be it.

Senator WONG—On that issue, what other safeguards, if any, are required? It is one thing to say people should be advised appropriately and therefore knowingly enter into a deed of arrangement which alters their entitlement, but it may well be that what might be in the interests of a number of other unsecured creditors and secured creditors, as opposed to the employee, differ quite significantly. Employees, even if they are informed, may not have sufficient numbers to effect any change. Are there any other safeguards you would say should be put in place in circumstances where a deed seeks to alter the preference arrangements?

Mr Watts—I probably should have made myself clearer. We would propose that the voting arrangements should be such that the individuals who were forgoing those rights would in fact have a veto over the forgoing of those rights. In many cases employees have very few voting rights in terms of numbers and dollars, and that is where the difficulty arises—that, whilst they can be informed, they can simply be overridden. In fact, again, their entitlements are often being reinvested in the new entity that arises through that changing of the preference, so they should

have that veto arrangement. We believe any creditor should have veto arrangements where their rights are being forgone.

Senator WONG—You made the point, I think, that there are a number of different policy initiatives one could look at in this area and that trust funds are not the only option. I think you also agreed with some of the concerns that industry have raised regarding the super preference arrangements in that you conceded that there may be some cost imposition in terms of access to capital, particularly for medium enterprises. Industry would of course say that that would be passed on, either to the consumer or through an effect on their employing capacity.

Mr Watts—Yes.

Senator WONG—It may be that that is not the best policy mechanism to effect the securing of people's employee entitlements and that other measures, such as the ones you have outlined around reporting requirements and duties imposed on directors associated with that and/or a requirement that a certain proportion of entitlements be set aside in a mandated trust fund, might be better. Would you see any mix of policy measures that would lead to you not advocating for a super preference for employee entitlements?

Mr Watts—I think the short answer to that is no.

Senator WONG—Why is that?

Mr Watts—Although there are cost implications, it is a question of who bears that cost, and the substantial burden that falls upon employees compared with the minor burden which would be distributed amongst—ultimately, in some cases you are right—some employees, is our concern. We would think that super preference is something that we would continue to advocate, from moral grounds more than anything else—not just economic grounds but moral grounds. The people least able to bear the burden should not bear that higher level of burden.

Senator WONG—What if their entitlements are being safeguarded through other processes?

Mr Watts—If their entitlements were completely safeguarded through other processes that would be another matter. The only way we could see it being safeguarded through another process would be through mandatory trust arrangements or through a legislated protection scheme. It is a question then of who bears the burden and the cost of that as well. Whilst we support a proper employee entitlements scheme, it is still a taxpayer funded scheme currently, and we believe that the employers should bear the burden. We think that super preference is something which facilitates that, as opposed to a process where the taxpayer funds it.

In the case of trust funds, whilst trust funds do resolve that issue they are not going to be the answer for every company. Whilst we think that super preference is an arrangement which does have some difficulties, most of those difficulties, we believe, are associated with the ability to separate the employing entity and the entity that actually holds the assets of the company. That is more of a concern with super preference for us.

Senator WONG—You think there are some limitations to a trust fund arrangement, but one of the recommendations of the ACTU is the requirement that employees contribute to either a

trust fund or other arrangements to secure employees' entitlements. What are the limitations, and are you resiling from that part of your submission or clarifying it?

Mr Watts—I think we are just clarifying it. There will be different courses for different horses. The structure and nature of companies will differ so the ability for some employers to enter into insurance arrangements will be easier. The companies that have substantial capital assets that are otherwise unencumbered may be able to provide some sort of security, in the absence of super preference, over those assets. For companies which are new starters, companies which do not have substantial capital, there are greater difficulties with trust accounts and entering into other arrangements with those companies. So in many cases there are more difficult arrangements. Or you can have a company structure that is so complex and changeable that you may have trust arrangements with one company but the employees are moving between one company and another.

Partly, those issues can be resolved through some of the pooling arrangements in the case of insolvency, but where you have joint enterprises and arrangements with other companies that becomes a bit more complicated. So there are some practical difficulties with trusts in certain cases. But we believe that there are great benefits to trust accounts with the level of certainty they provide in the relationship between employees and employers, so it is something to be advocated. We recognise, though, that the level of opposition from many employers to trust accounts is such that it is going to be very difficult unless it is legislated for.

Senator WONG—In paragraph 9 on your recommendations page you say, 'Employers should be required to contribute employee entitlements to a trust fund.' Are you talking only about accrued entitlements or about accrued and contingent or a proportion of contingent?

Mr Watts—We are talking about accrued and, most likely, a proportion of contingent liabilities.

Senator WONG—Have you turned your mind to how you deal with the issue of contingent liabilities?

Mr Watts—There is a role for actuaries in determining what the level of contingent liabilities would be in the future, given the level of proposed investment and the state of the business. That is a process that we think is probably taking place formally at the moment. But these arrangements should be more formal so that, as I have said, a company that decides to put aside 25 per cent of contingent liabilities in the forthcoming year has to justify why it is in fact 25 per cent and not 75 per cent.

CHAIRMAN—As there are no further questions, Mr Watts, we thank you very much for the ACTU's submission, for your appearance before our committee and for the assistance are you giving to our inquiry.

Mr Watts—Thank you very much for the opportunity.

Proceedings suspended from 12.55 p.m. to 2.25 p.m.

MOLLER, Mr Carl, Employee Solicitor, Minter Ellison

WALKER, Mr Ian, Partner, Minter Ellison

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public, but if at any stage of your evidence or answers to questions you wish to respond in private you may request that and the committee will consider such a request and move into camera if necessary. We have before us Minter Ellison's submission, which we have numbered 43. Are there any alterations or additions you want to make to the written submission at this stage?

Mr Walker—Mr Chairman, could I call on Mr Moller to make a few opening remarks and then perhaps we can answer any questions.

CHAIRMAN—We will move to that shortly. This is just dealing with the written submission, with whether there are any amendments you need to make to that.

Mr Walker—No, we have none.

CHAIRMAN—I now invite you to make some opening remarks, at the conclusion of which I am sure we will have some questions.

Mr Moller—Our opening remarks proceed by way of overview. The subject of the joint committee's inquiry is extremely wide. Our submission focuses on one relatively small aspect of that subject. Set against the background of the major policy theme with which the inquiry is primarily concerned; it might be regarded as a technical or legal concern only. Despite this, the subject of our submission, namely the joint and several appointment of liquidators and receivers, is an important one and has in recent years given rise to not insignificant uncertainty and litigation. Accordingly, the area is one which should be clarified—a step best taken, in our view, by legislative amendment in the manner identified in our submission.

Of the issues identified in the joint committee's issues paper, our submission is concerned with the mode of appointment of liquidators and with liquidators' ability to exercise their powers and discharge their functions properly. That ability is essential to the efficient and expeditious conduct of windings-up. For the reasons identified in our submission, our concerns also extend to the appointment of receivers and the exercise of powers by them, although we acknowledge that receivership is not an issue the joint committee has identified as falling within the scope of its inquiry. Given, however, that receiverships often arise in circumstances of insolvency, consideration of that topic is relevant. Although, as we have observed, the scope of the committee's inquiry is extremely wide, we would prefer to limit our remarks to the topic of our submission. Moreover, several of the issues that are the subject of the inquiry are also the subject of current matters in which our firm, Minter Ellison, is acting. Accordingly, it would be inappropriate for us to comment on those issues.

Our submission is concerned with the practice of joint and several appointments in external insolvency administrations, which we define to include receiverships, voluntary administrations, the administrations of deeds of company arrangement and windings-up. It has long been the

practice for accounting firms and insolvency practitioners to take joint and several appointments on insolvency engagements. Essentially, a joint and several appointment is one in which two or more insolvency practitioners take office and are entitled to exercise their powers jointly and severally—that is, together or individually. A joint and several appointment offers considerable advantages in terms of convenience and expedition in the conduct of an insolvency regime. Those advantages are identified and discussed in part 4 of our submission.

There have been several cases in which joint and several appointments have been the subject of litigation. That issue inevitably forms part of a broader argument in which a party seeks to impugn the manner in which an insolvency practitioner has exercised a power or function. The recent case of Harvey v. Burfield is illustrative. One of two liquidators applied to court to examine two people formerly involved with the company in relation to a series of transactions. A challenge to the application for examination was successful because the application had been brought in the name of only one liquidator rather than in the names of both. Another recent example is the High Court decision in Kendle v. Melsom concerning the joint and several appointment of receivers. As Harvey v. Burfield illustrates, arguments are inevitably extremely technical. In Kendle v. Melsom, the High Court divided three to two on whether the exercise of powers was valid, and even the majority of the court did not agree as to the reasons for the validity.

In our view, the scope for such technical arguments to be raised should be narrowed. That step can be achieved by relatively simply amendments to the Corporations Act: namely, the repeal of subsection 506(4) and the insertion of new provisions into parts 5.2 and 5.6, to clarify that when more than one receiver or liquidator is appointed their functions or powers can be exercised by any one of them. Taking our proposed amendments in turn, the effect of subsection 506(4) is to require that where several liquidators are appointed the members or creditors, as the case may be, must determine at the meeting at which they resolve to wind up the company which one or more of the liquidators may exercise the powers given by the act to the liquidators.

In the absence of such a determination, a default position operates, requiring the liquidators' powers to be exercised jointly, and every solo exercise of power by one of multiple liquidators may be impugned and set aside, a consequence which flowed in Harvey v. Burfield. In practice, the determination required by section 506(4) is overlooked and never made by creditors or members resolving to wind up a company. Moreover, by virtue of the automatic transition of an administration to a winding-up, effected by sections 446A of the Corporations Act, it is questionable whether there is scope for the determination to be made at all in those circumstances.

As we discuss in section 5.4 of our submission, we can think of no policy justification that requires creditors or members to have to make the determination referred to in subsection 506(4). Nor do any of the cases in England or Australia which have considered the provision or its equivalent explain the need for it. Most of the cases cited in Harvey v. Burfield are English decisions dating back more than a century. In our view, therefore, section 506(4) should be repealed. The default provision should be that, except where the creditors or members appointing the liquidator provide otherwise, if more than one liquidator is appointed then their functions or powers should be exercisable by any of them severally. A provision to that effect should be inserted into part 5.6 of the act. By way of comparison, we observe that such a provision already

prevails in respect of voluntary administration—effected by section 415A—and deeds of company arrangement under section 451B.

As to receiverships, a provision allowing multiple receivers to exercise their powers jointly and severally is common in modern forms of mortgage debentures—although, as the decision in Kendle v. Melsom illustrates, such provisions may be lacking in older form debentures. Again, for the sake of clarity and to ensure consistency between different forms of insolvency regime, a similar provision should be inserted into part 5.2 clarifying that when more than one receiver is appointed their functions or powers can be exercised by any one of them, again subject to the resolution or instrument made by the secured creditor appointing them providing to the contrary. In conclusion, in our view such provisions will provide clarity to the practice of joint and several appointments, thereby ensuring that they continue to be utilised to advantage in the conduct of external insolvency administrations.

CHAIRMAN—Thank you very much. Mr Walker, do you have anything to add to that by way of opening statement?

Mr Walker—No.

CHAIRMAN—Can you tell me in rough terms what proportion of cases and in what circumstances multiple administrators or liquidators are appointed?

Mr Walker—It is very common. The majority of administrations—certainly large administrations—would be multiple appointments. Most of the larger firms would choose to have two co-appointees take office, if they had the option. In terms of liquidation, where it is a voluntary process—either a creditors' voluntary winding-up or a members' voluntary winding-up—again it would generally in the larger firms be two appointees. But it would be a matter of statistics, I imagine, in terms of looking at the number of actual appointments. There would be quite a number done in that fashion on a regular basis.

CHAIRMAN—What are the reasons for having multiple appointments?

Mr Walker—Principally to facilitate the administration of the receivership—or the administration. If you have one person as the appointee, in theory that person has to take every decision and carry out every act. Where you have joint appointees both of them have to carry out all the acts, unless there is a severance of that. You cannot change the office—it is a joint office—but you can divide responsibility and have each of them perform all the powers severally—so individually they can perform all their powers. Unless you have that carve out, if you like, they cannot.

CHAIRMAN—So, on the current interpretation which applied in that court case, they cannot act severally.

Mr Walker—It depends what they are. If they are an administrator, part 5.3A provides that they can act jointly and severally. If they are a voluntary liquidator, they need to have the power conferred on them by the creditors at the time of their appointment to exercise their powers severally. The problem as we see it is that there is presently an automatic transition provision from administration to liquidation where a member's voluntary winding-up is deemed to

commence and the creditors are deemed to have nominated the administrators as liquidators. That is at a meeting when the creditors vote for a resolution that the administration should end and the company should go into liquidation, or when they have terminated the deed of company arrangement.

Mr Moller—The point is not so much whether they can or cannot. In most cases they can, or it is assumed that they can. The difficulty is in circumstances where there is a technical argument that they cannot, whether it arises under an old form of debenture where the point is not made in the mortgage debenture or in a winding-up where the determination is not made under subsection 506(4). Coming back to your question about the advantages of a joint and several appointment, this was discussed at some length by the New South Wales Court of Appeal, particularly by Justice Kirby and Justice Meagher, in a case we cite on page 6 of the submission. They gave very useful summaries of the advantages of a joint and several arrangement in terms of the efficiency of the conduct of the regime.

CHAIRMAN—And you are saying that in practical terms, apart from this fairly limited area, that is the way it generally has been operating?

Mr Walker—Yes. In a large administration where a significant number of issues need to be dealt with on a daily basis by somebody as administrator or liquidator, particularly in administrations where things are moving fairly quickly, there is an element of efficiency which occurs simply because only one person has to decide. If two people can make the decisions, assuming they have confidence in one another's judgment they will leave certain parts of the administration to the other, so that you do not get a duplication of effort. You get individuals making decisions which effectively operate as the decisions of both of the administrators to bind the company in administration, so it does work to produce efficiencies. In larger scale administrations that is certainly very important.

Mr Moller—Take, for example, the process of signing a cheque drawn during the course of the liquidation or administration. If the joint appointees both have to sign the cheque, you have to physically present it to both of them—track them down wherever they might be in the office, the city or the country—and have them sign the cheque. If you can have one of them do it, it is much easier.

CHAIRMAN—As a nonpractitioner looking at this from the outside, the question that arose in my mind—and I think you have partly answered it, Mr Walker—was how you avoid decisions being made by one that conflict with and have an opposite effect to decisions made by the other. But you have indicated that what they actually do is split up their areas of administrative responsibility.

Mr Walker—Yes, more often than not.

CHAIRMAN—So they are not going to make a decision in one area that is relevant to another area?

Mr Walker—That is right. There will be some critical areas in which they will consult on sensitive issues, but by and large—if they have decided to sell an asset, for instance—one of them will take responsibility for that process, manage it and make the decisions. The final

decision as to sale may in fact be referred to a committee of creditors for its consideration as well before the administrators finally make a decision.

Mr Moller—Justice Meagher, in the NEC Information case, raised the prospect and described it in the terms that commonsense suggested that it would be a remote, theoretical possibility. Also in most cases the appointees are partners in a firm, in which capacity they have joint and several liability for each other's conduct anyway. Most firms have mechanisms in place to check off on conflicts and make sure they do not arise—quality control mechanisms, if nothing else.

CHAIRMAN—So what you are really advocating is, in a sense, a technical amendment, extending the provisions that apply in most areas of insolvency to a small area where, as result of a court case in particular, it is not currently applicable.

Mr Moller—Yes, I think you could observe from that decision that, although there is joint office holding—unless there is joint and several capacity to exercise the powers—if only one of them is then going on and exercising the powers, in theory the whole of the administration can be called into question later on. That is quite a serious consequence, which is really disproportionate to the perception of vice or problem that the section is designed to deal with. It does not appear to us that it is warranted—that it should be so difficult to confer joint and several power in circumstances where the creditors may or may not even have an opportunity, which is the current position under the transition from voluntary winding-up, or administration to voluntary winding-up.

CHAIRMAN—Are there any further questions on this issue, Senator Wong?

Senator WONG—Not on this issue. It is fairly clear that you are focusing on a particular issue. You say the implications of Harvey v. Burfield should be dealt with legislatively—is that right?

Mr Walker—That is right.

Senator WONG—I had some broader questions about administrators. I do not know if you are able to assist us in that?

Mr Walker—Yes.

Senator WONG—We have had a number of submissions where the issue of the independence or perceived independence of administrators has been discussed. We have been provided with a number of proposals, such as a roster system, the adoption of a code of ethics, a requirement that administrators make a statement of their independence at the creditors' meetings and so forth. It is essentially trying to deal with the perception some people have that administrators perhaps act in the interests of a particular creditor or group of creditors—or indeed for the directors—more than for some other creditors. I would like your views, if you have any, about the independence of administrators and whether or not there could be any changes that would enhance their independence.

Mr Walker—I think independence is often in the eye of the beholder. The administrators have a range of duties that they have to perform. They are required by law, as fiduciaries, to exercise

them impartially. The perception that they will favour one side or other in the process will often come about because of the process of appointment, in terms of where their appointment is sourced, if you like, and who has promoted them as the appointee. Again, I think if you look at the way that appointment has come about and the work that has been done to initiate that promotion, if you like—in other words, why they are there and how they have come to be in this position of nominated favourite or selected person to hold the office—the question is whether there is any bias that comes about as a result of that.

Sometimes the period prior to the appointment is a very important time to enable any appointee to gather information about the company to ensure that they are as well informed as possible about the company before they take the appointment. In administration under part 5.3A, if we are talking about that particularly, it is a very short time frame. They have to hold the first meeting within five business days and within 21 days of the commencement they have to have convened that first meeting, by then having produced a report and formed a view on what should happen as to the company's affairs and made recommendations to the creditors. That is an extremely tight timetable.

I concede that there will be circumstances where, if the appointee has fulfilled a role of monitoring the company—for a secured creditor, for instance—for a long period of time, it may be possible that it will be difficult for the appointee to distance themself from the expectations of the secured creditor. But when they come to act, they must act impartially and objectively in the interests of all creditors. I am not so certain that the processes in place and the checks and balances that provide opportunities for creditors to challenge appointments as they are at the moment are not adequate; I think they probably are.

Senator WONG—One of the areas where this has been raised has been in respect of employee entitlements.

Mr Walker—Yes.

Senator WONG—Or employees. You are correct: people have the legal remedy to challenge appointments. But the practical reality is that that remedy is unlikely to be taken up by employee creditors, isn't it?

Mr Walker—Yes, I suppose that is possibly right. The question, then, is whether the employee creditors are going to be disadvantaged as a result of the appointment in any way, in any event—no matter who the appointee is. The fact is that the employee priorities are currently enshrined, to the extent that they are protected in the Corporations Act, ahead of the floating charge assets—behind the administrator, of course, in terms of his remuneration. So, if the aim is to ensure that someone whom the employees are comfortable with is chosen as the administrator in every case, I am not certain that that is an appropriate rationale for amending the principles on which appointments may occur. I think it is fair to say that, certainly in the larger administrations, employees, where they are concerned, do express that concern and do organise themselves sufficiently to make application to remove an administrator—as they did, for instance, in the Ansett case with regard to the first administrator.

In the cases of both Ansett and Pasminco, they took steps to have their representatives appointed to vote as their attorneys at creditors' meetings. So they do organise themselves. I

would concede that in a small administration that is not likely to happen, but I question whether the vice that is perceived—which is potential preference presumably for a secured creditor—can really occur in a practical sense, in the sense that the employee entitlements come out of the floating charge assets. I would be reluctant to say that I think it is a good idea; I would be reluctant to support a change in the current position to meet a perception that perhaps the position of employees generally is somewhat at threat or under pressure when administrations occur. I think we know that is the case, but I do not think that really has anything to do with the independence or otherwise of administrators. I think it is more to do with the way the security regimes work and the way 556(1) priorities work in practice.

Senator WONG—So your answer to some of these propositions, which are aimed at supposedly enhancing the independence of administrators, would be that you probably do not think they are necessary?

Mr Walker—I certainly think you can have as clear as possible a declaration of relationships, conflict and so forth—I would not shy away from that all—so that the creditors at the time of appointment, or at the first meeting of creditors, or even perhaps before that first meeting, get a very clear statement of the administrator's prior contacts with the company and are able to form a view about whether those are appropriate. I do not disagree with that as a principle at all. I think you should have full disclosure, bearing in mind that effectively these individuals are going to be fulfilling a task as responsible to and accountable to those parties. They should have confidence in their independence and their capacity to perform their functions.

I am just not so certain that you need a sledge hammer to crack a nut, if you like, when the nut is perceived conflicts, perceived lack of independence and when there are certainly opportunities in the process to control what has occurred. Certainly prevention is better than cure—I would agree with that. You really do not want to force it all to be left to the end for creditors to find out that the administrator was closely aligned with a related party, for instance, and had not disclosed that. I think you do need to know that up front, so I am completely in favour of absolute disclosure at the outset.

Senator WONG—Among the issues raised by a couple of witnesses this morning were concerns regarding deeds of company arrangement and suggestions that the effect of such deeds could be to alter the priority of an employee's entitlement. I am not clear to what extent legally that can be done.

Mr Walker—The law at the moment does not prohibit a deed of company arrangement from varying the statutory priorities.

Senator WONG—So there is no implication from the fact that the Corporations Law, in respect of liquidations, sets these priorities as to what rights would then accrue to people whose rights might have been abrogated by virtue of a deed of company arrangement?

Mr Walker—It is a very important point. The way part 5.3A operates is to give complete freedom to the company and its creditors to make an arrangement which suits them. Formerly, under schemes of arrangement under part 5.1, the law was basically that you would automatically see the priorities in a winding-up reflected in the provisions of the deed. There are at least two or three illustrations in administration where courts have basically said that you

would expect to see that happening. They were, ironically, tax cases where the Deputy Commissioner was endeavouring to recover unpaid tax, which actually had a priority still at that stage, and the deeds had purported to take away that priority.

There are examples of priority changing deeds around. In the Ansett case, for instance, there is one—that is subject to an appeal at the moment—where a decision has been made by a judge to suggest that the particular priority, which was for top-up superannuation obligations not paid by the administrators during the course of the administration or under the deed period, was not a priority under 556(1)(a) or any of the provisions of 556(1) and therefore it did not have priority. But the deed basically says that to the extent that it is a priority then it would be postponed.

Senator WONG—And that has been the subject of litigation?

Mr Walker—That is currently the subject of litigation.

Senator WONG—Is there a first instance decision on that?

Mr Walker—Yes, of Justice Warren.

Senator WONG—What does Warren say?

Mr Walker—She found that it was not a priority.

Senator WONG—So it was effective—the attempt by the deed to postpone the entitlement was effective?

Mr Walker—That issue has not really been dealt with, in the sense that all that was dealt with by the judge was whether the payment obligation should be treated in 556(1)(a) or (e) or (dd)—all of the provisions dealing with whether it was a cost and expense of the administration, whether it was wages and superannuation or whether it was just an expense: all of the 556(1) provisions that were relevant to it. It was essentially a top-up obligation relating to retrenchment of workers. On retrenchment they are entitled to a higher superannuation payment, and the question was whether this should be paid in priority as an expense in the winding-up. So she has not actually said whether the deed itself, to the extent that it sought to postpone this, was in fact effective—nor was she asked to really deal with that question-.

Discriminatory deeds are possible, so for instance a deed which discriminates between a creditor who is needed to keep the business running and one who is not will be effective. All that seems to be required is that the creditor who is not required for the business get more than they should in winding up so that it is not an unfairly prejudicial discrimination against them. But in terms of priority—coming back to your point—there is still some uncertainty about whether a deed which purports to change employee priorities, for instance, or the statutory priorities generally would be objectionable.

Senator WONG—And what limitations might be inferred in relation to it—for example, whether it place greater onus on the class whose rights are abrogated to consent to the deed and so forth. Those considerations have not occurred.

Mr Walker—No. It is fair to say that part 5.3A is quite different to part 5.1. The system of voting in classes does not exist in part 5.3A. For instance, in the priority position the employees have the same value per vote as every other creditor. It would seem appropriate that the statutory priorities should be observed and that a deed should not attempt to alter them unless there was some other form of compensation offered for that lack of priority. It is hard to see what that would be unless it was security of some description going forward in the deed of company arrangement in an ongoing business, for argument's sake.

Senator WONG—But currently there is no regulation that would achieve the outcome you have just described: that is, ensuring that if a group of creditors altered their position in terms of what it would be under the priority payments—

Mr Walker—Under the winding-up?

Senator WONG—in winding up by virtue of the deed arrangement there is no requirement that they be appropriately compensated.

Mr Walker—No, there is not.

Senator WONG—Or any additional regulation, in fact.

Mr Walker—No.

CHAIRMAN—I thank both of you for your appearance before the committee and for the submission you have given. Thank you for assisting our inquiry.

[2.58 p.m.]

D'ALOIA, Mr Anthony, Partner, D'Aloia Handberg

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public but if at any stage of your evidence or answers to questions you wish to respond in private you may request that of the committee and we will consider such a request to move in camera. We have before us your written submission, which we have numbered 15. Are there any alterations or additions you wish to make to the written submission?

Mr D'Aloia—I actually made two submission, one on 31 January 2003 and one on 12 May 2003.

CHAIRMAN—Yes, we have 15 and 15A—sorry.

Mr D'Aloia—There are no changes to those, but this morning I drafted a submission on another topic. I do not know whether it is appropriate to go into that at this hearing but I am happy to do so if it is appropriate.

CHAIRMAN—It relates to this inquiry?

Mr D'Aloia—Absolutely.

CHAIRMAN—You may present that as an additional submission. If you want to introduce that during your opening remarks in a moment, you may do so.

Mr D'Aloia—I will.

Senator WONG—What does it relate to? I just want to see if we need to get a copy before we ask questions.

Mr D'Aloia—Do you want a copy?

Senator WONG—Would you just remind us what it relates to. What are the topic areas that you cover?

Mr D'Aloia—It is to do with the voting of related party creditors at meetings of creditors.

Senator WONG—We will get a copy of it, thank you.

CHAIRMAN—We will get it copied before we proceed. While that is happening, I invite you to make your opening statement, at the conclusion of which I am sure we will have some questions for you to respond to.

Mr D'Aloia—Thank you for the opportunity. I will very briefly outline the very essence of the two submissions that I made earlier. The first point that I make in the first submission, dated 31 January, is to do with the procedure for appointing a liquidator in a creditor's voluntary liquidation. My submission is that it should be as quick and as easy to put a company into liquidation as a creditor's voluntary liquidation as it is to put a company into voluntary administration. Voluntary administration can be effected at the stroke of a pen, whereas a creditor's voluntary liquidation takes at least seven days before a liquidator is in place.

The reasoning behind that submission is that we find that creditors prefer to have an insolvency practitioner take control of the assets as soon as possible. In an instance that I have personal familiarity with, a company's directors came to see us and there was no business; there were assets there but the business had ceased trading previously. There was going to be no deed of company arrangement proposed, and the proper instrument—as I called it—for that situation would have been a creditor's voluntary winding-up, so that is what we initially proposed to do. But there was a secured creditor involved, who expressed their preference for a voluntary administration because it would mean that the assets would be under our control immediately, rather than in at least seven days. So we used the voluntary administration instrument in that case, when really it was not the most appropriate tool to use.

The other reason is that directors themselves, in that hiatus period of seven days, are very unsure about their legal position. They fear the possibility of becoming personally liable for debts that are incurred, even if they are not actively trading. They are not comfortable with that hiatus period either, and we find that quite often they say, 'Is there something quicker we can do, rather than a creditor's voluntary liquidation?' And that leads to voluntary administration.

I am sure, or as sure as I can be, that the architects of part 5.3A did not intend that voluntary administration would be used as a trapdoor into liquidation, although that is what we find is actually happening. That is not due to any fault on the part of 5.3A; it is due more to the fact that the procedure for placing companies into liquidation as creditor's voluntary liquidations did not change with it, at the same time. It remained the same procedure that had historically been in place. I guess that is the gist of that first point there.

The other point I make in the first submission is about the independence of administrators. I make two submissions there. The first is that administrators appointed to companies should be required to send creditors a statement of independence, which should inform creditors of any relationship or involvement that the administrator—not the directors, as appears in the submission—had with the company or its directors prior to his appointment. That is quite an important difference there: the involvement of the administrator with the directors prior to his appointment as administrator.

In tandem with the requirement for administrators to send creditors a statement of independence, I think that any creditor who moves a motion at a creditors' meeting—pursuant to section 436E of the act—to replace the administrator should be required to make a statement to the meeting as to the reasons why he believes the incumbent administrator should be replaced. Those two points go to the very heart of the way that part 5.3A is intended to operate. It is clearly intended that creditors have the benefit of the professional advice of an independent insolvency practitioner in making an informed decision about the company's future at the second meeting of creditors. That is all I want to say here about that first submission.

The second submission that I made on 12 May is really to do with secured creditors vis-a-vis voluntary administrations. There are a couple of instances that I cite in that submission. I will read out the first instance:

One of the primary purposes of Part 5.3A is to provide the directors of companies that are or may become insolvent with a quick and inexpensive means to address their financial difficulties. It was intended by the architects of Part 5.3A that the Voluntary Administration process would be invoked by the directors of companies in financial difficulty and certainly the vast majority of voluntary administrations have been invoked by directors of the companies concerned.

In this first instance—the first that I am aware of—the directors of a public company sought the appointment of administrators because a recent development affecting the company rendered it insolvent or possibly insolvent. A secured creditor held a fixed and floating debenture charge over the assets of the company. The overwhelming majority in value of the assets in this instance were fixed charge assets, like plant and equipment.

It would have been a large and complex administration, and the administrators' fees were expected to exceed the realisable value of the floating charge assets, so the insolvency practitioners—before accepting the appointment—prudently sought the consent of the secured creditor to allow their fees and the cost of the administration to be paid out of the fixed charge assets also. The secured creditor denied that right, so the practitioners withdrew and did not accept the appointment.

The directors approached another firm of practitioners, but the same scenario was repeated. In the end, the secured creditor did exercise their power and appointed a receiver and manager, but only because the directors threatened to go to the Supreme Court for the appointment of a provisional liquidator unless the creditor did something. The point that emerges from that is that the directors of the company sought to use part 5.3A of the Corporations Act in precisely the manner envisaged by its architects, but they were frustrated by the secured creditor.

The key duties and obligations of an administrator are, firstly, to investigate the business and financial affairs of the company with a view to exploring the alternatives available and to form an opinion as to which of the alternatives is in the best interest of creditors; and, secondly, to report his findings and recommendations to the company's creditors. The whole purpose of the above obligations is to enable creditors to make informed decisions about the company's future at the second meeting of creditors, at which the future of the company is determined.

In this second instance that I am aware of, an insolvency practitioner was appointed as administrator of the company by the directors, and a secured creditor held a fixed and floating debenture charge over the assets of the company. Again, the majority in value of the assets were fixed charge assets and the costs of the administration were expected to exceed the proceeds of realisation of the floating charge assets, which were only minimal.

Shortly after the administrator's appointment and still within the decision period in which the secured creditor could appoint, had the power to appoint, a receiver and manager, the secured creditor sent a letter to the administrator stating that none of the proceeds of sale of the fixed assets were to be applied to anything other than the costs of realisation of the fixed charge assets. The particular practitioner concerned disregarded the letter from the secured creditor and continued to do what he was obliged to do, but compliance with the secured creditor's letter

would have meant that the administrator would not have been able to complete his investigation and form a considered recommendation as to which alternative was in the creditor's best interests. This would have served to truncate and distort one of the fundamental principles upon which part 5.3A was built.

The solution to those problems that I have suggested is that section 443E(1) of the act should be amended to extend the priority of the administrator's rights of indemnity to cover unsecured debts and debts of the company secured by fixed as well as floating charges on property of the company—so to extend that just from floating charge to fixed charge as well. The reasoning for that is that secured creditors are well recognised within the operation of part 5.3A. They have the power to circumvent the entire administration process simply by appointing a receiver and manager, which is their right. By doing so, they therefore adopt the costs of the receivership via the indemnity that they provide the receiver and manager.

If secured creditors choose not to exercise their security by appointing a receiver and manager, they are implicitly consenting to the continuation of the administration process and agreeing to allow the administrator to retain control of the company and its assets and to continue with what the administrator has to do—that is, investigate the affairs of the company, consider the alternatives available and make a recommendation to creditors. Secured creditors should not have the power to truncate or distort the administration process by telling the administrator which of his functions he can and which of his functions he cannot pay himself for out of the fixed charge assets. Section 443E(1) of the act provides that the right of indemnity given to the administrator by section 443D has priority over all unsecured debts and debts of the company secured by a floating charge. This is the section that enables secured creditors to subvert the administration process in those instances.

Senator WONG—Perhaps I should let you know we do actually have your written submission in front of us.

Mr D'Aloia—All right. I will just briefly run through the submission you have just received from me, which is to do with the voting rights. At the present time, related party creditors—that is, creditors that are related, in the Corporations Act sense, to the directors and officers of the company—are obviously allowed to vote on all items of business and all motions at all meetings of creditors of a company in administration and under a deed of company arrangement. Unfortunately that ability is able to be abused and sometimes is abused. It tends to be abused in two instances that I am aware of: at the first meeting of creditors, where creditors have the statutory right to replace the administrator if they wish to do so; and in the second meeting of creditors where the voting is on a deed of company arrangement proposed by the directors.

Directors of a company in administration may offer creditors a deed of company arrangement which has as its main object the prevention of the company being liquidated and its affairs being investigated by a liquidator. Commercially there is nothing wrong with such an object, provided that the return to creditors under the proposed deed returns them more than would be available to them under a liquidation of the company. But it is possible now with the votes of related party creditors for directors to carry a resolution accepting a deed that does not return creditors as much as a liquidation would return to them. I know that creditors who feel that their interests have been prejudiced by a vote at a creditors meeting have a right to apply to the court for a

remedy, but in reality this right is rarely used by creditors because to do so means spending more time and money on a customer they have already lost money on.

My suggestion there is that the onus should be reversed—that is, that motions at meetings of creditors concerning replacement of the administrator and acceptance or otherwise of deeds should be determined on the votes of third-party creditors only; and that if directors of the debtor company and/or the related party creditors themselves feel that they have been or will be aggrieved by the exclusion of their votes they should apply to the court for a remedy. This suggestion is not intended to prevent related party creditors from participating in the proposed deed if it is accepted by third-party creditors, only from unfairly carrying a vote.

CHAIRMAN—Thank you very much, Mr D'Aloia. On your suggestion for overcoming the problem of the voluntary administration procedure being used to place a company into liquidation rather than to maintain it as a going concern, can I address that in the context of the Insolvency Practitioners Association suggestion, which is that the voluntary administration procedure be amended so that, with the administrator's consent, creditors can resolve to place the company into liquidation at the first meeting of creditors. What do you see as the pros and cons of your suggestion as against their suggestion?

Mr D'Aloia—I was not aware of that suggestion but I think that would work. I think that would address my concern.

CHAIRMAN—With regard to the independence of administrators, is there inappropriate touting for business on the part of administrators?

Mr D'Aloia—That depends on what you consider to be inappropriate. That is not really my point. My point is that, however a practitioner gets an appointment, he or she should be independent. If there is any prior contact then a creditor should be aware of it, and they should be made aware of it before that first meeting.

CHAIRMAN—Doesn't the process of appointment, or selection, go to the issue of independence?

Mr D'Aloia—Not necessarily. I do not think it does.

CHAIRMAN—You do not think that a proposal like a roster system, for instance, which some have suggested, would address the issue of independence necessarily?

Mr D'Aloia—I do not think so. The Supreme Court has had a roster system and it has moved away from that. It is cumbersome and you do not get the person that you need or want necessarily.

CHAIRMAN—What would be the content of the statement of independence that you have suggested?

Mr D'Aloia—It is simply another sheet of paper that goes out to creditors convening the first meeting and it is referred to in the body of the covering letter. The statement of independence merely sets out either that prior to a particular date when first approached we had had no contact

or knowledge of or dealings with any of the directors of the company, or that if there was some prior contact that is set out so creditors can decide whether it constitutes a lack of independence or not.

CHAIRMAN—What is the issue in proposing that creditors be required to state their reasons for replacing the administrator? Wouldn't it normally occur that the reasons would be stated?

Mr D'Aloia—No. If you think about what is happening, the creditors at that meeting are being asked to vote on a motion: they are being asked to vote to replace one administrator with another. Quite often it is simply done by innuendo. I am saying that the person moving that motion should state the reasons for their belief that the administrator needs to be replaced.

CHAIRMAN—Okay. A number of the submissions we have received have referred to the relative rights and remedies of secured and unsecured creditors. You have suggested that there are issues in relation to secured creditors potentially undermining the purpose of voluntary administration procedure by the failure to appoint a receiver. You also referred to that in your opening statement. Can you give us a bit more detail about the nature of that problem and the effect it has on the voluntary administration procedure?

Mr D'Aloia—The effect can be at least twofold—those that I have referred to in the submissions. Directors who go to use that instrument in precisely the manner that it was intended to be used can be frustrated from doing so by an indecisive secured creditor who simply does not know or will not make an appointment. In the instance that I quoted in my submission, if the administrator's right of indemnity against the assets of the company extended to the fixed charge assets it would not have been necessary to get the consent of the secured creditor. You would still do it as a courtesy to the secured creditor, I expect, but their saying no would not have made any difference. You could still have accepted the job and done what was required to be done and been paid for it.

The other way that it affects a voluntary administration, again in that instance I quoted, is that compliance with the secured creditor's request would have meant that, because of the limited funds available from the floating charge assets, a thorough job could not have been done in reviewing the affairs of the company and making a considered recommendation to creditors as to what the future of the company ought to be. Those are the two potential ramifications.

Senator WONG—There was a suggestion in one of the submissions that there be included in corporations regulations a code of ethics for administrators. Do you have any view about that?

Mr D'Aloia—Does the submission say precisely what that code would look like?

Senator WONG—I think it makes reference to the code of ethics which is contained in the Canadian bankruptcy and insolvency rules. I assume it would simply be something which emphasises the independence of the administrator and so forth.

Mr D'Aloia—In principle, I think the more the standard of ethics is defined and the more statutory force that is given to it the better.

Senator WONG—So you would have no objection in principle?

Mr D'Aloia—No.

Senator WONG—You probably would like to see what it would actually say before you said yes to it?

Mr D'Aloia—Yes.

CHAIRMAN—As there are no further questions, thank you very much for your appearance before the committee and for your submission. It has been very helpful to us.

[3.24 p.m.]

CRUTCHFIELD, Mr Philip David, Barrister, Victorian Bar

ZWIER, Mr Leon, Member and Insolvency Practitioner, Arnold Bloch Leibler

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public, but if at any stage of your evidence or answers to questions you wish to respond in private you may request that of the committee and we will consider such a request to move into in camera. We do not have a written submission from you, but we are looking forward to what you have to impart to us in terms of your knowledge and experience. I invite you to make an opening statement, at the conclusion of which we will move to questions.

Mr Zwier—Perhaps I should briefly provide you with an introduction about myself. I am an insolvency practitioner, a lawyer. I have been involved in the area of insolvency law for about 20 years. I have represented directors, creditors, landlords, parents, administrators, employees, trade unions and the ACTU at different levels in numerous insolvency administrations in general, and probably administrations under part 5.3A, more recently, in particular.

The primary submission I would make is that part 5.3A generally, in my view, works satisfactorily for the purposes of reorganising companies' affairs. Probably the most recent example I could take you to, in which I have been involved, would be the Ansett administration, where I acted on behalf of the voluntary administrators, the 'two Marks'. In that particular administration, with a very strong supervisory role of the court, it worked very successfully. The court's role should not be underestimated. The court played a role in empowering the unions to represent the employees; the court played a role to extend the period of time in which an administrator could retain control of property in his possession but not owned by the companies, without incurring personal liability; the court played a role in extending convening periods; the court played a role in approving fares before the creditors had done so; the court extended the time to sign the deed of company arrangement, which again was very useful; and the court authorised the use of the Internet and a hotline to communicate with creditors, to save millions of dollars. I think one of the submissions referred to $28 million; we estimate it to be more in the region of $40 million plus. The court played a very pivotal role, and the short point I am trying to make is that, whilst those who may have designed part 5.3A at the outset had not intended the court to play such a supervisory role, it is a key reason for the success of part 5.3A.

In my view, part 5.3A can be improved and modified, and I intend to touch upon perhaps three very brief points in that regard. First, there is no definition of insolvency in the act which is sufficient. Section 95A itself provides a circuitous definition, but the failure to provide a definition of insolvency creates difficulty for those who are advising company directors, particularly, because there is no direct reference in a piece of legislation to what insolvency means. I can tell you that, when advising directors, the minute you begin as a lawyer to take them to case law they find that incredibly frustrating and assume that there is some conjecture or argument about what it may or may not be. I might add that more recently I have acted for one of the largest United States corporations in relation to a problem in Australia, and they and their

New York, Denver and other attorneys were incredulous that Australia did not have a defined section of an act which set out what insolvency was.

The second short point I would like to make is that, when a company is insolvent or nearing insolvency, certain duties arise. The most common duty that directors are familiar with is the duty not to insolvently trade—that is, not to incur debt when a company is insolvent. There is actually no positive duty anywhere contained within the act for the board itself of a corporation to cease trading or to invoke any process. So I find, as an adviser, that very often a client will say, 'On what basis ought we be making an appointment? Where does it say that we need to make an appointment?' In my view, it is a deficiency that should be addressed.

The other short point about insolvent trading is that the insolvent trading issue is a threat. It is a stick, not a carrot. There is nothing within the legislative framework which says to a director, 'If you embark upon the following course of conduct, you will be exonerated from personal liability.' Yet personal liability is a big driver for directors of corporations. If there were model guidelines—or if ASIC were to produce guidelines—which set out what it is that directors are expected to do to avoid personal liability, it might assist in an orderly restructure of a company's affairs.

Probably the key modification that I would strongly submit ought to be made to part 5.3A is to take away the right of directors to appoint a voluntary administrator when a company is insolvent—that is, under section 436A as it is presently drafted, directors of a company can put the company into voluntary administration when it is insolvent or likely to become insolvent, which suggests a future point in time. I would like to take away the opportunity for directors to be able to put the company in when it is insolvent. The reason for doing it is that company directors traditionally run the company to a point where it is hopelessly insolvent and then seek to invoke the provisions of part 5.3A, the objects of which are to maximise the chances of a company continuing in existence, but by then it is too late. If you took away the right of directors to put a company into administration when it is insolvent, they would be forced to act much earlier in time because their advisers, whether they are lawyers, accountants or specialists, would be saying, 'If you want to embark upon a process to maximise the chance of your company remaining in existence, you need to move earlier.'

I also think there are some other benefits that would flow from it. Directors would be extremely cautious about the choice of administrator. They would be looking for someone who is most likely to be able to fix the problem not just take control of their company and liquidate it. It would probably avoid the phoenix company phenomenon because insolvent companies cannot be reorganised through this process by the board. It would leave open the opportunity for liquidators and secured creditors to invoke the provisions and, if a liquidator took the view that a company could be saved, it could be pursued down that path.

The only other point, which I want to make very briefly, is in response to a submission from the tax office about discriminatory deeds of company arrangement. The tax office, in its submission, suggested that discriminatory deeds of company arrangement—that is, where different unsecured creditors get different sums of money—should be disallowed. As someone who reorganises companies, to me such a proposition is repugnant to any sensible reorganisation, and that is because there are always key and vital creditors who need to be paid 100c in the dollar or they are not going to do business with the company in the future. If you

took away the ability to discriminate between returns between unsecured creditors, it would certainly limit the ambit and operation of part 5.3A significantly. Those are my brief submissions.

Mr Crutchfield—My background is also in the insolvency area. I have practised in that jurisdiction here and in England. During my time in England, I had exposure to the UK administration provisions and also to the US chapter 11 provisions through the Maxwell collapse and other matters. I want to make several points. The first point is that I would agree with Leon that generally the system works, and one indicia of that is the fact that the UK have in large part copied our provisions now in their Enterprise Act.

The second point is, and it is one that they have finally bitten the bullet on in the United Kingdom, that in my view banks—that is, secured creditors, holders of fixed and floating charges—ought to be bound by the voluntary administration provisions. The hoary old chestnut that interest rates would go up is just an in terrorem threat; I do not think that is true at all. In the home of banking they have now done it and it has been that way in the United States ever since chapter 11, so, in my view, that should happen. I also agree with Leon that an earlier commencement date for administrations would be an advance. I think, too many times, companies that simply cannot be saved are invoking the voluntary administration provisions, often for the reasons Mr D'Aloia suggested, as a short circuit to the voluntary liquidation of creditors.

I also think that changing the test would be important in changing the psychology. We have borrowed our law from England. Legislators here and in the UK grew up reading in Dickens about debtors prisons. Insolvency has a pejorative overtone in our system, whereas in the US someone once said jokingly, 'If you go into chapter 11, you put it on your curriculum vitae.' There is a different psychology, and I think that is a psychology we can learn from, perhaps through—as Leon says—making it easier. People will run arguments that you cannot go into administration unless you are actually insolvent and therefore the resolution was invalid, and that sort of thing.

The third point is in relation to professional standards and the independence of the voluntary administrator. Picking up on something Senator Wong was mentioning earlier, the anecdotal evidence is that there are small companies out in the suburbs with small amounts of money involved, where directors will appoint a friendly administrator and do a deed of company arrangement. The sums are so small that the courts never see those sorts of matters. In my view, you should need to be at least an official liquidator in order to be a voluntary administrator. There need to be some sorts of professional standards where there is a regulatory body, like with solicitors and barristers, who can strike a person off. At the moment that can only be done through ASIC. ASIC will probably have already told you, or will tell you, that they have obviously got limited resources.

The fourth point is that employees should have priority over the fixed charge element of the charge. Clever lawyers have emasculated the provisions of the floating charge priority through the charges over book debts. The weakness in the provisions becomes evident when you are dealing with situations like that of a company that runs a coal mine, which is only a hole in the ground and does not have any floating charge assets, or, if there are debtors and the bank has a fixed charge over them, there is nothing there. I think that ought to be fixed. The next point is

that I think the courts ought to be looking more critically at extensions of the convening period. For some of these small companies, the administrator will go along and seek an extension of the convening period. It will often be a situation where the director has appointed the administrator for the dominant, if not the sole, purpose of buying time so that the director cannot be sued under the guarantee under section 440J. I think section 440J is a misplaced provision.

The last point, again picking up on something Senator Wong was putting to Mr Walker, is in relation to employee entitlements and cramming down entitlements. On that I would concur with Leon—discriminatory deeds are important and they should not be prohibited for this reason: the courts have sorted it out. There is the full Federal Court authority of Lam Soon Australia Pty Ltd (Administrator Appointed) v. Molit (No. 55) Pty Ltd, a case where there were two supermarkets, one profitable and one not. Under the deed the creditors of the unprofitable supermarket got—for the sake of the example—1c more than they would get in a liquidation and the creditors of the profitable business got a lot more. The court said, 'That's not unfair. Why isn't it unfair? Because if you did not have a deed it would just go into liquidation, and you are getting more under the deed than you would in a liquidation. The purposes of the part were being fulfilled because you are saving the business—you are allowing the business to trade on.' So the courts are dealing with those issues, in my view.

CHAIRMAN—I will first ask a question in relation to your proposal that directors should not be able to put a company into voluntary administration when it becomes insolvent, they should have to move prior to that time. Do you know what the attitude is of other players in the field to that proposition—directors, creditors or whoever? Have you made an assessment of what the general attitude would be to that proposal?

Mr Zwier—I know that it was the subject of some debate at a master's lecture given, at which a sitting judge concurred with that view. I have expressed that view at a number of lectures that I have given. Plainly, the profession is divided on things like that. The smaller practitioners probably get a lot of work from people holding off to the very end and depend upon it for their own businesses, but I think it would increase the probability significantly of being able to save the larger administrations—for example, Ansett. The directors of Ansett could not have waited until it was absolutely insolvent. Ansett went into administration at a point in time when there was absolutely no prospect of selling the business; it was insolvent. If that choice was not available to the directors, query whether or not they might have gone into administration at an earlier point in time. Had they gone into administration at an earlier point in time, there may have been some cash left in the till. When the two administrators were appointed, there was nothing at all left. The first administrator might have ceased trading or ceased trading certain lines. My view is that, with anything that is different or new, there are always arguments for and against it. My view is that it would be a positive and sensible change, but there are those who would say that it would take away rights from companies that become insolvent quickly.

CHAIRMAN—Mr Crutchfield, I did not quite comprehend your comment regarding voluntary administration and interest rates.

Mr Crutchfield—What the banks say is this: if you take away our right to appoint a receiver over the top of the administrator, which is their current right under part 5.3A, there is a greater risk and we will just put up interest rates. In my view, that is a furphy.

Senator WONG—Why do you say that it is a furphy?

Mr Crutchfield—Because the market will sort that out. It has never been that way in the United States, and interest rates are traditionally lower there than in Australia. In the United Kingdom, the home of banking, if one goes back and looks at the Cork report of the 1970s, which led to the first rescue regime over there, they were talking about how credit is the lifeblood of the economy and how the banks have to have this right to appoint a receiver. The analysis that has been done in the UK has obviously concluded that it is not a problem there either, because the UK Enterprise Act, which has just been introduced, requires the banks to be bound by the administration procedure.

Senator WONG—Would you say that, in terms of any flow-on to increased price of capital, it is more a question of where the bank's security ranks in terms of the priority of winding up than whether or not they can appoint the person who liquidates the company?

Mr Crutchfield—I think that is right, Senator, and for this reason: the pool of people who are the administrators or the receivers is the same and they have their duties.

Senator WONG—Precisely.

Mr Crutchfield—I do think it is a furphy and it detracts from a rescue regime, which is what this is meant to be.

Senator WONG—Why does it detract? Because you can have an administrator in place who is trying to at least enable the company to trade out of some of its debts and then the secured creditor comes along and says, 'No, here comes the receiver?'

Mr Crutchfield—Yes, and the receiver sells the assets. Although the receiver has a duty to obtain the best price reasonably obtainable in the circumstances, the practical reality is that the receiver could advertise and sell the business tomorrow and get one dollar more than he needs to pay out the secured creditor; whereas the administrator might think, 'Gee, the gold price is low now. I will just mothball it and sell it later.' If the bank is getting out, it will not care; it will just sell now.

Senator WONG—So it is your view that it is contrary to the purpose of part 5.3A?

Mr Crutchfield—Yes.

CHAIRMAN—With regard to the issue of the appropriateness and timing of the first meeting of creditors after an administrator assumes control of a company, it has been suggested that five days is too soon. Indeed, some have even suggested that a first meeting is not required, that the second meeting should be the meeting required. Do you have a view on that?

Mr Zwier—I firmly believe it is important to have a meeting as soon as practicable after a company goes into voluntary administration. I believe it is in the interests of every class of creditor and also in the interests of the voluntary administrator. I do not personally believe that five days is too short a period of time. It puts practitioners under a deal of pressure to comply with that time frame, but so be it. It is important for stakeholders to understand what they are

now dealing with with the company. Creditors can easily be brought into a meeting by telephone hook-up. In Ansett, we used the Webcast successfully—I think it was the biggest Webcast ever. There is no reason why five business days cannot be complied with.

Mr Crutchfield—I tend to agree. Leon would know better than me. He does that and I do the litigious side of things. But I am in favour also of the short time periods in the part. We all know that the more time you have to do something the more time you take, and the creditors pay for that.

CHAIRMAN—And the second meetings? Some suggest that the maximum time for that should be extended out to 90 days rather than the 28 days, which is current.

Mr Zwier—Again my view of how part 5.3 operates is probably a little closer to chapter 11 than the way the traditionalists would view part 5.3A. With the courts' supervisory role and the provisions of section 447A, with any particular administration which is complicated and requires more time an application can be made to the court. It is relatively inexpensive—Philip will not be happy to hear this—and it need not have barristers appearing at those particular applications. The courts are amenable to hearing them at relatively short notice. I think it is an adequate safeguard. There should be pressure upon a speedy resolution. In answer to another part of the question, the convening period was extended sensibly for a number of months. Back in 1994 when I did Brashes, which was the first public company collapse that occurred under this regime, again Justice Haine, sitting as a single judge, as he then was, also sensibly provided extensions of the convening period.

CHAIRMAN—Another issue raised in submissions is the suggestion that the voluntary administration procedure is open to misuse in that it is being used as a means for placing a company into liquidation rather than maintaining it as a going concern. The Insolvency Practitioners Association have suggested the VA procedure be amended so that, with the administrator's consent, creditors can resolve to place a company into liquidation at their first meeting. What is your view on that proposition and also the earlier proposition that the VA procedure is being misused?

Mr Crutchfield—I tend to think that is right, that it is being misused or at least used for purposes not intended, as Mr D'Aloia has said, because it is the easy way to get into a creditors' voluntary liquidation. I think that also adds to the stigma of voluntary administration, and there is my point about trying to move it more towards the rescue psychology which chapter 11 has. So I would concur: I think that is a problem.

CHAIRMAN—Do you see the insolvency practitioners' proposal as a solution—that creditors can resolve at the first meeting to place the company into liquidation?

Mr Crutchfield—I prefer Leon's idea where you have a disconnect between administration and liquidation.

Senator WONG—You and the IPA are essentially saying the same thing—and I think also Mr D'Aloia as well as Ernst and Young this morning—that the voluntary administration process is being used in practice as a quick way of getting to liquidation. Their response is: 'Well, that's okay; let's just make it easier.' Your response is: 'Well, no, let's actually have an administration

process that works, and keep the two distinct.' I am not quite sure whether you have any specific proposals regarding how you actually require administration to come earlier; whether you are suggesting some sort of change to the directors' duties or some positive duty, together with your suggestion, Mr Zwier, of not allowing some positive statement that directors are not permitted to trade while insolvent or something like that.

Mr Zwier—Perhaps I can address Senator Chapman's point and then deal with the issues that you raise, Senator Wong. If you took my regime, which says directors cannot invoke part 5.3A when a company is insolvent, there ought never to be a situation where at the first creditors' meeting it should be wound up. That would only ever happen if the company were insolvent at the time of the directors' resolution, in which case the resolution in some way would be flawed. So it would not be necessary. It may well be that it goes down that path for other reasons—by court intervention or by the second creditors' meeting—but fundamentally I would be seeking to achieve, by that variation, to avoid company directors using it as a short-cut way to put hopelessly insolvent companies into liquidation, buying back the assets and reconstructing them in some way. They could not use it that way. They could only go to put it into voluntary administration when they were likely to become insolvent in the future; that is: 'We've got a problem that we can see one month, three months, six months out. We've got cash in the bank and we can pay our debts as and when they fall due at the moment from money that we've got, but in the future we know we will not be able to do so.'

Secondly, the reason I would like to have some positive duty imposed upon directors to deal with their companies in some way is that it is silent. As an adviser I am invariably asked by company directors: 'What's the position now? You've told me I'm insolvent or am likely to be insolvent.' In truth, the directors can keep operating the company. The proviso is that they cannot trade whilst insolvent, so they cannot incur any more debt. But if they move into a cash on delivery regime—that is, they buy all of their goods and services for cash and are not incurring any more debt—the creditor treats it as payment for a past service but the company treats it as cash on delivery and can keep going for a period of time without infringing the insolvent trading provisions. There may be issues about whether or not the directors have breached the duty they owe to the company to have regard to the interests of the creditors. That might arise if they were to deplete the assets further in that period of time but, assuming they have an honest and reasonable belief that they are going to trade profitably on a COD basis, they do not need to invoke any process at all. So the world at large is trading with an insolvent company which need not go into any form of administration.

If I am asked as a practitioner, 'Is there a positive obligation to put the company into administration or liquidation,' the answer is that there is not, unless there is a breach of some other duty. So what I advocated in my opening statement was some positive statement that, when a company is insolvent or likely to become insolvent, the directors have a positive duty to do something. To me, duties being imposed upon directors make companies act, because the single biggest factor which influences a company's direction is the personal liability of its directors. Again, with employee entitlements, if there were a positive duty of directors to ensure that the company always had sufficient assets to pay the employees their entitlements in full —and personal liability if it did not—that would have some influence in dealing with shortfalls for employees.

Senator WONG—While we are on this, you would advocate an amendment to 436A that removes the right to go down this path if the company is insolvent?

Mr Zwier—Yes.

Senator WONG—So you would limit it to 'is likely to become insolvent'?

Mr Zwier—Correct.

Senator WONG—And you would also impose on directors a statutory duty to, if they are of the view that the company is likely to become insolvent, act by, amongst other things, appointing an administrator?

Mr Zwier—Yes, I agree with that.

Senator WONG—I am not putting it to you; I am trying to clarify your argument. Is that what you are saying?

Mr Zwier—It is, but provision 436A uses the words 'likely to become insolvent'. Some—and I think Philip is one of them—take the view that 'may become' would be a better phrase than 'likely to'.

Senator WONG—It would be a lower level.

Mr Zwier—Correct: it would lower the threshold.

Senator WONG—Can you clarify—and this is pretty relevant at the moment—why you say those amendments you propose in relation to limiting voluntary administration and imposing that duty would avoid the phoenix company phenomenon?

Mr Zwier—In my experience, when I have looked at problems like this the directors of phoenix companies gut their company so that it is completely insolvent. They then put it into voluntary administration and propose some kind of arrangement whereby creditors might get 2c in the dollar. They resume control of the company, but they have basically pulled out all of its wealth and it is insolvent when it goes into administration. Phoenix companies really require conduct which borders on dishonesty. If directors cannot invoke the provisions lawfully, because the company is insolvent, an insolvency practitioner might say: 'I can't sign a consent to act here, because you do not have a proper power to put this company into voluntary administration. Your only choice is to liquidate it. You can liquidate the company either by application to the court or by other processes which are quite different.' Reputable practitioners would have a role to play in ensuring that part 5.3A is not invoked when a company is hopelessly insolvent.

Mr Crutchfield—I think Leon is saying as well that, if they are forced to go into liquidation, it is very much harder to resurrect the company.

Senator WONG—That makes sense.

Mr Crutchfield—It triggers the breaches of the leases and all the rest of it.

CHAIRMAN—With regard to deeds of company arrangement, you defended the capacity of deeds of company arrangement to vary the payouts to different creditors, both secured and unsecured. Excepting the points that you made, is there really a danger of the mechanism being used for companies to avoid paying certain creditors?

Mr Zwier—I do not believe so. I believe there are sufficient protections within the framework of the legislation itself to ensure that that ought not occur. The types of safeguards against it being abused include the following: if a deed of company arrangement is unfairly prejudicial to a creditor or class of creditors—that is, that creditor or class of creditors would be better off in a liquidation—then the court will overturn the deed of company arrangement. That is one safeguard. If related party debt is being used wrongly then section 600A will be invoked, and the court plays a role in making sure that the related party debt cannot be used to unfairly prejudice creditors or a class of creditors. In addition, there is what has been described by Justice Warren as the 'magical provision' of section 447A, which allows a court broad discretion in any administration to deal with a deed, for example, as it sees fit.

There are safeguards throughout it. The great benefit of it is really as seen in the example Philip talked about—Lam Soon v. Molit, which was the supermarket case. I am involved in the reconstruction of a gold company at the moment. In the reconstruction of the gold company there are ordinary trade creditors, who are vital for its continued operation; about 1,000 employees whose jobs are potentially affected and historical hedge derivative obligations to institutions. The way it could be reconstructed in a deed of company arrangement, and the way in which it has been proposed that it be reconstructed, is such that the people to whom the old, historical, debt is owed will receive, say, up to 40c in the dollar, and all the trade creditors will receive 100c in the dollar, against a backdrop which will mean that if the company is shut down and liquidated then realistically the creditors can expect to receive 15c to 25c in the dollar. It is a classic example of where the discrimination works very well. Trade creditors will get 100c in the dollar, the old debtors—the debt which is the historical problem for the company and which has led, fundamentally, to its insolvency—will do significantly better than they would in a liquidation, the business will be preserved and, hopefully, it will be a successful story. If discrimination between those creditors was not allowed, it might be impossible to reconstruct the company.

CHAIRMAN—We have had evidence this morning from a couple of witnesses who have been unable to access their entitlements under GEERS because the deed of company arrangement prevented the GEERS payments being recoverable from the company by the Commonwealth. How would you deal with that sort of problem?

Mr Zwier—My experience with the Commonwealth is that if you take a strong hand in relation to iniquities the Commonwealth government is generally very good about it. In Ansett there were 16,000 employees with numerous complications. It was not the GEER scheme in Ansett; it was the Special Employee Entitlement Scheme for Ansett, or SEESA. It worked very effectively, and Mr Maynard and his team in Canberra were first class in dealing with issues and one-off problems. If a creditor is unfairly prejudiced by a deed of company arrangement—that is, if their entitlements are taken away—then they ought to set aside the deed and have the company put into liquidation as a creditor adversely affected, and then they will be treated differently. That is one of the options.

CHAIRMAN—So you think the courts provide adequate remedy in that case?

Mr Zwier—The court provides a wonderful safeguard. There were problems with SEESA and the Federal Court provided ways for the SEESA payments to come through as well in that particular case.

Senator WONG—With respect, Mr Zwier, that assumes that the relevant creditor has the wherewithal to actually initiate proceedings. You keep talking about Ansett et cetera, but that was a very well organised campaign from the perspective of the employees, compared to quite a lot of other corporate insolvencies. Let me go back to the beginning on discriminatory deeds. I do take your point: it seems to me there are many occasions when the purpose of that part would be furthered by having a discriminatory deed. That makes sense, otherwise why else would you have it?

The first issue that occurs to me, and it has come up in the evidence, is the question of informed consent. It is of particular concern, I suppose, when you are looking at employee entitlements and smaller unsecured creditors who may or may not be legally represented. If you have a deed which would substantially and detrimentally alter their entitlements as compared to the position they might be in were the company liquidated, there are potential problems. We certainly have evidence of at least one case where there is a problem. In terms of people being asked to consent to such an arrangement, do you not think that there is any argument for any regulation of the extent to which a deed can discriminate in respect of certain classes of creditors without those creditors giving their consent, or additional requirements to ensure that people understand what they are agreeing to?

The evidence this morning from these employees was that they had very short notice—frankly, I do not think that the administrator complied with the time lines in the act anyway, but that is another issue—of the meeting where the deed was discussed. They were not able to be legally represented. In fact it was in another state so their capacity to attend it was obviously negligible. Their view is—and I have not seen the deed—that their rights were significantly compromised by the deed of arrangement that was entered into. It would seem that is a very different situation from the situation that you talked about where there are some positive reasons why you might say that this discriminatory deed should continue. I do not have a difficulty with employee entitlements being put in the mix, but I think people should be given the opportunity to make an informed choice about that, and I do not see anything in the legislation which requires the administrator to do that. Perhaps you can point me to that.

Mr Zwier—It is my belief that the report that an administrator makes, which contains the recommendations when convening the second meeting pursuant to section 439A(4), requires a full disclosure. I can tell you that in my experience I have in one reconstruction worked with employee entitlements and potentially put at risk the employees in relation to their entitlements for the benefit of reconstructing the company. The only way the company could be reconstructed and say—

Senator WONG—They knew about it; it was discussed with them and they made an informed judgment. Does that always happen?

Mr Zwier—No. The difficulty with the insolvency profession—and, again, this may have been explained to you before—is that it really divides between different practitioners. Serious practitioners are at the top end and they generally understand their duties and obligations. They tend to get the bigger work so they tend to have the resources and time to write their reports properly and make full disclosure. Then you have got the smaller matters at the other end of the scale where it becomes far more problematic.

The profession divides also between debtor firms and creditor firms. You will tend to see the same debtor firms in the phoenix company type reorganisations over and over again and you will tend to see the same creditor firms being involved in administrations with large institutions. There is a problem with the level of disclosure. My belief is that the framework, as presently drafted, would require an absolute and full disclosure. I also believe there are legal safeguards for the smaller employers and smaller administrations—and I say that because of the development of the practices of Maurice Blackburn Cashman, and Slater and Gordon. They are now becoming more sophisticated in understanding how the Corporations Law works, and they will take on cases like that.

Senator WONG—Do any of the safeguards to which you refer work in the absence of employees being legally represented?

Mr Zwier—I believe that reputable practitioners have an obligation to make the disclosures pursuant to section 439A(4), so they ought to be made.

Mr Crutchfield—The example you gave, Senator, would constitute a circumstance where the court would say that inadequate information was given, and that deed would be terminable. Your point is that in the small situations employees do not have the resources—

Senator WONG—Precisely.

Mr Crutchfield—But one needs to be careful having black letter law mandating a minimum, because you may end up with a situation—and take Leon's example—where, for the benefit of the business and the ongoing jobs, the employees are happy to give up part of their entitlements. Before you gave the example, my instinctive reaction was that no reputable insolvency practitioner in their right mind would propound a deed which took away employee entitlements, and by that I mean bring about a result—

Senator WONG—That is with the preference?

Mr Crutchfield—Yes. My view that they would not propound a deed that brought about a result that was less than they would get in the liquidation, because they would know that that deed would be terminated. I am surprised to hear those examples. In my opinion, if you are not making full disclosure and not properly explaining to people what you are doing, that sounds like an ethical breach.

Senator WONG—Do you think there is any argument for placing a greater onus on administrators in those circumstances—that is, where they are engaging in deeds which are discriminatory, in the sense that they potentially may alter the situation from that which it would

be if liquidation occurred—to provide information to the affected classes of creditors or to give those particular classes of creditors greater voting rights in respect of the deeds?

Mr Crutchfield—I am not sure about the second option. The first is what the courts currently require. Putting it into the legislation is not going to necessarily make any difference, unless a breach of the provision led to the deed being void, do you see?

Senator WONG—Yes.

Mr Crutchfield—You cannot legislate against bad practice, otherwise you end up with a huge Corporations Law. The Ontario Companies Act, for example, did have 82 sections. You cannot just keep making more and more legislation to deal with these sorts of things. In my opinion, it comes back to the professional issue—regulation.

Senator WONG—What about the right of veto? That was raised today.

Mr Crutchfield—The right of veto for the employees?

Senator WONG—If a deed sought to discriminate against employees' entitlements.

Mr Crutchfield—For the deed to be valid, in my view you would need to have at least a majority of the class of employees affected voting in favour of the deed.

Senator WONG—That was what I was going to ask: is that your view on the case law?

Mr Crutchfield—The case law at the moment would say you just cannot do it, full stop. That is how most deeds are propounded, such that you do not compromise, less than a liquidation, unless you have got the consent of the affected class. Leon and I may disagree about this, because we are on opposite sides of the matte. Where this may come up—in Ansett—I suspect that Leon would say that as long as he has got a majority of the class in favour of what is happening, the employees, and as long as they are properly informed, then he can do it. The courts might currently say, 'No, you've got to get everybody's consent, because you're cramming down on what they'd get in a liquidation.'

Senator WONG—But those are still issues open to legal argument.

Mr Crutchfield—Yes.

Senator WONG—What would you say to a requirement that a discriminatory deed be at least agreed to by the majority of those in the class whose entitlement is arguably discriminated against?

Mr Crutchfield—I have no difficulty with that in principle. If I was sitting as a judge in a court, that would be the kind of test that I would be interested in hearing about—without prejudice to what I might subsequently say. All I am saying is that I do have difficulty with the black letter requirement for that, because you might have situations where, through employee blackmail, for example, they might be able to bring about a situation which is not in the best

interests of the rest of society—that is creditors, the tax office, the business being able to go on and trade.

Mr Zwier—I want to pick up on something that you raised, which I thought was a great point. To the extent that the deed of company arrangement is proposing a regime that deviates from the priority of section 556, there should be an absolute disclosure of the differences. To me that would be the safest and most palliative way of dealing with that issue.

Senator WONG—I thought your evidence, Mr Zwier, was that you thought that that duty was already implicit in legislation.

Mr Zwier—I think it is implicit already under the provisions.

Senator WONG—It is a question of whether the practitioners actually think that?

Mr Zwier—Correct. To the extent that they might seek my advice, I would certainly say that they have to disclose it. That might be a very short way of giving it some prominence in the section 439A(4) report. That might be an easy way of doing it. The Ansett deed of company arrangement that was put up also deviated from the provisions on liquidation in relation to set-off. Originally it was proposed that there would be no set-off in the Ansett deed of company arrangement. A whole lot of creditors came up to the administrators at the second creditors' meeting and said, 'This is terribly unfair to us because we would set off rights we have against obligations that we owe.' The administrators on the floor, when they had resolutions suggesting the amendment, accepted those suggestions and the ultimate deed of company arrangement changed. The Ansett superannuation issue is very vexed. Because there is a shortfall, the employees will take it either as redundancy or superannuation, and there is a lot of conflict about how to resolve that issue.

Mr Crutchfield—At the moment it operates after the event, in the sense that the requirement arises out of section 445D, which is that the court can terminate the deed if the information that is given is misleading or there is a material omission et cetera. I think your question is about putting up front a positive legislative requirement to do it. If the parliament were to go down that path, the rhetorical question might be: why just stop at employees? Then it becomes very prescriptive, setting out what needs to be in the act for every possible situation. I am not sure that is workable.

Senator WONG—Although one might say that employees—who have entitlements—are a slightly different type of creditor.

Mr Zwier—They are. I hope I was not seen to be saying that it should be limited to employees. I thought the idea of—

Senator WONG—Yes. I was responding to Mr Crutchfield.

Mr Zwier—That would to me be a more appropriate way of dealing with it.

CHAIRMAN—Another issue that has been raised with us is the method of voting by creditors on a voluntary administration. Are you aware of any concerns about the current method of voting by creditors?

Mr Zwier—In every voluntary administration there is always tension between the different stakeholders and the different types of creditors and there is always the risk, of course, that the employees will dominate by number, or that the bank, which might have a very large debt, will dominate by value. Frankly, I think that the system as it presently stands works well. I have no difficulty with the fact that if there is deadlock an administrator should have a casting vote.

CHAIRMAN—So you support that provision?

Mr Zwier—I do support that. An administrator should be compelled to give reasons for the exercise of the casting vote. Once again, in my view part 5.3A works well on the voting and on the casting vote, because of the general supervisory role of the court. Without that general supervisory role of the court, it would be problematic. It is really very difficult to find a perfect, expeditious way of resolving all of the issues, including all the class issues. I personally think that the present system works adequately.

Mr Crutchfield—I concur. Do not tinker with the voting; I think it works.

Senator WONG—Mr Crutchfield, I want to clarify a couple of things that you said in your opening statement. You made the comment that secured creditors should be brought in to the voluntary administration process. Is this a reference to the issue of whether or not they should also have a right to appoint a receiver?

Mr Crutchfield—That right should be taken away in my view, yes.

Senator WONG—I think you said that employees should have priority over fixed charge creditors.

Mr Crutchfield—Yes. The way the priority provisions work at the moment for employees is that they have priority over the floating charge element of the bank's charge. In my opinion, the original rationale was that the employees, through whose work the fund is administered for the benefit of the bank, should get their wages paid as a priority; they should take priority over the bank. That is the way it was done in Victorian England. Now, as I said in my opening statement, clever lawyers have emasculated the floating charge element, and I think the original purpose has been undermined. Employees should take priority over the whole element. It would also do away with arguments about what is fixed and what is floating.

Senator WONG—Do you mean they should take priority over secured creditors, full stop?

Mr Crutchfield—Yes, over the whole charge. They should come first.

Senator WONG—There would be some opposition to that I would think from business. The argument we heard this morning from ACCI is that that kind of alteration would increase the price of capital et cetera.

Mr Crutchfield—That is what we were discussing earlier. It is probably the last banking brief I get, but I think that is not the case at all. Parliament intended employees to come before the bank. That is why they have a priority over the floating charge element of the charge, in my view.

Mr Zwier—I will amplify a little. I do not think that giving employees a separate priority regarding fixed charge assets is ultimately going to be the solution. I say that for this reason: what will inevitably happen is that companies that might have operated with fixed charge assets in entities which had employees will, basically, as a prerequisite to getting their funding, be required to reorganise their affairs such that you will find that the fixed charge assets will be removed from the entities which have the employees. Lawyers are going to get rich reorganising companies and accountants are going to get rich having more accounting work to do, and all that will happen is that there will be a division between the fixed charge assets and the floating charge assets and where the employees sit, which I do not think is adequate. I agree with the sentiment that is expressed. I have always preferred the idea of imposing positive obligations upon directors, with consequences for directors if they are not able to meet those obligations. It sharpens the minds of directors, when they have to start to take account.

Senator WONG—What sorts of obligations would you suggest?

Mr Zwier—Civil liability for companies—for directors and deemed directors—unable to meet the obligations of employees when companies collapse.

Senator WONG—Is this regardless of whether or not they are engaged in insolvent trading?

Mr Zwier—Yes.

Senator WONG—Is this for contingent liabilities as well as accrued?

Mr Zwier—Yes. It will make companies continually assess what the contingent liabilities are for employees and where they sit. Again, the thrust of my submission is that companies can be reconstructed and saved, provided they go early enough. All this will do is to make company directors say, 'We now need to bring in the corporate doctors at this early point in time to save our company, because we don't want to have any risk whatsoever of denuding the assets of this company and disentitling the employees, because it might become our liability.'

Mr Crutchfield—I would not support that.

Senator WONG—It is an even more radical suggestion than that of the ACTU.

Mr Zwier—I think Mr Combet would agree with it though.

Senator WONG—Mr Crutchfield, have you got any suggestions as to how the regulation of administrators should actually be done?

Mr Crutchfield—Unfortunately, no. It came up during one of ASIC's liaison committee meetings. I understand that it is an issue that they are looking at; it is certainly being discussed. My understanding is that you do not need to be a member of the IPAA in order to be a voluntary

administrator, and they do not have any mechanism for rubbing out errant insolvency practitioners. It is only done through the CPA, the chartered accountants association. My understanding is that even the insolvency practitioners think that this is a big issue. I have not got an answer.

Senator WONG—Just to clarify again, Mr Zwier, you actually advocate the insertion into the act of some positive duty to not trade while insolvent and to appoint an administrator at an appropriate time?

Mr Zwier—I do.

Senator WONG—And you do not think that is currently arguably covered by notions of what fiduciary duties directors have?

Mr Zwier—It is indirectly covered by the director's duty that is owed to the company to have regard to the interests of the creditors. It arises when a company is nearing insolvency. When a company nears insolvency, the directors have to turn their minds to whether or not they should keep trading or whether they are diminishing the return to creditors by doing so. If they continue to diminish their return, even if they are not trading whilst insolvent, arguably they are giving rise to a liability for themselves for a breach of that duty. It is a grey and difficult area. As one who advises company directors about what their obligations are, very often people say to me, 'Where does it say that we ought to be putting the company into voluntary administration?' We have an option because the company is likely to become insolvent—or is insolvent—but there is no positive obligation to do anything about it.

The difficulty is that directors who are acting bona fide in the interests of their company are always optimistic. They always think it is going to get better, that they are going to make the next sale and that they are going to find gold. There is always some reason why they should keep going. It is very difficult because they are emotionally involved. Leaving aside the example of phoenix company directors, they genuinely want the company to succeed so they push things to the nth degree. Ultimately, when you look back with the benefit of hindsight, they have denuded it of everything and there is very little there and then insufficient—

Senator WONG—But imposing a statutory duty is not going to change that emotional kind of response that people have.

Mr Zwier—Save and except that there are consequences for not complying with the legislation. Again, when directors are told there is a consequence they will act. If you are under a duty to put this company in because it is insolvent or likely to become insolvent then that makes company directors act.

Mr Crutchfield—I would make just one observation on that. It is more of a general one that perhaps I should have made at the outset. Someone once said that the limited liability company was the most important invention of Victorian England, more important than the steam engine. I for one agree with that in terms of separating risk from reward. I do not support the increased personal liability of directors. We are at the end of the spectrum now, where the tendency is to try and push directors into being trustees for people's money. I think we need to be careful not to go too far.

CHAIRMAN—Mr Zwier, you suggested earlier that there should be a definition of insolvency in the legislation. Do you have any suggestions from your own work, overseas legislation or other sources?

Mr Zwier—I do not want to be too loose here. My view would be to take probably some of the most recent pronouncements from some of the cases, particularly the Elliott-Water Wheel example, and to try and craft around that an adequate definition of what insolvency is. It is obviously a cash flow test and there are indices of insolvency which were referred to in the judgment, but I think we must be able to come up with a better definition so that one can point to it and say, 'This is what insolvency means.'

CHAIRMAN—I thank both of you for your appearance before the committee. It has been very valuable in our inquiry. Thank you very much.

Proceedings suspended from 4.22 p.m. to 4.38 p.m.

ABRAMOVICH, Mr Mark Daniel, Member, Association of Superannuation Funds of Australia Ltd; and Partner, Deacons

PRAGNELL, Dr Bradley John, Principal Policy Adviser, Association of Superannuation Funds of Australia Ltd

CHAIRMAN—Welcome. Are there any alterations or additions that you want to make at this stage to the written submissions?

Dr Pragnell—No. We might want to raise some other issues along the way.

CHAIRMAN—That is fine. I invite you to make an opening statement, at the conclusion of which we will move to questions.

Dr Pragnell—ASFA welcomes the opportunity to appear before this committee. ASFA is the main industry association for the superannuation industry, representing superannuation funds, their trustees and their members. An important disclaimer I would like to make in giving this opening evidence is that neither I nor Mr Abramovich are insolvency experts. We are here because we are interested in the interface between superannuation and insolvency law. Mr Abramovich is in a very unique position, having represented the Ansett Australia ground staff superannuation plan in the recent court cases. So he will be able to provide a unique perspective on that matter from the other side.

Superannuation, we believe, is critical within the context of employer insolvency. Superannuation is an important employee entitlement. It is more important in many ways than some other entitlements, in the sense that it is compulsory and it represents one of the three pillars of a retirement income system. For individual employees, superannuation is not only a significant entitlement of employment but, for many, constitutes their second largest asset after the family home.

In terms of requiring employers to meet their obligations, the main mechanism for that remains the superannuation guarantee. We are pleased that the government has introduced quarterly superannuation guarantee payments effective from 1 July this year. We believe that moving from annual to quarterly payments of the superannuation guarantee is an important move in ensuring and protecting employee entitlements in this important area. Despite a system that is generally robust and strong in protecting employee entitlements in this area, particularly the superannuation guarantee and its enforcement by the Australian Taxation Office, there do appear to be certain gaps. Many of these gaps that have been exposed, for instance, by the decisions in relation to the Ansett super case, are raised in the context of our written submission. But I would like to draw your attention to one—notably, the need to consider affording superannuation higher priority in a wind-up situation than it currently receives, which is at paragraph 556(1)(e) alongside wages.

We have expressed concern in our written submission about this relatively low standing for superannuation within the list of priorities for unsecured creditors. However, we believe that it is

important that superannuation be moved further up the ladder. It is obviously an issue for law reform. In paragraph 293 of the Ansett decision, Warren J. said:

> At the time that superannuation contributions were inserted in paragraph (e) the parliament could have elevated superannuation contributions to a high priority perhaps by insertion in paragraph (a). It did not in that paragraph.

Section 556(1)(e) also covers important issues with respect to defined benefit and deed of company arrangements. I will hand over to Mr Abramovich to deal with them now.

Mr Abramovich—Part of the difficulty that we have encountered in relation to the Ansett insolvency is the fact that we believe the legislation is deficient in dealing with defined benefit superannuation funds. From my understanding, whilst those types of funds are declining they still hold significant amounts of money—in the billions—and accordingly you really need to consider that these amounts must be protected. They do fall into a different category from accumulation funds, which most employees are put in and are more like bank accounts.

What the Ansett case exposed is to do with when you have a defined benefit fund that is in a funding deficiency. We think the court made an incorrect decision. I must admit it is a very technical area, so I will try and explain it in lay terms. The judge said there was a pre-existing obligation and the funding obligation. She actually found there was an obligation that the employer, and therefore the administrators, had to fund. It was a pre-existing obligation and the funding debt did not obtain priority. We are talking about a deficit of between $150 million and $200 million for the ground staff plan alone; in one of the other Ansett plans, the Fab scheme, at one stage it was $10 million. They affected, for example, 8,000 to 9,000 members in the ground staff plan—Mr Zwier was talking about 16,000 people, for example—and about 1,760 people in the Fab scheme.

How that difficulty arises is found in the way that defined benefit schemes work. An actuary gives a funding and solvency certificate. That certificate sets the minimum employer contribution rate. Usually, when the investment markets are working well, the system seems to work, and in the past the employees would get the surplus. Here we have a deficit. Can we recover that in an insolvency? If not, the poor employees, some of whom obviously have been working 35 to 40 years and are nearing retirement, are going to have their benefit significantly reduced. You will spend a few years in court trying to sort that out, and adjust benefits downwards.

One of the difficulties is that a funding and solvency certificate, which is found in the Superannuation Industry (Supervision)—I will call that SIS—Regulations, at regulation 9.15, has a formula and part of that formula is the definition of what is known as the BEF, which relates to former members. We do not think that reg really works in a situation where there is a deficit in a super fund. Where that is relevant is that the FSC—the funding and solvency certificate—actually says that it is designed to pay out anyone who becomes a former member whilst protecting the remaining members' minimum requisite benefits, which is like the super guarantee equivalent.

Just putting that in the context of an Ansett situation, it would mean that the people who left employment at a certain time—let us say, earlier—would get 100 per cent, the other people in the line would get 100 per cent, 100 per cent, 100 per cent, and then as the money went down

people might get 80 or 90 per cent, up to this minimum SG level, until it gets to nil—and so some people might actually get nothing. So we are saying that regulation does not work in that type of situation.

What we are saying about how that flows through in the context of this inquiry is that maybe 556(1)(e) should be clarified. We are suggest not only that the priority should be put higher but that it should be clarified to include defined benefit funds and their characteristics. I must admit I do not have a suitable recommendation for you now.

Senator WONG—I was going to ask you for that.

Mr Abramovich—It is difficult.

Senator WONG—I am lucky enough to be on the superannuation committee as well. I would have thought it is an extremely difficult situation to deal with insolvency in the context of defined benefit funds. Your submission does not put forward a view about what should be done; it simply says that superannuation should be accorded a high priority in where it appears in terms of preference. You do not have a view that you are putting to us about how defined benefit funds should be dealt with; what you are saying is there is a problem and it ought to be dealt with.

Mr Abramovich—Yes. I have not had sufficient time to do that. I am quite happy later to try and work through something.

Dr Pragnell—Yes, we might be able to follow up on that.

Mr Abramovich—It is complex—that is what I will say, in a nutshell, on that point. Just to finish on that, the funding and solvency certificate is of course on the assumption that you have an ongoing company. It does not assume that 90 or 95 or 100 per cent of the people become former members in one hit, so it just does not work in that respect.

Before I start talking about deeds of company arrangements, I might just raise one point that you may wish to consider. Again, this relates to amendment of the SI(S) Act and is relevant to administrators. Section 64 at the moment is about the provision that covers the deduction from an employee's salary or wages by an employer and the requirement under this section that the employer remit that promptly within 28 days. It is a strict liability provision, and there are 100 penalty units if the employer fails to forward that on to a super fund within that time. I would ask the committee to consider an amendment to that section to include either in that section or in the definition of 'employer', an administrator or a receiver. I have had a look at the definition in section 10 and where it then flows into 15(a), which is the definition of employer, and it just says 'ordinary meaning'. It does not cover a voluntary administrator, deed administrator or receiver.

Senator WONG—Notwithstanding that generally the administrator is regarded to stand in the shoes of the company?

Mr Abramovich—That is correct. They like to have that power but sometimes, I am saying, they do not always exercise it correctly.

Senator WONG—I appreciate that, but isn't it legally arguable that 'employer' there would extend to the administrator?

Mr Abramovich—I did not think it did.

Dr Pragnell—It is something to be considered, I think.

CHAIRMAN—The employer would not be an individual; the employer would be the employing company, surely.

Mr Abramovich—An employer could be an individual.

Senator WONG—That is a different situation.

CHAIRMAN—If you were working for a sole trader.

Mr Abramovich—Yes. It is just that, as far as I could see, the definition of employer does not tie in to the Corporations Law, for example, at this point in time. That was just a point to consider.

Senator WONG—That is section 64 of the SI(S) Act?

Dr Pragnell—Yes.

Mr Abramovich—We did have certain difficulties in chasing the administrators for $11 million in outstanding contributions. We eventually did get it but it was like pulling teeth. I am lucky enough to take the chair of my opponent here, who was advising the administrators. I am not saying that he has done anything incorrect, but it was difficult.

One of the issues that Mr Zwier raised is quite appropriate and we also picked it up. It is the issue of priority in the winding-up and the variation of those priorities by a deed of company arrangement. We are concerned that you have these statutory provisions under 556(1)(e) and then you have the almost 'magic provision'—as he calls it. I am not sure that it is so magic. It allows the administrator to propose a deed that varies those positions. In the Ansett case—and I am not sure if this has been made clear to you—what they have said is that, firstly, if the trustees are successful in the appeal before the full Supreme Court and that priority is accorded, then they will still say that in their deed the retrenchment benefit—this is what we are all fighting over: extra retrenchment benefit—still constitutes an unsecured debt and therefore is placed with the general pool of unsecured creditors. In fact, it seems to lose its 556(1)(e) priority with respect to the deficit. The fund has money; that is not in the details, it is just this part that we are claiming.

CHAIRMAN—Outstanding deposits, in effect?

Mr Abramovich—Yes, that is right—the extra contribution that would be required to make up the final members' benefit. Some of the examples of the voluntary administrators can be questionable. They attempted to state that the letters of voluntary redundancy they sent out to employees did not constitute a retrenchment for the purposes of the ground staff trust deed.

Senator WONG—You are either retrenched or you are not.

Mr Abramovich—That is right. The point is that the court subsequently found that you are retrenched: 'Redundancy/ retrenchment is a cute use of language: same thing. Thanks very much for coming.' The trustees should not have gone to the expense of having to have that determined in the first place. It is also a way whereby an administrator, if they step into the shoes of the employer, then exercises the powers of a principal employer in a corporate superannuation fund. Therefore, they have significant powers. I will not go as far as saying that it is a fiduciary position, but they have to exercise those powers properly, in my view. You cannot say, 'Sorry, that does not trigger a certain benefit being paid in a super fund,' which was almost in a backhanded way what they were trying to do. That could lead to employers in solvent companies trying to do the same thing in different ways so as to deny payments of higher benefits. I am not sure if it flows that way exactly, but they could do certain things. That is a concern.

The problem with the variation of the deed of company arrangement is that even if the trustees win the appeal in the Supreme Court they then have to go to the Federal Court to set aside the deed of company arrangement. They have to argue, as Mr Zwier said, that it was unfairly prejudicial, which I think, hopefully, we will win. Again it is another man-made step that has been put in the way in order to satisfy the payment of an employee benefit, especially such an important one.

One of the proposals that ASFA has put—in recommendation 4—is that superannuation was left out. I think it was left out in GEERS and it was definitely left out in SEESA. The interesting thing about that is that it clearly tied in with the priorities in 556. What the government in the loan agreement with the administrators did, and which was ratified by the Federal Court, was that they effectively stepped into the shoes of the employees and cemented their priority. It is actually lower than superannuation—redundancy benefits and long service leave, for example, are lower than (e). That allowed the administrator, in its deed, to try to knock out this super component and put it lower. By putting it back in, it actually retains the priority that the legislation intended in the first place. I think that is quite important. The government could then think, 'Is there a cost?' Of course they have paid for it in the first place but then they are looking for reimbursement from the assets of the company. That is how they are doing it. So there does not seem to be an extra cost in doing that.

Senator Wong, you picked up some interesting comments regarding deeds of company arrangements—what is actually disclosed and whether employees know their rights. In this case the employees were represented by the unions by way of a proxy vote. I do not think the employees themselves would have really been told what the superannuation and other employee entitlements meant and their value and the tax arrangements—that is, what is beneficial to them—to make an informed vote. There are issues there. Whether or not appropriate and full disclosure is made is a different matter but that is what I believe occurred here.

By allowing the deed of company arrangement to vary priorities, in my opinion it could defeat the operation of the Superannuation Guarantee (Administration) Act, which is the underpinning act of the government's superannuation and retirement incomes policy. It is there to put in a system that underpins the age pension and the compulsory savings that the government is pushing. You do not want anything that would defeat that end aim. They were the main points that I really wanted to raise with the committee.

CHAIRMAN—From my point of view your written submission and presentation today has been very comprehensive. I do not know that we will have all that many questions.

Senator WONG—I have a couple of quick ones. You advocate that the act should not allow discriminatory deeds of arrangement—in other words, deeds of arrangement that alter the priority given to various creditors, in particular, from your perspective, superannuation entitlements of employees. Is that right?

Mr Abramovich—That is correct.

Senator WONG—The argument that was put forward—you may have been here for some of the discussion—by some other legal practitioners is that sometimes discriminatory deeds are precisely what is required to get the company going again. They argue against the sort of blanket prohibition that you are advocating. I know you are not insolvency practitioners, so you may not have any comment on this issue, but I am wondering if you think there is a halfway house between saying it is not permitted or permitting it with certain safeguards such as appropriate disclosure, perhaps that the majority of the relevant class of creditor—in this case, employees—have to approve the deed and so forth.

Dr Pragnell—We are coming at it again, as you identified, not as insolvency practitioners. I think we probably would be open to considering there being some middle ground between the two positions and the possibility of there being some kind of safeguard. The point we are trying to make is that, currently, deeds of company arrangement are being used to undermine existing priorities, and that is definitely something that we would like to see addressed in any future law reform.

Senator WONG—On that, is it quite a widespread problem from your perspective? Are we talking about something that you see, in the context of your industry, reasonably often? Or is it really only the Ansett case that has presented itself as a significant problem?

Mr Abramovich—In my personal experience, it would just be the Ansett case that I could comment on at this point in time. The only thing that I would like to add to what Brad said is that what you have to weigh up is the distinction of business risk. We have trade creditors, for example—and I hear exactly what you are saying, and I agree. With trade creditors, there is business risk. With employees, there is not. That is value for service that they have given, and that is where we would be coming from.

Senator WONG—I would have some sympathy for that. The impact on the individual may be quite different.

Mr Abramovich—In this case, the trustee has been extremely proactive, because its duty is to preserve the assets of the trust, carry out the terms of the trust and act in the best interests of the members. It has the resources to run this in court, but employees do not. They are in a weak bargaining position, and they are the ones who are affected the worst.

CHAIRMAN—To what extent do you think the move to requiring quarterly contributions to the superannuation guarantee mollifies the problems that you have highlighted?

Dr Pragnell—I think it does definitely address some of the outstanding issues. You could have situations where up to 13 months of superannuation could go unpaid quite legally because the liability did not crystallise until 28 July for the proceeding financial year. The fact that the SG basically works, that compliance is quite high and that ATO enforcement is generally effective in our view means that you will see more employers contributing on a quarterly basis. I think as well you will see that steady cash flow going in. So I think the quarterly SG has been an important step in that direction, but again I think that the Ansett case did expose some other weaknesses.

Mr Abramovich—The only thing I want to add to that is that you are never going to stop a bad employer—one who does not want to pay—irrespective of timing. Most employers are paying monthly to start with, because of super fund requirements that they pay monthly, which is fine. So the majority is probably covered. It is really just those rogue employers who would not comply or did not pay super in the first place. I do not think that quarterly payments would change that. I think the only thing is that if you have a very vigilant tax office that responds quickly to an employee complaint then it will bring forward the timing. So in that respect it is a benefit.

Dr Pragnell—On a related issue, in the Cole Royal Commission into the Building and Construction Industry the question was raised as to what degree employers do comply with quarterly payments in that particular industry and that that be closely monitored by the tax office. Commissioner Cole did suggest that there be consideration of monthly payments and stronger enforcement if low compliance levels were continuing to exist in that industry.

CHAIRMAN—That completes my questions too because of the comprehensiveness of your earlier presentation. Thank you very much for appearing before the committee.

Committee adjourned at 5.05 p.m.