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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Australia's insolvency laws

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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Wednesday, 20 August 2003

Members: Senator Chapman *(Chairman)*, 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 Brandis, Chapman and Murray and Mr Byrne 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 4.38 p.m.

POTTER, Mr Mike Edmund, Chief Executive Officer, Council of Small Business Organisations of Australia Ltd

CHAIRMAN—Today the committee continues its public hearing program into 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 provide. Parliamentary privilege refers to the special rights and immunities attached to the parliament or its members and others necessary for the discharge of parliamentary functions without obstruction or fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of evidence given by him or her before the parliament or any of its committees is treated as a breach of privilege. Furthermore, unless the committee should decide otherwise, this is a public hearing and as such all members of the public are welcome to attend.

I now welcome Mr Mike Potter from the Council of Small Business Organisations of Australia to the hearing. The committee prefers that all evidence be given in public but, if at any stage of your evidence or answers to questions you prefer to give responses in private, you may request that of the committee and the committee will consider such a request to move into camera. The committee has before it a written submission from the Council of Small Business Organisations of Australia, which we have numbered 16. Are there any alterations or additions that you want to make to the written submission?

Mr M.E. Potter—No alterations or additions at this time.

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

Mr M.E. Potter—In sending our submission in to the inquiry, we looked at the points that were under consideration. The three areas that we felt had an impact on small business were the rights of creditors, the cost of external administrators and the treatment of employees' entitlements. The key issue and concern for most of the small business community—and I had the pleasure today to review the submission with our counsel—comes back to the impact of small business being an unsecured creditor. When a company either goes into administration or liquidation, they often feel that their rights from their perspective are not being taken care of, often because the size of the debt that is owed to them is so small in comparison to the overall figure. That has obviously been a concern.

In terms of the cost of either administration or liquidation, the fees amounts seem to be very high in comparison to the typical cost for running that organisation. From reading some wonderful information that was sent to me by Frank on all these areas, I know that there are certainly guidelines to assist and there is also some protection for when you can get an appeal to the fees being called upon—I think there is a fee appeal to CALDB. The reality is perception. The perception is that we are too small, it is too costly to chase, and that they really rely on fairness at the end of the day. Our observation often is that the fees are paid out of the cash that is in the company and when the time comes to settle with the creditors there never seems to be

much left for unsecured creditors. That is a concern. I do not know what the solution is in that regard, but it is an issue.

Treatment of employees' entitlements is the same issue. Most small business are concerned. If their business is forced to go into administration or liquidation, often it is because they have used their moneys to run their business, expecting a return on their future incomes to cover those costs. Often they are not there because the receivables they were expecting to come in are lost due to the failure either of their own company or, as is often the case, failures of companies—it causes a chain reaction.

Senator BRANDIS—I have some sympathy for the view that small business creditors in an insolvency are deferred to employee creditors and are discriminated against. But among small business creditors in some circumstances you will find a situation in which some are secured and some are unsecured. What I have in mind in particular—and I think this exists uniformly around the country; I know it certainly exists in Queensland where I come from—is that, in building contracts, subcontractors are entitled to claim a charge and give a notice of charge. I assume that among your constituent organisations there are a lot of small businesses which are subcontractors to principal building contractors. Do you have any observations to make about what seems to be the anomaly that, where a subcontractor's charge can operate, some small businesses—that is, those which fall within the definition of 'subcontractors'—can become priority creditors whereas other small businesses which do not fall within the definition of 'subcontractors' cannot become secured creditors?

Mr M.E. Potter—This is always the tough question. In the building industry, as I understand it, that was brought in to protect those small businesses.

Senator BRANDIS—My point is that it does not uniformly protect them. It generally does, but not uniformly.

Mr M.E. Potter—The difficulty is that most unsecured creditors in that regard are not looking at the failure. They often look at it from a perspective of wanting to continue in business and they take up a contract that they feel will work. Many times they may not be aware of what they can do. It seems to be unfair that some are protected and some are not. I would like to see a situation where they are all protected. That is the difficulty that we face.

Senator BRANDIS—I suppose if all are protected, none are protected, because if everybody is secured then they all rate equally so they may as well all be unsecured.

Mr M.E. Potter—That is the unfortunate part for small business: they want to survive and they take a contract. Credit is a gift, not a right. Unfortunately, a lot of small businesses do not understand that and they really have to manage their receivables, which means that they have to look at what is happening in their business, have control of it and, when their receivables reach a point where they feel there could be a problem, they have to stop doing the extra work and collect their money. But that does not happen.

Senator MURRAY—Mr Chairman, I am sorry, I have been called to the chamber for a debate. I am unsure of how long I will be away. There is one question I would like to ask, if you would not mind me interrupting.

CHAIRMAN—Sure.

Senator MURRAY—Mr Potter, we understand that, when votes are determined on a matter, the result is determined by the number of creditors and by the value of creditors and the casting vote is by the administrator. I can understand what is at stake for those who are voting—their money is at stake—but to give a casting vote to someone who might make money out of their own decision or out of the way they vote seems to me an uncertain principle. Could you comment on whether you believe that in every case administrators do the right thing in the way they vote.

Mr M.E. Potter—It comes down to how the casting vote reached that point. Yes, you are trusting the minder to make a right decision for the majority. Under the present situation I think it would be difficult to find an alternative. Effectively, if it came to an issue that the administrator is going to make the casting vote and it is going to have an impact on his fees, then who do you have as the impartial judge thereafter? Until we find an alternative way the current system probably has to prevail. But it can be unfair.

Senator BRANDIS—I would like to go back to pursue my issue. I want to posit to you a hypothetical case. You have a medium sized building company and it has a portfolio of major contracts for the construction of buildings. At the headquarters of your medium sized building company, there are also services provided to it in its administration and maintenance; for example, it has a gardener who contracts to do the garden and a small accounting firm that contracts to do its accounts. It has a variety of service providers to its administration or its headquarters. The building company becomes insolvent and is put into liquidation. Those small businesses with whom it deals as subcontractors to its sites can claim a charge and be protected. But the gardener, the small accounting firm, the electrician and whoever else might be providing services to its central administration—in other words, services that are not specifically related to a construction project—cannot claim a charge and are not protected. It seems to me unfair that one category of small business creditors should be placed on a different footing from another category of small business creditors, purely by almost the random circumstance of the nature of their engagement with the insolvent company. What do you have to say about that?

Mr M.E. Potter—I would agree totally. It is totally unfair. If you are doing business with a company that goes insolvent, then the creditors to that company through contract should all be treated the same. Ultimately the revenue to that company is coming from those contracts where the others have protection. In like terms they equally should have protection, particularly where moneys can come in from another source that has not been paid. They should be paid out.

CHAIRMAN—The issue you raised of the costs of administration has been raised by us with other witnesses. Yesterday we raised it with the practitioners. Their view is that costs are based on reasonable fees for those involved in providing the service. Do you see any alternative way in which fees could be determined?

Mr M.E. Potter—Under the IPA guide they say that there should be a guide to hourly rates for administration, from office juniors to principal appointees. There is a set structure. The issue becomes how you charge for the various services rendered; how does that equate to typical charges in a typical business if it was a going concern? From that point it seems that the charge

that would be a cost to the business if it was not in difficulties is very different from what they get charged. It sometimes seems to be exorbitant.

In my past business life, where I sold product to a number of different companies, I probably had a few, not a lot of, bad debts—I was very lucky in my business; I must have managed it well—but I did deal with the cream of Australian business. For those that I did have, it was often a case where the unsecured creditor in simplistic terms was trusting that the moneys would flow through. The charges by the administrators seemed to be exorbitant for the amount of work that appeared to be done in those small companies. It seemed to always equate to nearly the amount of cash the company had. When all the cash was used up for management administration, then the company was totally wound up. There was virtually no money for the unsecured creditors. It is still an area of concern. I need to do some more research because I do not have detailed facts and figures at my fingertips.

Senator BRANDIS—Has COSBOA any concerns about the impact of fraudulent phoenix companies in the small business sector? Can it suggest any measures to deter phoenix companies?

Mr M.E. Potter—That was an area I saw as part of your inquiry but I have not looked at it closely. It is a very difficult one. I do not have any facts and figures or comments at this stage. I can ask the question of my people and come back to you.

Senator BRANDIS—What is COSBOA's assessment of the impact of the proposed maximum priority rule on the recovery of employee entitlements?

Mr M.E. Potter—It is a difficult one. If I understand it right, the employees' entitlements would be above those of secured creditors. Is that correct?

Senator BRANDIS—The proposition is that the Corporations Act would be amended to elevate the priority of employees' entitlements above secured creditors but that provision would only apply to large companies. Since most instances of unpaid employee entitlements in insolvencies occur in small businesses, it is suggested that a maximum priority rule would have a limited impact on recovering employee entitlements.

Mr M.E. Potter—The issue was more in terms of: if a priority went above the secured creditors, such as a bank, and the small business basically was borrowing its money from the bank, would it have difficulties getting loans from the bank?

Senator BRANDIS—Surely the answer is yes, they would.

Mr M.E. Potter—Yes.

Senator BRANDIS—If you were a banker, you would not lend to a borrower who could not give you the best security.

Mr M.E. Potter—That is correct. That is why our concerns are where you put the entitlements in relation to the secured creditor from a small business perspective. At the end of the day, for many small business owners it is their personal home that is on the line.

Senator BRANDIS—That is right.

Mr M.E. Potter—If we could find some other way of supporting the loan without having to do that, I would suspect that the average small business would be keen to see its employees' entitlements paid. As I said in my submission, by and large, from the discussions I have had with people, many small businesses try to pay out those entitlements. It is when they have a sudden disaster in the business because of a chain reaction that they are caught unawares. They suddenly find that the big amount of money that was going to come in from a contract does not come and they suddenly go into liquidation or receivership. They feel very badly that the entitlements of their employees are not there.

In that regard, I did speak to the man who ran Budget Bricks in Melbourne—the company died as a result of the Boral case—and he said that his biggest concern about it was the fact that the loyal employees he had working for him for many years lost their entitlements, along with the fact that he lost his house. It becomes a very difficult time. In small business, employees are like family; it is about relationships. In the years I ran businesses I picked people who would make a fit, so you would be most concerned if your business could not meet those entitlements.

Senator BRANDIS—There is plenty of anecdotal evidence, isn't there, not necessarily in an insolvency but perhaps in the growth phase of a small business, of directors who have put their family home on the line in order to support the borrowings from the bank? They take almost subsistence drawings from the business to ensure that the employee entitlements are met.

Mr M.E. Potter—That is right. Often the concern for small business is that the person running the business does not really value their own worth because they want to make sure everybody else is paid first. That is the challenge. Small business would say, 'On the one hand, yes, we'll be in favour of the entitlements to have a priority but, on the other hand, if it has an impact on our borrowings and our ability to run a business, then we'll have to say no.' If you cannot get the capital to run your business, you will not be in business.

Senator BRANDIS—This is not the policy of the government—I am just thinking aloud: the more one thinks about secured creditors other than financiers, who almost by definition have to be secured creditors, the more it seems to me that the fewer priority creditors there are, the better. That avoids the justice issue of discriminating against different classes of creditors who may, in substance, be on the same footing. Whether that goes for employees, for subcontractors with a charge or for any other species of preferred creditors, the more you take out of the pot that can be distributed at large, the less there is left for everybody else. It seems to me to affront some pretty elementary principles of distributive justice.

Mr M.E. Potter—In a perfect world there should be no secured creditors. That way everybody would be treated equally.

Senator BRANDIS—You would concede, wouldn't you, that a financier has to be a secured creditor because they are putting up their money as a lender? That puts them in a somewhat different position than a seller of goods or services.

Mr M.E. Potter—I would not disagree with that in principle. It is just that if we did not have them as secured creditors, then there would probably be a more equal share when you pay out

the money. The reality is that if you go into business you need to borrow money. If a person is going to lend you the money, they want a return on their investment. It then really comes down to the fact that the unsecured creditors have to look at a better way of managing their receivables. The difficulty for them often is that they are faced with the fact that they may be captive to the company they are doing business with. Because of longevity of service or demand for the product, a relationship is built up. They have no understanding that the company could be in trouble, then suddenly they have a big debt with that company and they go under and lose everything.

CHAIRMAN—It has been suggested by some that there would be advantages in the adoption of a debtor in possession business rescue regime along the lines of the chapter 11 provisions in America, as an alternative to the voluntary administration process. I was wondering whether COSBOA has a view on that.

Mr M.E. Potter—Only from my experience in having lived in the States. When you observe how chapter 11 is used there, it is about trying to save the business—'How can we restructure and allow the business to carry on and reorganise itself?' From that standpoint, it does help the creditors to that company a little, because it gives them a notice that this company is in danger, as distinct from the company suddenly closing. I think something like that may be a positive. How much that really would impact in terms of small business using it I would say is probably going to be small, but it certainly would have tremendous impacts on the likes of an HIH. If something like that had happened, they could have had control of it before it had to be closed completely. It may be something that we have to look at as a country, in view of the fact that we are getting larger and larger organisations dominating in certain industries, and maybe that type of process must be considered for the future.

Senator BRANDIS—I just want to draw together the strands of the questions I was asking. Do you recommend that as a general principle this committee should conclude that the number of categories of secured creditors should be reduced?

Mr M.E. Potter—In the interests of the small businesses that are unsecured, in order to give them a greater return when the payout is made, I would say yes.

CHAIRMAN—I have one further question, too, Mr Potter. In your submission you refer to the administrator, receiver or liquidator taking complete control of bank accounts, records, receivables and payments. You then say that if a company comes out of receivership it is the responsibility of the directors to file annual and tax returns but the receiver does not have to provide the records and details to the directors to complete this task. Do you have any practical examples of that happening or the consequences of that?

Mr M.E. Potter—I am aware of one situation where that did happen. I do not have the specific details, but it was a real mess for the accountant to try to restructure everything. I was very surprised when I heard the story. Why would that be allowed to happen? If you are administrating a company, you save the company, you hand it back to the owners and all the records and all the details should go back automatically. I was just surprised that it did not happen. That was some time ago. The law may have changed and I may not be totally familiar with the current position. But if, as a result of managing the company—and this did worry me—

certain records were not there for the directors when they came back in to file tax returns and follow their asset guidelines, then I have to say there is something wrong in the system.

CHAIRMAN—Thank you very much for your appearance before the committee and your contribution to our inquiry. It has been very useful.

[5.02 p.m.]

COLLIER, Professor Berna, Commission Member, Australian Securities and Investments Commission

DOPKING, Mr Stefan, Director, National Insolvency Coordination Unit, Australian Securities and Investments Commission

DRYSDALE, Mr Mark, Executive Director, Public and Commercial Services, Australian Securities and Investments Commission

CHAIRMAN—I now welcome the representatives of the Australian Securities and Investments Commission to the hearing. The committee prefers all evidence to be given in public, this being a public hearing, but if at any stage of your evidence or answers to questions you wish to give that evidence or answer in private, you may request that of the committee and we will consider such a request to move into camera. We have before us the written submission from ASIC, which we have numbered 24. Are there any specific alterations or additions you wish to make to the written submission at this stage.

Prof. Collier—No, Chairman.

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

Prof. Collier—Thank you, Chairman. The Australian Securities and Investments Commission welcome the inquiry and we look forward to being of assistance. Our agency regulate corporate insolvency in this country. We have responsibility for the supervision of liquidators and are empowered to refer matters to the Companies Auditors and Liquidators Disciplinary Board or take a matter to court in appropriate circumstances. Further, we can and have taken action against officers of companies for breach of duty and insolvent trading. We have a number of cases currently before the courts.

ASIC maintain a liquidator assistance program and works with other regulators, including ITSA, and professional bodies such as the Insolvency Practitioners Association of Australia. ASIC have established a national insolvency coordination unit, which has primary responsibility for conducting surveillance on companies which we believe may be at risk of insolvency. That unit plays a key role in relation to policy development and stakeholder liaison and is located within the Public and Commercial Services directorate, headed by Mr Drysdale and by Mr Stefan Dopking, who is here with us. That is all we have to say for the moment.

CHAIRMAN—One of the issues that has been raised by a number of witnesses and, in particular, the Australian Taxation Office is concern about public confidence in the voluntary administration process being undermined by an absence of impartiality on the part of administrators.

Senator BRANDIS—Perceived.

CHAIRMAN—Yes, perceived absence. Did I omit that? Sorry, Senator Brandis. They have suggested that a roster system could be introduced whereby administrators would be appointed on a random basis. Could you comment, firstly, on the express concern of ATO about the perceived impartiality and, secondly, how you might see whether a roster system would work—whether that would be effective or not.

Prof. Collier—I will make some introductory comments on that, Chairman. From ASIC's perspective, the Corporations Act requires liquidators who also act as administrators to be company officers. They, therefore, have the obligations of officers of the company. We understand from our consultation with stakeholders that there is a perceived problem with administrators, the nature of the problem essentially being in some cases because administrators are appointed by the directors of a company. This possible problem also may arise in circumstances where there is a creditors' winding-up.

One point to note is that we receive very few complaints about insolvency practitioners. We currently work with the Insolvency Practitioners Association of Australia—who I will refer to as the IPAA, if you don't mind, for the rest of this session—on their code of practice and independence. For example, we have worked with them to ensure that, in the notice of the first meeting which they send out when they are administrators, any relationship with the company is included.

We currently have a project going on the registration requirements of liquidators. We will give some consideration to policy guidelines in relation to independence and disclosure by practitioners of their relationship or any previous arrangements they have had with the company. One point to note is that we currently have three matters before the CALDB—the Companies Auditors and Liquidators Disciplinary Board—in relation to independence matters. As I mentioned before, ASIC is the body which can refer matters in relation to disciplinary proceedings to the CALDB involving liquidators. We have no views on a roster system at this stage.

CHAIRMAN—We have received a number of submissions raising a range of concerns about the conduct of two external administrations, Seafood Online and Yusen Daly Smith International. The concerns generally relate to the conduct of the external administrators. There are a number of issues raised in those submissions: overcharging; improper practices; employed to obtain appointments; serious impediments to the removal of administrators; too much power in the hands of administrators; manipulation of voting procedure; biased administrators; overuse of legal services; inadequate provision of information to creditors; outright refusal by administrators to provide information; and extensively prolonged process allegations, the purpose of which was to maximise fees.

Can you make any comment on those two particular administrations and whether they are an indication of systemic failure or inadequacy in the law governing the conduct of insolvency administrations? Have you inquired into the conduct of those two administrations and the concerns raised with us?

Prof. Collier—I will work backwards. The Seafood Online matter is currently the subject of ASIC investigation. We are unable to comment further at this stage. It is an operational matter. I can make a comment or two on the second case. We may have to take any other questions on

notice. My understanding is that we have received one complaint on that matter. The complaint, in our view, gave rise to no evidence of any offence being committed. I also understand that our decision not to investigate the matter further was the subject of review by the Commonwealth Ombudsman. My understanding is that the Commonwealth Ombudsman validated our decision initially. Beyond that I have no comments. If you wish, we can take any further questions on notice, though, on the second matter.

CHAIRMAN—One of the complainants, Mr Terrence Byrne, in Seafood Online alleged that 'ASIC simply recorded the complaint and did nothing'.

Prof. Collier—We are investigating that matter at the moment.

CHAIRMAN—So you would reject that allegation.

Prof. Collier—We do.

CHAIRMAN—In relation to Seafood Online, submissions have proposed that more and better information be provided to creditors in the early stages of an insolvency. They specifically suggested an independent information service be provided by ASIC in the early stages of insolvency, that there be a form of contract of engagement for use in insolvency matters to protect the interests of creditors, and that there be conditions of tendering developed by ASIC. Would you like to respond to those proposals?

Mr Drysdale—I will make a couple of comments. I have not seen the submission, but, in terms of an information service, there are about 6,000 appointments a year. If we were to pick that up, you would understand what it would mean to our workload. Seafood Online is an example of where the system may well work as it is meant to. If what is alleged to have happened in that particular administration proves to be correct, then the options ASIC has for investigation and then referral to a body such as the CALDB could well play out.

In answer to your earlier question about whether this is representative of a wider issue or a systemic issue, I do not think it is. Our evidence is that, as Commissioner Collier has said, we do not actually get very many complaints in this area. We get some complaints and there are definitely some administrators that we would be interested in looking at—through the licensing and regulation work that Commissioner Collier mentioned at the start. But it is not something that looks to us like an epidemic of misbehaviour. Rather, where complaints are brought to our attention, we have a process and we are following it.

Prof. Collier—I might add one comment in support of what Mr Drysdale said. I have a few statistics here. Last year we received approximately 12,000 pieces of information and complaints all-up. Of those we have received 224 complaints about the conduct of auditors and liquidators combined.

Senator BRANDIS—Can you disaggregate those?

Prof. Collier—I do not have that information specifically here.

Senator BRANDIS—Can you let us know?

Mr Drysdale—Yes, we can send it through. We will take it on notice.

Prof. Collier—We can take it on notice, yes.

CHAIRMAN—In both the case of Seafood Online and Yusen Daly Smith, one of the allegations is overuse of legal services. For example, in Yusen, Mr Tom Smith, one of the minority shareholders of the company in liquidation, alleged that the fees of the liquidator exceeded $600,000, but the legal expenses paid to Blake Dawson Waldron came to over $1 million. Is there a deficiency in the law in failing to limit legal service expenditure in these situations?

Prof. Collier—I would not comment that there is a deficiency in the law. We tend to look at fees which are charged by insolvency practitioners overall, including any fees which they incur by way of other professional services such as legal services which they may seek while they are acting as a liquidator, receiver or administrator of a particular matter.

I can, however, make a few comments about fees, because it is an issue which does arise. When we receive a complaint about fees—and we do occasionally receive such a complaint—we then look at industry standards of the insolvency practitioner and the hourly charge based on the skill of the practitioner. We also look at whether or not there has been proper disclosure by the practitioner to the creditors. As you would know, generally speaking, in liquidations and administrations the approval of the creditor or the approval of the court must be sought.

We do not normally get involved in fee disputes, but we would get involved if there was something untoward. We currently have one matter we are looking at taking to court, but it is an operational matter so I will not discuss it any further. We would not normally take a practitioner to the Companies Auditors and Liquidators Disciplinary Board, although currently we have three matters involving fees. Fees is an area which is on ASIC's radar at the moment as far as insolvency practitioners are concerned.

CHAIRMAN—Another allegation in relation to Seafood Online is that Knights Insolvency Administration and Mr Trevor Schmierer were involved in a mutual fee generation racket which was kept secret from directors and creditors at the time of the appointment of the administrator. There is an allegation that some $100,000 was paid in secret commissions to the debt management consultant. Are you able to comment on those allegations?

Prof. Collier—We are very sorry, Senator, but we cannot comment on that matter.

CHAIRMAN—I assume they are a part of your investigation.

Prof. Collier—Yes.

CHAIRMAN—Those allegations have been made to you as well as us, I assume.

Mr Dopking—We just cannot discuss the operational aspects of it. It may jeopardise some of the work we are doing and it is a current matter.

CHAIRMAN—I understand that.

Senator BRANDIS—Ms Collier and gentlemen, this committee heard some evidence last week from Professor Keay, who is an academic specialist in this field. Among other things he said to us that there is a strong case to be made for the integration of corporate and personal insolvency so as to make it uniform, both allowing for necessary differences as to the legal principles and also administratively. What is your view about that? Do you think that the current system of a separate structure for personal administration, a separate act—the Bankruptcy Act—and a different structure for corporate insolvency ought to be maintained, or should it be integrated?

Prof. Collier—I am aware that in the United Kingdom there is a single insolvency regulator. That has been in place since approximately 1986, I understand. There were reasons for their integrating insolvency regulators, including efficiency. We have no particular views about the integration of the regulators. At the moment it is the case that it seems to be working from our perspective.

Senator BRANDIS—The status quo seems to be working?

Prof. Collier—The status quo seems to be working. We see no systemic problems arising as a result of the separation of the regulators.

CHAIRMAN—Mr Drysdale, or Mr Dopking, do you have views about that?

Mr Drysdale—We have looked at it, Senator. Some issues are the same. Often it is the same individual who is acting either as a trustee in bankruptcy or as an administrator under our regime. For things like surveillance or for us to audit their practice or their behaviour et cetera, you could see where there might be an argument in efficiency. In terms of the law, there are occasional issues brought to our attention where—under bankruptcy versus under our legislation—there is a degree of sufficient difference that adds costs or adds to confusion. They would be the reasons why you would do it—and I think this is where Professor Collier was coming from—but it is not something that has been raised with us: people coming to us and saying that it is a large problem that needs addressing.

Senator BRANDIS—I was wondering about that. With all due respect to Professor Keay, as we all know, all academics like the elegance of uniform and integrated principles. In a practical sense—at the coalface, as it were—is there a call among the people with whom you deal for the two systems to be integrated?

Prof. Collier—No, Senator. One point to note is that, as part of our stakeholder activities in ASIC, we conduct regional liaison community meetings with the insolvency practitioners three times a year around Australia. We also conduct regular liaison meetings with the IPAA, and this has not been raised as an issue at all in recent times, to my knowledge.

Senator BRANDIS—Let me move onto something else, again arising from evidence that we heard yesterday. There is a view expressed among some that the code of practice for insolvency practitioners should be given the force of law. For example, like directors' duties under the Corporations Act, a breach of it would be an actionable wrong and, indeed, a prosecutable quasi-criminal wrong. What is your view about that?

Prof. Collier—As part of our discussions with the insolvency profession around Australia, we raised this as an issue. In Canada, it is my understanding that they have a code of ethics which has the force of law. We have raised it as an issue for consultation with the practitioners, and it is something we may be taking forward as part of our own policy proposals in the future. It is something that we are actively considering at the moment.

Senator BRANDIS—But you do not have a settled position in relation to it.

Prof. Collier—At the moment, there are provisions in the law which require insolvency practitioners, when they are acting as liquidators or administrators, to act in good faith and to act in many other ways in relation to their fiduciary obligations.

Senator BRANDIS—Most obviously, under the Corporations Act liquidators and administrators fall within the definition of 'officers'.

Prof. Collier—They do, indeed.

Senator BRANDIS—Every legal obligation which attaches to company officers, by definition—by virtue of their office—also attaches to liquidators and administrators.

Prof. Collier—Indeed. I also believe that, under section 536 of the Corporations Act, ASIC may take a matter to the CALDB; for example, if we believe that a liquidator is not acting as a fit and proper person. Having a codified set of ethics is an issue we would take on board and continue to discuss with the insolvency practitioners, and it is something which we may develop further in our own policy work.

Senator BRANDIS—But ASIC's position at the moment is that it does not recommend to this committee that the ethical guidelines ought to be codified so as to create enforceable legal rights.

Prof. Collier—I do not know if we would go as far as saying we would not recommend it to the committee.

Senator BRANDIS—You are not. You are simply saying you are thinking about it.

Prof. Collier—Then I think that you have stated it accurately. At the moment, there are guidelines. The IPAA has put out guidelines. ASIC tends to work very strongly with the IPAA on their statement of independence, for example.

Senator BRANDIS—In your experience, though, having regard to the fact that, as we have said, administrators and liquidators have all the obligations of company officers under the Corporations Act and also under the general law of fiduciary obligations, do you detect a lacuna in the enforcement of legal obligations on the part of liquidators and administrators to act properly and in good faith—

Prof. Collier—Yes.

Senator BRANDIS—or is that sufficiently covered?

Prof. Collier—No, we would not detect a lacuna. The basis upon which I would say that is, as I said earlier, that we receive relatively few complaints about the conduct of insolvency practitioners in their particular administrations. It is a very small proportion of the complaints we receive every year.

Senator BRANDIS—Speaking from my own experiences, as somebody who practised law in this field before I came here, it seemed to me that the case law about the obligations of liquidators and administrators imposed an extremely high fiduciary standard on such persons.

Prof. Collier—Yes.

Senator BRANDIS—Is that your impressionistic view?

Prof. Collier—Yes.

Mr Drysdale—I totally agree with that. It really goes to your philosophy of regulation, if you like, of a profession and whether you need to go to a statute based approach for regulating a profession or whether you go, as you do in the law and as you do in accounting generally, to an ethical basis and a professional basis, which is the model that we currently have in place. Our view is that there is not a weight of evidence that says that you would need to go to the black-letter approach. There is an issue that we have started to explore with the IPAA. In most self-regulatory systems or professional regulatory systems, there is a power of the professional body to take disciplinary action. That does not exist with the IPAA as the insolvency regulator.

Senator BRANDIS—Does it not? I was not aware of that. That seems to me to be a gap.

Mr Drysdale—Yes. The IPAA will refer back to either the Institute of Chartered Accountants or the CPA, but they do not take action themselves.

Senator BRANDIS—Because the IPAA is kind of a derivative professional body rather than a qualifying and principal professional body?

Mr Drysdale—Yes.

Senator BRANDIS—I understand.

Mr Drysdale—As you would be doing in this sort of inquiry, as you go forward and look at how that profession might develop, it may be that that is an area you would look at over time to see whether or not it is an area for improvement or for change. That is the sort of thing we have been speaking with the IPAA about.

Senator BRANDIS—I am not sure how familiar you are with the other submissions, but the Law Council of Australia came before us last week and they made a submission that the categories of persons eligible to be registered as insolvency practitioners should be widened to include lawyers. Can I invite your comments on that specific proposal and more generally on the question of—irrespective of whether the lawyers are the beneficiaries—whether or not the qualification to be an insolvency practitioner at the moment is appropriate or whether it should be widened or, indeed, narrowed?

Prof. Collier—This is something which we have discussed publicly with the insolvency profession around Australia in our meetings. We believe that the situation of registration of insolvency practitioners is something which could quite validly be reviewed. Indeed, the standards of experience and qualifications of insolvency practitioners could also be reviewed. We currently have a project going in ASIC, following discussions with the insolvency practitioners, and we are looking at possibly doing some policy work to build up to a proposal for licensing of insolvency practitioners as distinct from registration.

Senator BRANDIS—I am interested in this, Ms Collier. Can you elaborate quite fully on that for me, please?

Prof. Collier—Yes, I will, to the best of my ability, Senator. We would see licensing as distinct from registration. Licensing is a procedure whereby in order to maintain one's licence one has to continue certain levels of experience, staffing, resources, educational qualification and so on as distinct from a one-off registration, which is currently the situation. We are also looking in our work, which is both research and consultation at this stage, at whether there should be one class of liquidator as distinct from two, which is currently the position. We are looking at the possibility of raising a proposal akin to the current situation in relation to financial services regulations—receiving a licence there. Similarly, we would be looking at raising a proposal in relation to licensing of insolvency practitioners.

Senator BRANDIS—This licence would be renewable periodically upon satisfaction of the maintenance of an appropriate level of qualification and experience.

Prof. Collier—Exactly, Senator. Indeed, it would also be possibly removable in certain circumstances, which would have to be defined. The Insolvency Practitioners Association of Australia—the IPAA—has indicated some support and interest in that proposal as well. Mr Drysdale, do you have anything that you want to add to that?

Mr Drysdale—On your specific issue about lawyers, the IPAA has opened up its membership to lawyers. I have seen something of that submission and it is an interesting proposition. In this sort of licensing research project, one of the things that we would look at is what do you really need to be effective as a liquidator.

Senator BRANDIS—Mr Drysdale, can I prompt your thoughts and offer this observation. It seems to me that since the beginning of time people have thought insolvency practitioners are a specialisation of the accounting profession and, in more recent times, lawyers and others have been more frequently thought of as insolvency practitioners. But in terms of the actual work that is done in a winding-up, if it is a small or uncontroversial winding-up, the work is largely administrative, and in a large winding-up the work is largely managerial. It does not draw particularly from the specific skills of either accountants or lawyers. Would you agree with that, or would you like to comment on that?

Mr Drysdale—I would agree that that is a reasonable characterisation of a lot of the work. I would add, though, that in both cases you do need some specific accounting and legal knowledge and skills.

Senator BRANDIS—Quite.

Mr Drysdale—That is where I assume you are going: what is the range of qualifications or skills that are required to be effective as a liquidator? That is exactly what we think we need to look at as well. It is something, as Professor Collier has said, that we have raised with the liaison groups around the country. When you have those discussions, it goes straight to the issue of whether lawyers should be allowed to be liquidators.

Senator BRANDIS—Or, indeed, goes to even a broader issue, which I think has been discussed in this country for some little while now, and that is whether being an insolvency practitioner should be regarded as a profession in its own right.

Prof. Collier—I believe the IPAA would think the answer to that would be yes.

Senator BRANDIS—I do not have a firm view one way or the other, but it seems to me they have a reasonable case because insolvency is so specific and specialised that one could make a case for saying that being an insolvency practitioner is something sui generis.

Prof. Collier—Indeed, Senator. If we do take our proposal on licensing further, that would give more support to that proposition.

Senator BRANDIS—Yes, indeed it would.

CHAIRMAN—I want to ask some questions on deeds of company arrangement. What is ASIC's view on the advantages and disadvantages of deeds of company arrangement, particularly in the context of submissions that we have had that they are increasingly being used as a mechanism for companies to avoid paying some creditors, and the fact that very few of them yield dividends to creditors?

Prof. Collier—I have one comment to make on that observation. The purpose of a deed of company arrangement is to ensure that creditors are, as much as possible, paid as distinct from not paid. That is the entire purpose of part 5.3A of the Corporations Act—to maximise the chances of a company continuing in business or, if that is not possible, to ensure a more favourable payment system to be put in for the creditors, rather than winding-up the company. As I said before, we have received few complaints about deeds of company arrangement specifically. Mr Dopking, would you like to comment on that further?

Mr Dopking—You are right. The complaints have been few. I think the question you specifically asked was whether there is an advantage or disadvantage in the way deeds are being used. One of the issues that has come up is that voluntary administrators are appointed by directors, so there is a perception—and this is raised by creditors—that there is some influence being brought upon people. The complaints that we have received do not suggest that and the complaints are minimal. Of the 6,000-odd appointments, about 2,300 of those are voluntary administrations and, by and large, they are dealt with in accordance with the law.

Prof. Collier—This also gets back to the point we were discussing early about independence. Another point I would like to make is that, while maybe not always satisfactory, in circumstances where particular creditors feel they are disadvantaged by a deed of company arrangement, there is always the application procedure to the court in order to have a deed set aside under section 447A of the Corporations Act.

CHAIRMAN—Another issue that has been raised with us is the absence of data on the operation of voluntary administrations beyond the number of commencements. Is that a fair comment? Does ASIC believe there are strategies that could be applied to improve the collection of statistics about how the insolvency laws are operating?

Mr Dopking—The statistics that we collect are the nature of the appointments. I do not believe there is a mechanism to collect statistics on the number of voluntary administrations which pay dividends. Other than the fact that there are a number of companies which convert to liquidation, that is the limit of the statistics that are currently collected. You would be able to calculate from the statistics which are attached to our submission. It is set out clearly that there are voluntary administrations which are appointed and then there are further statistics which show the companies that are converted to liquidation. If you are looking for a broader range of information, such as the success of deeds, whether deeds fail for whatever reason, those sorts of statistics are not captured, not available.

CHAIRMAN—Section 305 of the Bankruptcy Act enables the Commonwealth to underwrite the costs of inquiries in relation to the estate of a bankrupt or a deceased debtor instituting, continuing or defending legal proceedings relating to the estates of bankrupts or deceased persons, and proceedings before the AAT reviewing a decision. There is no equivalent provision in the Corporations Act in relation to assetless companies and assetless administrations. We have had submissions suggesting the establishment of an assetless companies' fund to fund the investigation of companies that have no assets. Can I seek your comments on what you would see as the value of that and also who might administer such a fund? Are you generally aware of the nature and extent of the problem of assetless administrations?

Prof. Collier—We note that assetless administrations appear to be a problem in the business community. As Mr Drysdale said before, there are approximately 6,000 corporate insolvencies every year. The assetless administrations issue has been identified to us by the IPAA, particularly in the context of investigation of conduct which may give rise to an offence—that is, the investigations by the liquidators, not the conduct by the liquidators. It also identifies a problem in a 1997 working party report. At the end of the day, we believe that this is an issue for government. It would require law reform. It would also require large sums of money to fund it and a review of the role of ASIC in such a scheme. Beyond that we have no views.

CHAIRMAN—In a sense, that also leads into the issue of phoenix companies and the provision of section 206F of the Corporations Act, which is available to allow ASIC to disqualify a person from managing corporations for up to five years. Can you tell us how many people have been disqualified under this provision in the last financial year?

Mr Drysdale—I think it is four. I will check that and forward it to you.

Prof. Collier—We will be happy to take that question on notice, Senator.

CHAIRMAN—Are there impediments in the law to detecting and dealing with fraudulent phoenix company activity?

Prof. Collier—Perhaps a threshold point would be a comment which we also made to the Cole royal commission: phoenix activity in itself does not necessarily give rise to an offence. It

is not unlawful for a company to become insolvent and for the directors to set up a company subsequently. That in itself is not unlawful. It is clearly where the conduct in question is systemic and is intended to deprive creditors of payment that we believe a problem arises.

CHAIRMAN—Do you have mechanisms to detect that situation?

Mr Drysdale—'Mechanisms to detect' is really about the targeting of our enforcement work. One of the mechanisms is public complaint. Another is information coming to us from insolvency practitioners themselves. Another is a technique that we are now using as a result of the additional money that government gave us in the last budget to look at directors' insolvent trading or potentially insolvent trading. We are working with some of the credit reference organisations or credit analysis organisations, which spend time on building systems to identify companies that are potentially at risk. They are mechanisms we use to identify potential targets for that sort of action.

The insolvent trading program was a pilot but is now being funded by government. It is really aimed at looking at companies that we identify through those sources, then getting in there early and seeing whether they are companies that have a financial problem and whether their directors should be turning their minds to those chapters of the Corporations Law that address that sort of problem.

CHAIRMAN—I also understand that you use the ASCOT database of company officers for checking against ITSA's national personal insolvency index.

Mr Drysdale—That is right.

CHAIRMAN—Are the same checks available against state business names registers?

Prof. Collier—I do not believe so.

Mr Drysdale—No, not in a systematic way. The reason I hesitated is that up until the mid-nineties most of the state business names registers were either run or organised with ASIC. In particularly the larger states it has been taken back by the states and they run the registers themselves. If we are doing an investigation on the basis of one of the sources I spoke about earlier, checks of things like business names registers, the bankruptcy database—the MPII—are routine parts of the early stages of that investigation.

Prof. Collier—Could I just make an additional observation? We actually receive very few complaints about phoenix activity, or at least very few complaints which we can identify as relating to phoenix. I believe it is 0.8 per cent of complaints which relate to phoenix activities specifically.

CHAIRMAN—Is there anything we can learn from the way overseas jurisdictions deal with phoenix companies?

Prof. Collier—The way overseas countries have dealt with phoenix activities is not something we have to hand. Much phoenix activity, such as it exists in the community, I understand is tax related. Accordingly, in many cases where there would be phoenix activity

directed against the tax department, we would receive information from the taxation department to the extent to which they are able to communicate it to us in accordance with the secrecy provisions of the taxation legislation, or the taxation department under their own extensive powers would take action, given that they are the creditor involved and have the direct information on the phoenix activity in question.

My understanding is that in some jurisdictions there is legislation on taxation which may assist the regulators in question but I have no particular specific example of that to hand tonight.

CHAIRMAN—Are the legislative impediments, such as the secrecy of the tax act, excessive in preventing adequate information to flow between, say, the ATO, ASIC and state revenue authorities to deal with this particular problem of phoenix companies?

Prof. Collier—The extent to which agencies can share information is truly a question of government policy. I understand, however, that the government in its response to the Cole royal commission is looking at the issue of sharing of information, and we await that response.

CHAIRMAN—In relation to the definition of insolvent trading, the AWU has suggested that the definition be changed to preclude trading when a company's net unsecured assets fall below the value of total employee entitlements. Can you perhaps comment on the disadvantages and advantages of such a change in the definition? Would one of the disadvantages mean that a company experiencing temporary difficulties would have less opportunity to trade out of those difficulties?

Prof. Collier—Currently under the Corporations Act, as I recall, insolvency is defined as being unable to pay one's debts as and when they fall due. That takes into account temporary illiquidity of corporation, and contemplates circumstances where a company may be temporary illiquid but can recover or may be able to gather resources from other sources, such as loans et cetera. That is a fairly traditional definition of insolvency. In changing the definition of insolvent trading as you have just described, one disadvantage which occurs to me is if you have a company which has no employees. It may be a small company which is run by the shareholders or the directors; it may have specific arrangements in relation to entitlements which do not sit well with such a definition. We would need to give this further consideration but that strikes me as an obvious possible disadvantage of changing the definition in such a way.

CHAIRMAN—A number of submissions have raised concerns about the provision of information on the level of accrued and contingent employee entitlements. Again the AWU raised the question of providing financial information about the level of accrued and contingent employee entitlements. They are seeking to have included in union agreements a requirement for companies to provide financial information on a regular basis. They also propose that accounting standards be altered to include redundancy or severance pay liability of a company in annual reports. Are you able to comment on the adequacy of accounting standards governing the provision of information about the status of outstanding employee entitlements in annual reports?

Prof. Collier—No, Senator, not tonight.

CHAIRMAN—Do you have any views on the AWU proposal?

Prof. Collier—No.

Mr Drysdale—It would be interesting to attempt to quantify annually the total redundancy obligation that a company might owe if it was to go into that state. I wonder how you would do it. You could see what the cost would be in doing that but I am just not sure what the benefit would be.

Mr Dopking—Another thing that comes to mind, too, and can come into play is that reporting entities and a large population of the companies in Australia are not required to prepare accounts. That is another hurdle that you may have to consider when addressing that issue.

CHAIRMAN—Another issue that has been raised with us is the fact that, when administrators and liquidators are appointed, company records are often incomplete. Again the ATO has raised this issue. It refers to cases of poor record keeping and the difficulties that administrators have in piecing together the business affairs of companies on occasions. Is this consistent with your own experience?

Prof. Collier—I believe that would be the case, yes. Indeed, it is often characteristic of a company which we may investigate as having been insolvent that their records are poor. I cannot recall the exact section, but the Corporations Act currently provides that, where the records or accounts are deficient, it is a rebuttable presumption that the company is insolvent from that point onwards.

CHAIRMAN—What are the obligations placed on a director to ensure that company records are up to date, accurate and complete? What are the consequences if they are not?

Mr Dopking—Section 286 is the section that deals with books and records and there is a requirement, depending on the size of the entity, to certainly maintain adequate books and records to enable the company affairs to be audited, should they be required to be audited. If you extend that definition, you would expect to see adequate books and records to be able to assess the financial position of the company.

Auditors are appointed to prepare the audit report but, with a large population base of the companies, that is not the case, but the books and records still have to be maintained to a certain standard. I am not quite sure of the purpose of the tax office question—whether it is to a standard to enable them to assess tax liabilities, whether it is to a standard that enables directors to have meaningful information and inform themselves on the position of a company, or whether it is to a standard of the definition in the Corporations Act—but certainly the Corporations Act has those guidelines.

CHAIRMAN—One of the issues that has been raised is that, when an administrator is appointed, they often have to come in and attempt to reconstruct the company's accounts and, obviously with inadequate records, they find great difficulty in doing that to a satisfactory degree—to provide their reports to creditors and so on, including the tax office.

Prof. Collier—Perhaps if I can make another comment. Mr Drysdale referred to our corporate insolvency program where, on the basis of information we have, we will be and have been visiting companies in Australia which have exhibited symptoms of financial distress. One of the

issues which we look at when we go to those companies is the status of their books and records. Mr Dopking, you might want to comment slightly more on that.

Mr Dopking—The issue of the tax office raising the issues that books and records be put up would enable a self-assessment system, for example, to quantify the actual extent of the books and records. We work very closely with the insolvency professions, through a system that Mark Drysdale might want to comment on, in assisting the liquidators and the insolvency profession to obtain the books, records and financial data about the company to help them discharge their responsibilities and report to creditors. It comes back to the issue of what sort of information and accuracy in calculations the ATO are looking for in that example. Certainly from our own perspective we assist the practitioners to fulfil their role in reporting to ASIC and to creditors about their affairs by taking an action against directors who do not want to necessarily assist liquidators.

Prof. Collier—We have a complaints compliance action program, and I will just mention a few statistics. To date, we have had 393 company officers prosecuted for 625 offences in relation to failure to provide adequate books and records and reports as to affairs to insolvency practitioners, where the practitioner has been appointed as a liquidator or an administrator, for example, of a particular company.

CHAIRMAN—What is the extent of the obligation placed on administrators and liquidators to furnish a full and complete assessment of a company's financial position and what deems a report to indeed be adequate? What are the criteria that are applied?

Mr Dopking—Sorry, I didn't hear the last part of your question, Senator.

CHAIRMAN—What are the criteria that are applied to deem whether a report is adequate?

Mr Dopking—This is in the context of voluntary administration?

CHAIRMAN—Both voluntary administration and liquidation.

Mr Dopking—In the context of voluntary administration, the act is quite clear. Section 439A requires a voluntary administrator to conduct an inquiry into the affairs of the company and report to creditors on the circumstances of the company arriving at its present position, which is the appointment of a voluntary administrator. There has been some case law which has helped to settle that. The case law and the general practice is that it has to be in sufficient detail so that there is sufficient disclosure to creditors to make an informed decision. The legislation also provides that, if there is insufficient time for that to be undertaken, then application be made to the court to extend the convenient period so a more detailed and thorough assessment of the company and the alternatives available to creditors can be investigated.

CHAIRMAN—There are no further questions from the committee and, on that basis, I thank each of you for your appearance before the committee and for your assistance with our investigation.

Prof. Collier—Thank you, Senator.

[5.56 p.m.]

HARRIS, Miss Denita, Policy Manager and Industrial Advocate, National Farmers Federation

POTTER, Mr Michael, Economics Policy Manager, National Farmers Federation

CHAIRMAN—I now welcome the representatives of the National Farmers Federation. 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 that evidence or answer in private, you may request that of the committee and we would consider such a request to move into camera. We have before us the NFF's submission which we have numbered 30. Are there alterations or additions you want to make to the written submission at this stage?

Miss Harris—No, thank you, Mr Chairman.

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

Miss Harris—Thank you. The National Farmers Federation appreciate the opportunity to make additional comments beyond our initial submission that we have provided to the committee. The NFF understand the reasons for the Commonwealth government's proposed legislation to give priority to employee entitlements over secured creditors, and that has been the sole focus of our submission. It is NFF's view that there must be a fair system for employees to access their entitlements and we acknowledge that employers are legally required to pay those entitlements.

NFF is concerned, however, that there may be an unintended consequence of the proposed legislation which would have an indirect negative impact on Australian farmers through increasing the cost of capital. Australian farmers are particularly vulnerable to increases in the cost of capital and/or the reduction of access to capital. This has been particularly evident during the current severe and long-lasting drought. Farmers already face difficulties in accessing external funding. As a result, they have a relatively high level of owner equity. The reasons for the high equity ratio are cited by the Rural Industries Research and Development Corporation in the financial performance of the Australian broadacre agricultural report as the high levels of risk in farming, the volatility of farm income and the inability to consistently meet loan servicing costs.

NFF is concerned that the proposal to change the status of employee entitlements will create additional barriers to farming accessing capital, regardless of the small business exemption of the proposal. The costs of the proposal on large businesses can be passed on to smaller businesses. In addition, some financial institutions limit access to finance across the board, despite the small business exemption. This may result in farmers facing increasing difficulties in generating funds for investment or overcoming extreme circumstances, such as drought.

The impact of the proposal may also be felt by farmers as creditors. NFF, as a consequence, is seeking a reconsideration of the proposed legislation in respect of changing the priority of the employee entitlements over secured creditors because of perhaps this unintended consequence flowing through to Australian farmers. Thank you.

CHAIRMAN—Thank you, Miss Harris. Do you have anything to add, Mr Potter?

Mr M. Potter—No, I do not, thank you, Mr Chair.

CHAIRMAN—In relation to the specific issue you have raised of giving priority to employee entitlements, given that the government announced small business would be excluded from that provision, your concern is that, nevertheless, the impact on larger businesses would be such that borrowing rates and so on, which might be applied to them at a higher rate because of that provision, will flow through to other businesses, even though they are not directly impacted by that priority.

Miss Harris—That is correct, yes. That comes from discussions with representatives of the Australian Bankers Association, that there will be difficulties in meeting those criteria of small business. A bank will not know into the future whether a business will go from a small business into the large business definition under the proposed legislation and, as a consequence, they will have to deal with all businesses on the same level. That is looking far more closely at the risk analysis as a consequence of that change in priority. There are numerous flowthroughs and the banks are saying it is too hard to meet that criteria or definition of small business because of fluctuations in the future.

Senator BRANDIS—For that very reason the policy would act as a disincentive to grow.

Miss Harris—That is correct.

Senator BRANDIS—The small business close to the cut-off line, as it were, would have a very significant financial disincentive to expand beyond the definition.

Miss Harris—That is correct, yes.

CHAIRMAN—Would you excuse us for a few minutes, while we attend to the division.

Miss Harris—That is all right.

Proceedings suspended from 6.01 p.m. to 6.06 p.m.

CHAIRMAN—There have been other suggestions in terms of protecting employee entitlements, such as requiring companies to regularly provide reports to employees on the financial position of companies and, in particular, their ability to meet their obligations in relation to employee entitlements. That was an AWU suggestion. The ACTU suggested that, in addition to being required to provide details of accrued and contingent employee entitlements, that should be required to be reported. Also, if a director asserts that there is adequate provisioning for employee entitlements, they should be personally liable if those entitlements cannot be met.

CPA Australia suggested several alternatives—for example, compelling companies to make full, progressive provision for annual and long service leave payments and injury compensation payments in a separate, designated trust account and making similar arrangements for PAYG tax deductions and retaining designated employee entitlements in an industry trust fund, or similar arrangement, which could be properly monitored. What is your response as to the impact of any of those measures, either directly or indirectly, on farmers?

Miss Harris—There are two aspects to that—whether or not you mandate such provisions or whether you encourage effective business practices within business. NFF's position always is to encourage better business practices by companies as a preferred approach over mandating.

In respect of the Australian Workers Union's suggestion about reporting to employees the company position, we have seen a number of examples in enterprise agreements where that has been an agreement between the parties and has worked well. But it is part of an all-encompassing agreement on a variety of human resources aspects that have been taken into account in building up productivity and morale within an organisation. It may be a very good provision that can be included in enterprise agreements, but cannot be seen in isolation from other aspects.

In terms of the ACTU proposal about mandatory accruing, that can be limiting, particularly on start-up businesses and particularly in small businesses where it may be difficult in the first few years of a business to be able to progress to greater capacity—to progress and grow. By accruing those entitlements you may be forfeiting opportunities for employment growth. Nevertheless, there should obviously be a recommendation that there is some accruement of employee entitlements, particularly in respect of entitlements you know you will be aware of—such as annual leave or something that is definitely accruing by an employee—as opposed to benefits that may or may not occur in the future, such as redundancy entitlements. The issue is: where do you stop? I think it is a wise move to accrue for those entitlements you know will occur, as opposed to hypothetically taking into account something which may or may not occur, such as a redundancy payout.

As to CPA trust accounts, trust funds and industry funds, there has been concern in some sectors, although not within agriculture, about industry funds which have been established by unions. We certainly do not advocate mandating industry funds in terms of entitlements. Again, we think this is more effectively dealt with through enterprise bargaining, as part of an approach that can occur in the workplace.

Accounting groups, such as CPA, can work with their member organisations to better assist business, particularly small business, in becoming more aware of what their obligations are and how they can most effectively meet them, given their individual circumstances. Small business is the greatest area of employment growth in this country and we cannot stifle that. There are risks with employee entitlements and those risks need to be taken into account, but it cannot be to the detriment of small business growth which is so critical for employment opportunities in this country.

CHAIRMAN—Apart from your comments in relation to giving employee entitlements maximum priority, do you have any other comments on the operation and entitlements of the GEERS scheme?

Miss Harris—The GEERS scheme, we believe, is a good safety net. There obviously are arguments that there may be a need to legislate for it. There have been some issues that GEERS is a minimum safety net, as opposed to meeting all obligations that the employees may have been entitled to under certain agreements—such as occurred with Ansett. We think that it has worked well and that it should continue. There may be a consideration to legislate for it to ensure there is a balance in meeting employee entitlements, but I think the priority is to provide assistance to business to better accommodate employee entitlements, without necessarily making it mandatory. There could well be some reporting requirements that may assist, but that would probably be the limit of what we believe would be important.

Our members, in the main, are not companies—they are partnerships and trusts—so that any direct implications of changes to the law in respect of those issues will have minimal impact on our members. These issues have been predominantly indirect impacts as a consequence of that capital access.

CHAIRMAN—I note your submission refers to the fact that farmers are often unsecured creditors in insolvencies. A number of submissions have commented on the relative rights and remedies of secured and unsecured creditors under insolvency law. Do you have any comment on those relative rights and remedies relating to secured and unsecured creditors and whether the current structure is appropriate?

Miss Harris—We have not looked into this in detail but obviously farmers are burnt on many occasions as unsecured creditors. Certainly there are legal remedies that can be pursued to consider tightening up issues of security, but the objective is for fairness in a winding-up. From experience, I have seen some unfair advantages to those who have security over those who are unsecured. Small businesses, who are unsecured creditors, seem to be burnt and therefore more adversely affected than big business who do have security. Certainly we are concerned with that. But how you would legally consider the equity grounds of small business being adversely affected—as a result of being unsecured as opposed to having securities—is difficult to say and we certainly have not analysed that per se.

Mr M. Potter—There is a very big and broad issue about the order in which you put creditors. In preparing our submission to this inquiry we really were only considering the one issue about moving employees further up. There are huge amounts of issues if you try and shuffle around other parts of the priority chain. It is something which is very important, but it is just not what we have analysed in the context of our submission to this inquiry.

Senator BRANDIS—The whole point of the priority chain—to use your expression, Mr Potter—is that it is, by definition, discriminatory between classes of creditors. I can understand why, of necessity, lenders must be secured—if they are not secured they will not lend—but other than lenders it seems to me that there is a reasonably strong case to be made for equality between creditors. Would you agree?

Miss Harris—We certainly agree with that proposition.

Senator BRANDIS—Even employees and creditors. We use a different language about employees. We talk about employee entitlements, but the entitlements are nothing more than debts.

Miss Harris—We certainly agree with that proposition in principle. You are correct in saying that if secured creditors did not have that security then we would not have business growth in this country.

Senator BRANDIS—There is a double problem with the policy. One is that it is discriminatory and therefore necessarily means value judgments have to be made as to who is favoured and who is not favoured but, secondly, the more you expand the net of secured or prioritised creditors, the more self-defeating the policy becomes, because if everybody has priority, nobody has priority.

Miss Harris—Yes, I totally agree. It is something we have not considered; nevertheless, there is an aspect to consider the equity grounds of insolvency situations and there is a division of the remaining assets to those who are creditors.

Senator BRANDIS—I have never been able to see why, for instance, a person who supplies a good or service to a company as a small businessman should be more exposed to the insolvency of his debtor than an employee of the debtor should be exposed.

Miss Harris—That is correct. They are in the same financial circumstance as an employee. However, there is a perception, I guess, that the employee is a PAYG earner, who does not have any other opportunities, other than finding another job, whereas a small business usually will have ability to access income. But in the circumstances of farmers—

Senator BRANDIS—That may or may not be so. As we all know, there are many small businesses which have one client representing a disproportionately large element of their cash flow. Small businesses are geared, as employees are not, to a cash flow, so that if they lose, let us say, 40 per cent of their income through the insolvency of one customer, that will very commonly be the end of the business. It is simplistic to say that they have other sources of income. That may well be so but if they lose the one big customer, they fall below the Plimsoll line and sink.

Miss Harris—I certainly would not disagree with you. I was expressing the perception that is out there. It is the good experiences in farmers, where many of them are supplying in concentrated markets.

Senator BRANDIS—Is that what you meant by that expression in your submission 'supplying to concentrated markets'?

Miss Harris—Yes. For example, all the dairy farmers in one area might be supplying to one milk processor and if that milk processor becomes insolvent, then obviously a whole rural region will be severely impacted because of a lack of income suddenly occurring. We have obviously seen from the drought circumstances what indirect flows that then has onto the rest of the community.

Senator BRANDIS—I suppose it is an entrenched part of the culture of this country, isn't it, that those who derive their income from wages have always been given protections over and above those who derive their income from sources other than wages, albeit, as with your constituent organisations, they do it through the sweat of their own brow?

Miss Harris—As also the industrial relations advocate of the NFF who is constantly pounding her head in the centralised system of industrial relations, I could not agree with you more. It is an interesting system that we have in this country.

CHAIRMAN—In your comments you said that farmers are quite often burned in insolvencies. Given that a lot of farmers' produce is sold to organisations like the Wheat Board, the Barley Board and major stock trading companies like Elders, can you give us some examples of where farmers are getting burned in insolvencies, where they remain unsecured creditors and are not being paid?

Miss Harris—The only examples I have seen myself have been mainly in the horticultural area, where they are providing to medium sized wholesalers as opposed to large companies, such as Coles or Woolworths, where they do it directly. I have seen one or two experiences. We could certainly look into that to see if there is any particular evidence. It is not something that has come to our attention per se, but certainly we will consider it. That was one example, but in many respects most of them are dealing with either very large companies or, alternatively, the boards such as you described.

Mr M. Potter—One which may be useful is the small number of abattoirs which have shut down over the past couple of years. I am not aware of the particular financial impact that that has had on any one farm, but I am sure there would be a number of farmers who have been severely impacted by that. We can certainly look into that and provide you with any information which we can find.

CHAIRMAN—Some submissions have suggested that Australia should adopt the debtor in possession business rescue regime along similar lines to the American chapter 11 provisions as an alternative to or to replace the voluntary administration process. Has NFF looked at the chapter 11 provision, how it works and how it might apply in Australia and what the pros and cons would be of that?

Miss Harris—No, we have not. It is not something that is a priority issue for us at the moment. No, I could not answer that. I am sorry, Chairman.

Mr M. Potter—I have been following the debate but that does not mean that I can tell you what our members would think. I think there would be some interesting perspectives on that from our members and, of course, we would have to go through the process of seeking their input.

CHAIRMAN—As there are no further questions, I thank you both very much for appearing before the committee and for your assistance with our inquiry.

Mr M. Potter—Thank you.

Miss Harris—Thank you very much.

Committee adjourned at 6.22 p.m.