
COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

**(Subcommittee)**

**Reference: Australia's insolvency laws**

WEDNESDAY, 12 NOVEMBER 2003

SYDNEY

BY AUTHORITY OF THE PARLIAMENT

**INTERNET**

The Proof and Official Hansard transcripts of Senate committee hearings, some House of Representatives committee hearings and some joint committee hearings are available on the Internet. Some House of Representatives committees and some joint committees make available only Official Hansard transcripts.

The Internet address is: **http://www.aph.gov.au/hansard**

To search the parliamentary database, go to:
**http://parlinfoweb.aph.gov.au**

**JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES**

**Wednesday, 12 November 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

**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**

**Subcommittee met at 9.07 a.m.**

**HEDGE, Mr Peter, Committee Member, Business Turnaround Association**

**O'NEILL, Mr Michael Phillip, Committee Member, Business Turnaround Association**

**SAUER, Mr Robert George, Director, Business Turnaround Association**

**CHAIRMAN**—Today the committee continues its public hearing program of its inquiry into Australia's insolvency laws. Before we commence taking evidence, I reinforce for the record that all witnesses appearing before the committee today 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. I also wish to state that, unless the committee should decide otherwise, this is a public hearing and as such all members of the public are welcome to attend.

I now welcome the representatives of the Australian Business Turnaround Association to our hearing. As I have just indicated, this is a public hearing and therefore the committee prefers that all evidence be given in public. But, if at any stage you wish to give part of your evidence or answers to questions in private, you may request that of the committee and we will consider such a request to move in camera. The committee has before it three written submissions, one from Pacific Capital Corporation Ltd, which we have numbered 17, and two from the Business Turnaround Association, which we have numbered 18 and 18A. Are there any alterations or additions you wish to make to the written submissions?

**Mr O'Neill**—By way of explanation, the proposal put in by Pacific Capital Corporation was put in as a holding commentary on this whole area. The Business Turnaround Association formed only in December-January last year, at about the same time that your committee was asking for submissions, so it did take us a little time after that to go through the process of thinking through what our submission would be.

**CHAIRMAN**—Okay. Do you wish to make any additions to those submissions—apart from an opening statement, which I assume you will make later—or are they complete in themselves?

**Mr O'Neill**—We did have some other thoughts that you may like to hear about. Would you like to hear about those now or as part of the discussion?

**CHAIRMAN**—As part of the discussion—

**Mr O'Neill**—Okay, that is fine.

**CHAIRMAN**—unless there is something in writing you want to add.

**Mr O'Neill**—No.

**CHAIRMAN**—I invite you make an opening statement, or statements. Following that, we will proceed to questions.

**Mr O'Neill**—Part of the inquiry into Australia's insolvency laws goes to the voluntary administration system. Although it is part of the insolvency laws, we understand that the original intention behind the voluntary administration system was to help with the resuscitation of companies. It is in that context that we have given our submission. We are not strictly commenting on better ways of handling insolvency but, more, commenting on company resuscitation. We believe that although the voluntary administration system has worked well in many circumstances it is not actually suited to, and was not designed to assist, the greatest number of companies who need the services of a turnaround.

Largely that is because the voluntary administration system requires that a plan be put in place within four to six weeks of a company going into voluntary administration. We believe that the first thing you should do if a company is in trouble is try to turn it around and get it profitable, and then you make a decision about some compromise with creditors or about the form of the company. Trying to make those decision upfront, when the company is still in crisis mode, generally does not get the best out of the company in terms of going forward, and prematurely causes compromises, arguments and all sorts of distractions. Peter, would you like to follow that up?

**Mr Hedge**—Following on from what Michael was saying, one of the greatest services that someone could provide to address the issues of insolvency and to avoid insolvency would be to try to create an environment whereby organisations in distress have an option and an alternative to avoid insolvency, rather than just allowing the problems to fester until they ultimately have to call in an insolvency practitioner. Part of the submission suggests the creation of awareness within the community and the business community of addressing the problems of a troubled company prior to it becoming insolvent. That is the basis for the submission.

**CHAIRMAN**—Would you like to enlarge on the approaches that you see as most relevant to that?

**Mr Hedge**—It appears that there are two fundamental obstacles to those companies that ultimately become insolvent facing up to and addressing their problems on a more timely basis. Those obstacles are, first of all, the fear of the legal and civil ramifications for the individuals who launch an attempt to turn the business around, in the event that that turnaround does ultimately fail and the company becomes insolvent. That leads to all sorts of arguments about when the company was insolvent. Should those directors and parties trying to turn the business around have recognised and known that it was insolvent earlier and actually not tried to turn it around? Should they have just thrown their hands up, given the company to an insolvency practitioner and therefore suffered the obstacles imposed upon, and ramifications for, a business once an solvency regime is introduced? Possibly, by not exposing the company to that distress, that distraction and that cost, they might have been able to focus more sensibly on a turnaround plan that avoided that ultimate outcome.

So the first issue is: how does one address the Australian legal system that penalises and strikes fear into the hearts of directors who wish to try to address the problems of their company, because of the fear of personal liability? The second issue goes to raising an awareness within

the business community that there is, if you like, a halfway house between insolvency and a trading, profitable business. We should encourage people to recognise whether their organisations are at that halfway house and to put in place a well thought out and structured turnaround plan rather than to continue doing more of the same, which has caused the demise of the business to that point and will ultimately cause the business to become insolvent.

**CHAIRMAN**—Do you think that there is a need to make the definition of insolvency clearer by prescribing criteria against which you would judge whether a company is insolvent?

**Mr Hedge**—My personal view is that, commercially—and Robert, as the solicitor here, may wish to comment—it is not possible to prescribe insolvency as such. It is not a black letter situation. The more one tries to do that, the more it effectively brings to an end a company's ability to address its problems and turn itself around. If one of the boxes cannot be ticked, even if the company is saveable, an insolvency administration is initiated. Quite often it is the insolvency administration itself that creates the obstacles that prevent the company from being turned around.

**Mr Sauer**—It would be extremely difficult, and I am not sure that you can add any value by trying to further refine or define the point of insolvency. In terms of the existing statute in the voluntary administration system, the key element is that the system now has a trigger of insolvency or 'likely to become insolvent'. Once you have voluntary administration as an outcome of 'likely to become insolvent' that mentally sends people down a pathway which takes them to a voluntary administrator. Our perception is that the outcome of voluntary administration is either a compromise with creditors in a short space of time, as Michael described, or ultimately actual insolvency. The field narrows once you hit that point. We are saying: 'Let us create an alternative pathway at that point of "likely to become insolvent", as distinct from "already actually insolvent". Let us create an awareness of that in the community and have some mechanisms that will protect the officers if they choose one versus the other.' Our view is that that is likely to give a better outcome for creditors, the community and shareholders.

**Senator WONG**—The issue that you raise, I think quite rightly, is that voluntary administration tends not to be used early enough—not so much because there is a legislative problem but because there is a cultural problem. I do not have any difficulty with the notion that you have set up your council and you see some business opportunities for you in terms of selling yourselves as turnaround professionals and raising that awareness in the community. I have a greater problem with the suggestion that we should somehow amend the legislative provisions so as to give business turnaround professionals additional protections, because it seems to me you then open up a whole range of issues to do with regulating your industry, ensuring you have proper standards et cetera. You are creating a whole new regime, when actually the voluntary administration scheme was first set up because it was envisaged that directors would have the opportunity to get a third party to assist prior to the company actually being insolvent. That is the nature of the prospective test. The fact that it has not been utilised, I suspect, is an issue that is less about the legislation than about business culture. I think your proposal to try and develop these services is a very good idea, but I am not necessarily convinced that we require a legislative change to effectively implement a third stream over and above the administration scheme. Why wouldn't we just try and encourage companies—and one might need some amendment to the voluntary administration provisions—to utilise that earlier?

**Mr O'Neill**—There are a couple of reasons. One is that entering into a voluntary administration system often causes you to default on existing contracts. They could be financial contracts; they could be contracts with customers or suppliers.

**Senator WONG**—In response to that point, when I was practising—and this has come up again in evidence—it was quite common for contracts to have termination provisions in them that said, 'The contract shall terminate if there is an administrator appointed.' If I were still practising law, and business turnaround professionals started to become the norm, I would probably put into the contract, 'The contract shall terminate if a business turnaround professional is appointed.' If the issue is that we say for companies in crisis there should be some mechanism to limit the termination of contracts with suppliers and so forth, why wouldn't we put that into the VA scheme, rather than creating this separate scheme? To be blunt with you, if you were wanting this sort of privileged position—which is what you are essentially contending for—what I would probably say is that you have only been in existence, as you said, since the beginning of this year and I would want to see regulations and professional standards associated with the industry. It would mean more work for ASIC. It seems to me to be creating a whole new scheme, and I am not convinced that it is not possible to tinker with the current voluntary administration scheme to achieve the outcomes you are looking for.

**Mr Hedge**—I actually agree with everything you say, and I think you are saying exactly what the BTA has discussed as well. That question of why not encourage people to seek a voluntary administration earlier has vexed the industry and vexed commerce for decades. Why don't people recognise the warning signs of their corporate demise earlier, and why don't they seek help from people who might be able to help them earlier? As longstanding insolvency practitioners, one problem we have always recognised is: who wants to telephone an insolvency practitioner to talk about their problems when they are not at the stage of insolvency but are an underperforming business which, if it does not address its problems, will become insolvent? One thing I think everybody recognises and acknowledges is: the earlier the problem is addressed, the better the chance of the survival of the business. Over the decades, even through banks and finance communities, we have never been able to successfully introduce an insolvency practitioner with the label of being able to consult an organisation, particularly a large and complex one, about their turnaround problems. I agree to the extent that we should limit how we try to amend the existing insolvency laws.

**Senator WONG**—If I may interpose, can you see the regulation issue?

**Mr Hedge**—Yes.

**Senator WONG**—I would hope that every company which a business turnaround professional from your organisation got involved in could eventually continue to trade or at least pay more than 50c in the dollar, but the reality is that companies fail and will continue to fail. The policy issue with the voluntary administration laws is to try and balance the worthwhile objective of trying to rehabilitate the company with not compromising the position of creditors, given that a substantial number of those companies will fail. I suppose a good thing about the VA scheme is that you have a notionally independent administrator. We have had quite a bit of evidence that there is certainly a perceived, if not an actual, lack of independence in a number of administrators. Also I think we have had quite a lot of evidence on the need to try and improve that—for obvious reasons. The independence of the administrator is one way in which you try

and balance the two policy objectives: you try to rehabilitate the company insofar as it is possible but at the same time you do not compromise the rights of creditors, secured and unsecured. A business turnaround professional, from what I read in your submissions, is not independent in the same way; he or she would be a person appointed by the directors. At this stage I assume you are not suggesting that person would be an administrator under the relevant parts of the act.

**Mr O'Neill**—No, we are not.

**Senator WONG**—So the tension in this scheme rests with the sorts of protections regarding their behaviour that creditors would perceive are not there and, to my way of thinking, may well shift the balance a bit too far towards the directors' and the company's interests as opposed to the interests of the creditors. Senator Chapman may have a quite different view about this, and these are only my views, but I would be interested in what changes you would suggest be made to the VA provisions that might assist in creating a better culture of early intervention, given that I am not minded to look at creating a whole separate regime.

**Mr O'Neill**—Firstly, this concerns the nature of the person who is appointed. Voluntary administrators are registered liquidators, and so it is just like getting the undertaker in to resuscitate somebody; they have the wrong business focus to start with. Their training is not essentially in hands-on business turnarounds; it is what to do when it gets too late. Having said that, obviously some good skilled VAs have been appointed, and we saw examples of those in the conference that was held yesterday. But they are by far in the minority; it is one or two per cent of them. Secondly, the focus on VAs is in compromising with everybody before the actual business is turned around. The success of this whole industry has to be on operational turnarounds, not on financial engineering of making compromises. If you achieve the business turnaround, you do not have to compromise—and there is a time limit for doing that. Coming back to your comment about setting up an unregulated system that may be implicit in what we are saying, we have suggested that there should be a turnaround panel established, under the auspices of the ASIC, exactly the same as the takeovers panel that has been set up. I think it is generally accepted that the takeovers panel has been very effective in saving a whole lot of unnecessary legislation.

**Mr Sauer**—And litigation.

**Mr O'Neill**—Yes. It may appear that it is a big task. Could I ask Rob to make a comment on the complexities, or otherwise, of actually doing that?

**Mr Sauer**—Obviously, you are both familiar with the turnaround panel, so I will not go through the legislative side of things. The idea that we had was to essentially graft the proposal onto the existing legislative framework—to minimise the extent to which there was yet another legislative stream created, if I can put it that way. The powerful thing about the takeovers panel is that it avoids things like litigation, administrative and judicial actions. It brings a business perspective and it is well respected in the community for having that mixture of legal and commercial perspectives on issues which, by their nature, are in that grey region between law and commerce. We thought that was an excellent model and that you could actually just track the existing model and effectively expand the powers. You could change its name, perhaps. Although people call it the takeovers panel, that is not its proper name. It could be the companies

and securities panel—or maybe you could add something related to turnaround and then have some subgroups within that which have the relevant skill set to manage this part of the process.

Could I emphasise one thing that I do not think was clear from what came out before. Our concept was not designed for the primary purpose of capturing work for turnaround practitioners as such. It would be a matter for the directors to choose to appoint, or not appoint, someone as a turnaround specialist. In our model this element is perhaps closer to the debtor in possession, US type model. They could go to the panel, of their own motion, with their own, internally generated business plan and say, 'This is what we propose to do,' and it would be up to that panel to say, 'I'm sorry; this is not credible without someone else in there who has experience'—or whatever. Any implication that it is a sort of 'make work' exercise for a group is—

**Senator WONG**—I think that the work exists there. The services of your members are services you will be able to sell regardless of what legislative change is implemented. Frankly, there is nothing prerequisite, I would have thought, about some of the policy change you are seeking in terms of what you might do in the business community.

**Mr O'Neill**—There is one thing, which is the protection. That is all.

**Senator WONG**—Yes. This is where I disagree with you. We have had a lot of discussion about chapter 11, and I do not want to go through all of that. As I understand it, there is a reasonable amount of judicial oversight of that process, and there are some criticisms of the expense of that and so forth. It is quite a different stream, in terms of regulation, to that which we have adopted in Australia. The protective element is primarily through some of the legislative provisions and the independence of the administrator. The US system relies in part, in terms of the protection of creditors, on the oversight of the court.

**Mr Sauer**—Yes.

**Senator WONG**—I have some difficulties with how you would pick up some of the good things from this without compromising other things. It does not seem to me readily apparent how you would do that, given that, in the sort of thing you are talking about, by definition the person is not independent in the same way; therefore, what other judicial scrutiny or other legislative protections might you have? It is a very different philosophy around how you manage that. I would be more interested if changes to the VA scheme could be proposed. One is to look at the definition of insolvency, not so much prescribing tick box things—I agree with you about that—but changing the prospective test a bit so that more onus will be on directors to do something if there is a likelihood.

**Mr Sauer**—Creating a further onus may exacerbate rather than improve the problem would be my first comment on that. But I will track back to one of your earlier comments. The implication that judicial oversight was necessarily the appropriate form of oversight for what we are talking about is where I would strongly disagree.

**Senator WONG**—You are saying the takeovers panel would do it, are you?

**Mr Sauer**—Yes. I am saying that a judge does not actually have the right business skills.

**Senator WONG**—I agree, which is why Australia did not adopt that process. You are saying that chapter 11 is a good thing but, as I understand it—and I have only read second-hand accounts of the debtor in possession regime—there is a reasonable amount of oversight by the courts.

**Mr Sauer**—Yes, there is.

**Mr Hedge**—One of things that I think is also challenging the credibility of an administration is the lack of any sort of independent oversight in relation to turning a business around. Once an administrator is appointed, he has the independence to be able to address the issues. But, again, once an administrator is appointed, the company is insolvent.

**Senator WONG**—Or it is likely to be. Let us be honest: part of the problem we have is the issue you identified very early on, which is that the business culture in Australia tends to view administration as the precursor to liquidation, rather than as something to go into and then come out of. You might need to look at changes that you could try to effect through non-legislative measures to shift that culture. Mr Hedge, you raised an issue which I wanted to respond to. Essentially, I am saying that we have put a lot of eggs into the 'administrator as independent' basket in terms of protective issues in the broad sense. You are saying, 'No, we will create this panel and it can perform a regulatory function as the business turnaround professional.' You are saying that you want indemnity for the business turnaround professional. I think that creates a whole other set of legislative and regulatory issues. From our perspective, creditors might say, 'That system does not sufficiently protect us.'

**Mr O'Neil**—But there is not really any system around at the moment to protect them from VAs. There have been some awful things done in VAs either deliberately or not deliberately. They do not report to anyone, essentially. None of the creditors have got the money, the time or the inclination to take them to court and go through all the hassle. We think there would be far more scrutiny of the whole industry if there were a panel such as we are proposing.

**CHAIRMAN**—Is that the only change that you are proposing?

**Senator WONG**—And indemnity.

**CHAIRMAN**—Indemnity is part of it. How would the indemnity that you are proposing compare with the situation of the voluntary administrator?

**Mr Hedge**—It is interesting, because we have even been discussing a way of evolving the proposal as it currently is. Perhaps indemnity should not start addressing the rights of creditors or anything. Perhaps the panel's power is purely to grant immunity to the board if they are executing a properly prepared and reasonably based turnaround plan where they have no expectation of the company becoming insolvent but do not want their attempts to turn a business around to be used against them personally in 12 months time, if it is not successful.

**Senator WONG**—But the capacity for directors to be sued personally is pretty regulated. What you essentially seem to be saying to me is, 'Give people indemnity for essentially being good directors.' Yes, I agree that in the business culture it would be good if we had a situation where people were more prepared to bring in outside professional help earlier. I would have

thought if a company were coming into difficulties that they might want to try and seek that help earlier. It seems to me that is a business decision. That is not a decision about voluntary administration or whatever particular legislation applies. What you are essentially saying is we should give directors indemnity for actually being good directors.

**Mr Hedge**—No, that is not what we are saying. Robert made the point before that this also has nothing to do with bringing in outside people if that is not appropriate. This has to do with changing a culture and a mindset and enabling properly governed and well managed organisations and public company boards to be able to replace the CEO and see a turnaround plan implemented.

**Senator WONG**—There is nothing to stop them doing that now other than their own biases.

**Mr Hedge**—And the problem we have is they are not doing it at present and the main reason for that that keeps coming back is: 'I wasn't prepared to put myself at risk for endeavouring to sponsor this turnaround plan.'

**Senator WONG**—Who is 'I', the director or the—

**Mr Hedge**—The director.

**Senator WONG**—But what I am saying is under the existing law they are no more likely, I would have thought, to be personally liable for doing that than they would be, frankly, for allowing the company to trade while insolvent.

**Mr O'Neil**—I think the reality of life—

**Senator WONG**—As a matter of law—

**Mr O'Neil**—We have been doing turnarounds for 25 years. I did my first one in 1976 with a—

**Senator WONG**—So you do not need to have an immunity; you can do it anyway.

**Mr O'Neil**—Every time one comes along you really have to look at it and say, 'How far down the slippery dip is this company?'

**Senator WONG**—You have to make a judgment.

**Mr O'Neil**—'Are my cats, kids and house up for grabs here if things go wrong?' Every one we have done has been successful apart from one and in that I probably could have been sued because of the way things unfolded. It was in the agricultural industry and people said I could have predicted that the season was going to be bad. But because we did the right thing by everybody—all the banks were happy and the creditors were happy—nothing every happened. But that was pure luck. The number of people who turn down trying to resurrect companies and actually get them back on the straight and narrow is enormous because why would a turnaround specialist take the risk of this?

**Senator WONG**—Isn't a turnaround specialist in the place of a director?

**Mr O'Neil**—When you go into a turnaround you cannot have the responsibility without authority.

**Senator WONG**—That is what I am saying. So they have a similar set of obligations and protections under the legislation and at common law as a director would.

**Mr O'Neil**—Yes, but the reality is—

**Senator WONG**—So you are allowed to make mistakes.

**Mr O'Neil**—Sure. But the reality is that you need to go in, say, as an executive chairman or CEO to have the proper status to actually get everybody to cooperate with you. The reality is that if people have called you in things are bad. The reality is that you may be bordering on insolvency. But you essentially know and believe the company has a good product and a good market and you can turn it around if the staff will work with you.

**Senator WONG**—Are you also an administrator, Mr O'Neil?

**Mr O'Neil**—No.

**Senator WONG**—But you are, Mr Hedge?

**Mr Hedge**—I am. One of the views of the BTA is that this should not be and is not going to be a surrogate insolvency practitioners' association. It is genuinely trying to create an awareness and culture of turnaround. However, this is not about the Business Turnaround Association. This is about how we as a community can get the people who are in charge of companies that contribute to our community to address the issue of turning the companies around before they become insolvent. We are not promoting the fact that, if someone is employed by the company with the skills, they should not be doing it. They do not need to have an external consultant if one is not necessary. It is about creating an environment whereby the management will start to address their problems, because they feel that there is an alternative to sticking their head in the sand, and that alternative is being discussed and promoted within the community. They feel there is support for choosing the alternative of turnaround, rather than maintaining their head in the sand and, ultimately, finding the company insolvent.

**CHAIRMAN**—Are you saying that the current legal framework is an impedient or does not provide sufficient incentive or sufficiently early intervention?

**Mr Hedge**—It does not create any incentive. It does not even create an awareness within the community that the turnaround is an option. The reason why we have never been able to get companies that have gone into solvency to address their problems much earlier is that people just kept doing more of the same but did it twice as hard, faced with the problems they were encountering. They were not pinching themselves and saying, 'Maybe we should be looking at turning this business around.' When you look at other cultures around the world—we talk of it in chapter 11—you see that perhaps it is related to the cultural approach. For example, in the US, there actually is a turnaround environment. That environment is perhaps being created because

of the existence of a profession, but we argue that the profession is not the issue; the cultural idea of turnaround is the issue. It does not matter who does it, as long as they have the ability to do it.

**CHAIRMAN**—That is what I was trying to get at. You are not necessarily seeking additional immunities to apply to business turnaround professionals?

**Mr Hedge**—No.

**CHAIRMAN**—You equally need them to apply to people already in the company, if that is the way the turnaround was going to be effected.

**Mr Hedge**—Potentially people such as the CEO and the board of directors of Ansett 12 months before its collapse.

**CHAIRMAN**—So, in effect, doesn't that mean that you are looking for a more lenient regime than currently exists in relation to directors and business—

**Mr Hedge**—Not a more lenient regime. We are looking for an alternative and an option for those who are prepared to subject themselves to the rigour of being accountable for their plans and proposals.

**Senator WONG**—To the panel?

**Mr Hedge**—Yes.

**Senator WONG**—What is the nature of the indemnity? We might just have to disagree on this, because I do not necessarily agree that this is simply about the legislative framework. It seems to me that this is a broader issue about culture.

**CHAIRMAN**—I think what Penny says is right.

**Mr Hedge**—We agree.

**CHAIRMAN**—If you compare us with America, their culture is much more oriented towards saying, 'I failed but we'll get up and have another go.'

**Mr Hedge**—Yes.

**CHAIRMAN**—But that does not seem to be the case in Australia.

**Senator WONG**—I want to expand on what the chairman is saying. I think the chairman is right. In a climate where people feel that directors should be more accountable than they are—that is the public perception; I do not want to go down the path of whether or not that is accurate—to be asserting that there should be an even greater immunity for directors than currently exists is a difficult ask. What precisely would you be asking for?

**Mr Hedge**—It is interesting, because the turnaround panel, as such, if it evolves, could actually subject the directors to a greater degree of scrutiny in advance. It is saying that if you genuinely believe you have a turnaround proposition on your hands then show us your properly prepared plans, which at present is not something you would find with a lot of businesses that require turnaround. Even when the administration regime was introduced, it was said by the commissioners at the time that this will obviously be introduced once a plan has been prepared for how the administration is going to effectively assist the survival of this business. But what has happened is that the administrator has been appointed in many cases without the directors having even given the administrator the opportunity to have undertaken a financial review of the business to determine whether in fact there was a plan for the resuscitation of this business. So we try to encourage people—

**Senator WONG**—I understand that, Mr Hedge—

**Mr Hedge**—to prepare that plan early and then to be accountable for it.

**Senator WONG**—I understand all that, but the question was: what precise immunity are you suggesting?

**Mr Hedge**—Purely that, to the extent that they would be executing a plan, they would not be held personally liable in the event that the company becomes insolvent.

**Senator WONG**—What if, in the course of executing that plan, the provision that might have been made for employee entitlements was utilised for other purposes so that—say the company fails—employees, upon winding up, would actually have been significantly disadvantaged by decisions that were made. Can you see the problem?

**Mr Hedge**—With this concept, one of the ideas was that it would benefit the employees, because part of the plan—

**Senator WONG**—Only if it turns around, Mr Hedge.

**Mr Hedge**—Part of the plan would clearly indicate what provision there was to protect employees during this process and how the employees were going to benefit from this process, both by way of their entitlements being properly provided for—and Pan is a good example of where the employees' entitlements were clearly identified and properly provided for as part of moving forward to try to address the problems—

**Senator WONG**—Under a scheme of arrangements.

**Mr Hedge**—It was under the administration that such arrangements could be part of the turnaround plan, and I would see it as a very important part of it.

**Senator WONG**—I am trying whip through, because I am sure Senator Chapman has more questions. I have two things. One is the current scheme of arrangements which does exist under the act. Do you think there is possibility of utilising those provisions? Second, given that this is an idea still in its infancy, if we were minded to say that this should be considered but it is not at

a stage yet where it could form part of recommendations, what would be the best process? Should we have CAMAC look at it? What other fora do you think there are?

**Mr O'Neill**—We are intending to put a proposal in to CAMAC. We have had some discussions with them.

**Senator WONG**—It would seem to me that that would make the most sense. What about schemes of arrangements?

**Mr Hedge**—I think schemes of arrangements have a very important role, as does administration, in the restructuring of an insolvent company. The concept and the culture we as a community need to promote is that of turning the business around before it becomes insolvent. But if the turnaround plan includes compromises with creditors and other arrangements then administration and schemes are well tried and tested insolvency processes that adequately cope with that need.

**Mr O'Neill**—We would anticipate that if somebody moved outside the plan the indemnity would not apply.

**Senator WONG**—I can see a whole heap of litigation to work out what the bounds of the plan are.

**Mr O'Neill**—I am just saying that as a statement of intention.

**Senator WONG**—I understand.

**Mr O'Neill**—What we are saying is that if you do this and you are doing the right thing then just get on and do it. But, if you start stepping outside that, you may come back to the panel as things evolve—because they are not evolving as you had hoped they would be—and the panel may decide, 'Yes, we can cope with that and you can do it,' or 'No, it's time to call in a voluntary administrator.' It is not a hard and fast arrangement; it is a flexible, practical arrangement overseen by commercial people who have an understanding of this area.

**CHAIRMAN**—I can see the practical advantages and benefits. Senator Wong raised the legalities of it. If you have laid out a plan, how much detail do you have to have in it if it is a plan that is agreed before it can be determined whether someone wants to challenge that legally—you are not really acting according to the plan, you have stepped outside it? It seems that it would be a bit fuzzy around the edges and a bit grey. From a legislative point of view, I am trying to nut out how you would set that in place.

**Mr O'Neill**—It would be like a takeovers panel, in that all power in the area is with the panel.

**CHAIRMAN**—So you leave it to the—

**Mr O'Neill**—If the panel are not doing the right thing, the ASIC can just replace them. The problem has not arisen in the takeovers.

**CHAIRMAN**—So the panel are the final arbitrator.

**Senator WONG**—It all comes back to what sort of indemnity you are actually seeking. If you are acting reasonably, it might be that evidence of that is that the plan under which the directors and the new director—who is the turnaround professional and is essentially in the place of the director—is operating and has been approved by some statutory body. I would have thought that the possibility of personal liability in those circumstances would be pretty unlikely. What you are essentially saying to us is that you want a power to grant indemnity to a panel. I could easily see how people might criticise that politically, saying that a whole bunch of insolvency or business turnaround professionals—who may not necessarily have the interests of employees or other creditors as a priority—get to approve a plan which gives these people who have already stuffed up the company a whole range of immunities they may not have had.

**Mr Hedge**—The other option is that life just continues and we never get to that point in our community of trying to create a turnaround environment and we are continually picking up the pieces rather than trying to be proactive about avoiding insolvency. The suggestion is that the employees, the creditors and the community are better off by trying to find and create this tension to have companies address their problems at an earlier stage than to just resign ourselves to continually perfecting the system as to how dismember and bury the bodies once they become insolvent. It is perhaps 'out there' at this stage, but it is a genuine attempt to suggest some other option. Perhaps this seed of a thought can be developed and might lead to something more practical, if some of the practicalities have not yet been able to be addressed.

**Senator WONG**—Are you putting a submission to CAMAC on this?

**Mr O'Neill**—We will.

**CHAIRMAN**—So, in a sense, what you are trying to get to is perhaps some of the outcomes that chapter 11 in America tries to achieve, even if it is not successful, but without going to the legislative and framework extent that they have gone to?

**Mr Hedge**—Correct.

**Mr O'Neill**—Absolutely correct.

**Mr Sauer**—And with an appropriate skill set of supervision that will be more appropriate than the bankruptcy court judges that they have in the US looking at these things.

**Senator WONG**—I do not think we want to go down that path.

**Mr Hedge**—Exactly!

**Senator WONG**—I think we do agree on that.

**Mr Hedge**—We also believe that with some very good amendments that have been submitted by organisations like the IPAA et cetera our insolvency laws are pretty good. They are good at addressing insolvent companies. Wouldn't it have been fantastic if companies like Ansett and others had addressed their problems before they became insolvent, before they did not have enough money to pay the wages the next day? So what is it that would have encouraged the boards of companies like those to try to face up to and address their problems? What is it that

would have encouraged them to actually prepare a business plan 12 months earlier specifically addressing the questions of how they turn their business around and ensure it survives, instead of finding themselves in a situation where they did not have enough money to pay the wages so they had to appoint an administrator? We do not profess to have the answer, but something has to happen. If the creation of a turnaround panel does nothing more than advertise the fact to the business community that turnaround is an option then it will have achieved its objective.

**Senator WONG**—I agree with you. I think there is a lot of merit in that.

**Mr Hedge**—That is without any immunity being given to anybody; it is just the fact that it exists.

**Senator WONG**—You understand my reluctance about some of those issues.

**Mr Hedge**—Yes, and we agree with you.

**Senator WONG**—I think that in principle the notion of having a turnaround panel and whatever other mechanisms to try to shift business culture in Australia is meritorious. My concern is more that there is always this tension between rehabilitation and preserving the interests of the creditors.

**Mr Hedge**—It should not always remain the responsibility of the directors and those responsible for the company, and it is those people that we need to encourage because the threat of litigation if they get it wrong has not encouraged them to date; it has actually done the opposite: it has forced them down into their hole.

**Senator WONG**—But there is an implicit assumption that you making there, Mr Hedge, which is that somehow people would be safer not doing anything other than calling in a turnaround professional. That goes back to my previous comment that it might be arguable that in fact they are equally likely to be subject to litigation by not doing anything when they ought to have done something.

**Mr O'Neill**—I wish to go back to your point about indemnity in general for the directors. I think that, if practical, in all these turnarounds you generally need somebody in there to be the conductor of the orchestra. Most of the time the CEO and the directors have played some part—minor or major—in the current problems that the company has. I think the practicalities are that in most cases—maybe 90 per cent—you will need a turnaround coordinator in there. Perhaps the indemnity would be given to the coordinator, because he did not create any of the problems and he is coming in new trying to solve them so it really is not fair that he is lumbered with all the problems of the past administration. With Enron, this morning a lecture has been given by the chief executive officer. He has now come in and that turnaround so far is costing about $1 billion, but they are turning the company around and they will be paying money back, something which was not envisaged when the problems were first identified.

**Senator WONG**—I appreciate your organisation's perspective that this is not a subset of insolvency practice. But, given some of the issues that have been raised—and you might want to take this on notice—what about an amendment to the definition as to when a company can go

into voluntary administration, along the lines of having some different formulation other than the current one of 'likely to become insolvent'?

**Mr O'Neill**—You have to change the process though, because the process is at the moment that the plan should be put up within four weeks to six weeks. The VA is not focusing on operational turnarounds; it is focusing on compromises on day one and you have not built the company back up.

**CHAIRMAN**—Yes, protecting the existing assets.

**Mr O'Neill**—Yes.

**Senator WONG**—Which is a reasonable proposition if a company is sailing close to the wind.

**Mr O'Neill**—No, the first thing that you should be doing is looking at trying to operationally turn around; that is how people get their money back.

**Senator WONG**—Given some of the issues that I have raised, if you had any views on whether there are ways of tinkering with the current VA process, I would appreciate your providing them.

**Mr O'Neill**—Yes, sure.

**CHAIRMAN**—For instance, would legislative change be needed to suspend enforcement action by particular creditors, or could that be handled without legislative change?

**Mr O'Neill**—In the VA system?

**CHAIRMAN**—In the turnaround.

**Mr Hedge**—It is already in the VA system. We have been trying to brainstorm some minimalist approaches so that we do not introduce a new regime.

**Mr O'Neill**—To start with, it is too complex.

**Mr Hedge**—Yes. Administration does deal with insolvent companies who are looking for moratoriums to give them time to effect changes well. As has previously been said, to adopt some of the amendments—for example, those the IPAA have suggested—would deal with those issues.

**Senator WONG**—Which particular ones?

**Mr Hedge**—Again, I do not have it with me, but they have looked at a few of the areas in which it could improve the insolvency process of administration. We are encouraging people to try to turn the companies around before they become insolvent. The only slight amendment is the accountability for a turnaround plan—some independent body being able to overview it. In the US it is a big, costly judicial system. Our economy is not big enough and the sorts of

companies that would come before the panel are much more limited, so you would not need to create such a system. But the preparation of a plan starts to make people more aware of and accountable for their actions.

**Mr Sauer**—Of course, a lot of the VAs will be with miniscule or very tiny companies. We were suggesting that this would only apply—

**Senator WONG**—To the larger companies.

**Mr O'Neill**—To larger partners.

**Mr Sauer**—So we went for adopting something that was roughly in line with the small proprietary and large proprietary distinction for the publishing of accounts. Again, that was in sympathy with less legislative change, rather than more. If you pick distinctions that people are already familiar with, it tends to be easier. We really want to say that this is not for the small company with fewer than 50 employees.

**Senator WONG**—Generally they are not going to have the money to bring in someone like you. They are too small.

**Mr Hedge**—They do not have the greatest community impact as well.

**Senator WONG**—But statistically they probably have a larger number of insolvencies.

**Mr Hedge**—The facts are that a lot of businesses will fail. There is nothing we can do about that. One of the primary reasons is management skills and ability. In the smaller organisations, that seems to be the greatest reason for the number of failures, but the greatest community impact is from companies like Ansett, which should never get to the stage of insolvency. Once an insolvency regime is introduced, it is effectively the death knell of the organisation.

**Mr O'Neill**—Peter, in closing, you might like to mention what you found when you went into Ansett and got talking to the middle management.

**Mr Hedge**—Yes. The turnaround plans were there; they just had not been able to be introduced, as a result of the other issues that existed.

**CHAIRMAN**—Can you enlarge on that a bit?

**Mr Hedge**—We are out of time, and it would require a lot more discussion. But obviously the larger organisations like that would truly benefit from there being a mind-set of addressing declining performance, and a turnaround, rather than finding themselves in a position whereby, not having addressed the matters, they had moved into an insolvency regime.

**CHAIRMAN**—You say the turnaround plan was there in middle management.

**Senator WONG**—Did it filter up?

**CHAIRMAN**—Was there a lack of attention further up the tree?

**Mr Hedge**—It would be very interesting to have understood what actions the company boards were taking, faced with the clear warning signs of impending failure that Ansett had been showing for quite some time.

**Mr O'Neill**—From our experience, these boards of directors know that things are going to happen—and they are on a slippery dip—but they hope that things will turn around. They do not want to go and speak to insolvency practitioners because first of all they have to speak to a couple of them and word gets around town that they are in trouble. So they say, 'What else do we do?' They just sit back and do nothing. What we are saying is that before you actually label a company as insolvent why don't we create this label that you can be successful but you need to go through a turnaround. There is no stigma attached to that, such as approaching a voluntary administrator or a provisional liquidator. We believe that more directors will come forward and enunciate their problems earlier, which also means that it is easier to actually get an operational turnaround at that stage.

**CHAIRMAN**—Thank you very much for your evidence. This has been a very valuable session this morning. We are obviously exercising our minds on this issue as to how we can get a more beneficial outcome for the process. Some of the ideas you have put forward have potential, if we can work them through and see what legislative requirements are necessary to make them work practically—if that is possible.

[10.12 p.m.]

**JONES, Mr Michael, Partner, Jones Condon, Chartered Accountants**

**CHAIRMAN**—Welcome. The committee prefers that all evidence be given in public but if at any stage of your evidence or responses to questions you wish to give your evidence in private then you may request that of the committee and it will consider such a request to move into camera. The committee has before it your two written submissions, which we have numbered 12 and 12A. Are there any alterations or additions you want to make to the written submissions?

**Mr Jones**—No, not really. I thought I would use this opportunity to elaborate on some of the smaller points that are in there rather than the major points.

**CHAIRMAN**—I invite you now to make an opening statement. Following that, I am sure we will have some questions.

**Mr Jones**—Our submission basically supports the current regime, particularly insofar as it relates to the appointment and removal of administrators. We believe that the appointments, by and large, work very well. There have been some odd high-profile occasions—basically exceptions to the rule—where there have been court reviews of the process. But, by and large, we believe that the process whereby directors can appoint an administrator, administrators are immediately in charge of the assets, a creditors meeting is convened within a relatively short period of time, and creditors get the option of removing that administrator and changing the horses after a very short time is a good and healthy system. It works particularly well for the smaller end of town. That is the bulk of our submission.

The points that I wanted to elaborate on, if now is the appropriate time, really go to the small issues. I call this low-hanging fruit, LHF, in terms of the legislation—that is, where we could make some modest amendments to the act and get some big-bang impact with no downside whatsoever in terms of the operations. It really goes to efficiency. The act has a number of tasks that are required to be performed by liquidators, administrators and so forth which actually do not provide any added value to the creditors, the directors or the companies but bring significant cost to administrations. I think there is a need to review the entire act for these inefficiencies.

One of the ones that we mention in our submission is the fact that, in relation to the Corporations Law, there seems to be no authority for notifying creditors by electronic means. Here we are in the 21st century. Fax machines have well and truly dominated everywhere. Indeed these days it is hard to find a business—even a small business—without a web address. Yet the act seems to be fairly explicit that we need to use snail mail for the service of notices on creditors. Given the voluntary administration regime—where creditors are complaining that they are not getting sufficient notice of the first meeting of creditors, because two days in the mail out of five days is a big percentage of the lead time that you have—email notifications would add to efficiency. That is No. 1. You can get confirmation that the person actually received the email, so you get away from this ‘I didn’t get it’ business.

Secondly, administrators are required to circularise the same list of creditors on numerous occasions. There is the first meeting, the second meeting and the post meeting. Email lends itself very nicely to repeat bulk circularisation of creditors. So there are enormous efficiencies to be got if we simply enable email communication with creditors. That is enabled in the Bankruptcy Act, by the way, but not in the Corporations Law. There seems to be a discrepancy there.

Along the same lines, right throughout the act, there are things that could be eliminated and that add to the cost. I go to final meetings for creditors, for example. When you finalise an administration, typically a creditors voluntary liquidation, you are required to convene a final meeting of the creditors. The company is automatically struck off after that final meeting. I have been a liquidator since 1986. I have handled large numbers of creditors voluntary liquidations and nobody has ever attended a final meeting of creditors. That would be the same right throughout the entire profession. It would be hard to find anybody who would tell you that anyone has attended a final meeting of creditors. For that particular piece of legislation, we are required to call a meeting, advertise the meeting, send out notices for the meeting, do minutes of the meeting and lodge those minutes. When you put a system in place which does that, it adds substantially to the cost of the administration.

Moving backwards from there, we have annual meetings of creditors and, in large companies, annual meetings of creditors and shareholders. So you get public companies holding an annual meeting of the shareholders in a company which is in liquidation, which provides little or no utilitarian advantage to the insolvency administration but which adds substantially to the cost of the administration. I strongly suggest that we review that and delete it.

Likewise, there are forms right throughout the act. Form 524, which is a liquidator's or administrator's statement of receipts and payments, is required to be lodged with the ASIC on a six monthly basis. Large numbers of insolvencies are small, unfunded, no-asset administrations. Yet administrators, liquidators and receivers are required to lodge every six months a form filling out endless amounts of data pertaining to creditors, assets sold, assets realised and what his fees are—even if he is not going to be paid any fees out of the administration—which is data that nobody ever actually searches. If he happens to miss a deadline and miss the date for lodging form 524, the ASIC fines the liquidator.

If those forms or that information were of any utilitarian advantage to creditors, I would not be making these comments. Anecdotal information is that creditors do not even search the database for it. If they wish to get information on company liquidations from liquidators, administrators, receivers, what do they do? They ring up the administrator's office and they get a report. Those sorts of things could be addressed electronically if we simply required liquidators to put their reports up on their web sites and they were available for access. We all have web sites. In fact, there is an issue at the present time: many firms are putting their reports on web sites because it cuts down on the number of phone call inquiries you get and potentially cuts down the costs of administrations. It is also a good public relations exercise for liquidators. However, there is a privacy issue and various parties have raised with me that the reports that liquidators put up on their web sites are really private reports between the liquidators and the creditors and should not be available publicly. I think that that should be addressed in the legislation.

Broadly, there are a range of very small items in the act that could easily be amended that would substantially reduce the costs of administrations. It would have a powerful impact on

small and large administrations and would possibly go towards addressing one of the big complaints that we hear—that is, that the cost of liquidations and insolvency administrations is very high. We have created unnecessary work for ourselves right throughout the act.

Finally, recently the courts have clarified an anomaly in the act that requires administrators to personally attend the second meeting of the creditors. It was unclear for some considerable time. The courts now say, 'No, it is clear: administrators must personally attend.' On the surface, one might say, 'Well, why not?' I would agree with that. If it is sufficiently large, active and so forth, yes, you should be there purely from a public relations point of view, but to make it mandatory means that relatively small matters could easily be delegated to appropriate levels of staff within the organisation. These things would be a great improvement in relation to the costs.

The large charge-out rates that insolvency practitioners charge in terms of their hourly rates have been often criticised, but they reflect the fact that insolvency practitioners handle large numbers of unfunded administrations. They have to maintain their staff even though the work is not often continuous. That is built into the rates. If there could be a regime where some of the unfunded work is dealt with more efficiently, not only would the time on the jobs be cut done but also the charge-out rates across the board could be reduced as competition kicks into the marketplace and people find that they can do things more competitively.

**CHAIRMAN**—One of your main suggestions is that there should be no change to the appointment process for administrators. We have received significant evidence expressing concern about—one of the issues we are grappling is whether it is perceived or real—bias or lack of independence of administrators. Are you aware of that concern and, if so, how would you suggest that it be addressed?

**Mr Jones**—Yes. You would need to understand the real motivations behind the perceived concerns. The real motivations are since the introduction of the voluntary administration regime. In fact administrations have taken off, if you look at statistics but, by and large, it is the directors rather than banks who appoint administrators. Prior to the creation of the administration regime, it was the large banks that appointed receivers. If you have a look at the statistics, you will see a substantial reduction in bank appointed receiverships and substantial increases in voluntary administrations. But it is the directors who make the appointments primarily, and directors are not in the habit of going to large big-end accountancy practices when they make the appointments.

The only way that the large big-end accountancy practices become involved in many of these administrations is if the bank decides to wheel in a receiver over the top or if large creditors have significant votes on who should be the administrator. That is where the real problem comes in, because the voting requires not only value but also number to change the horses. I personally believe it should be so because, if indeed an administration is to be promoted, the one thing it does need fundamentally is the cooperation of the directors. In fact, one of the things that we have discovered in all the years we have been in practice is that there is a direct correlation between the value of today's assets and the amount of cooperation you get from the incumbent directors.

This is why, when you have court liquidations, compulsory bankruptcies and receivers appointed by banks, the locks are changed, the auctioneers are called in, the guards are put on

the doors, the directors run for cover and all the asset values diminish—and I do not mean the tangible assets, because today's assets are not tangible assets; the real asset values lie in things like databases, goodwill, licences, know-how and so on. The tangible assets today are by and large secured. The banks have mortgages over real estate, debtor factor of financing over debtors, stock mortgages and leases on plant and equipment. The physical hard assets are usually secured. So the real asset or the real advantage to creditors in trading out or putting something together fundamentally relates to how you can deal with those intangible assets, which is very much the nature of the business. As I said earlier, that is about the cooperation that you get from your directors. That is why it works very well to have the directors appoint the administrator, because they have to have the confidence that that administrator is going to be able to work with them.

At the same time you have this five-day meeting provision, and if the creditors really have a concern about the quality of the administrator, his independence or whatever, they have the ability to vote him out at a very early stage—and that can be reviewed by the court by exception. The court has significant power to do that and has exercised that power. In exercising that power the courts have actually laid down some fairly clear guidelines as to what is required of administrators. The IPAA has set out fairly clear guidelines, as have the Institute of Chartered Accountants and the CPAs, on what independence means, and in fact our practice has done so for quite a considerable time. Now it is a professional standard that there be an independent statement issued in sending out the notices to the creditors initially.

**Senator WONG**—I did note that in your second letter, I think. You make some comments about any proposed roster system—and I think they are pretty consistent criticisms, but I do not really want to spend a lot of time on the roster system proposal, because it seems to me pretty flawed—and you seem to oppose having some sort of statutory inclusion in the legislation of something like a code of conduct or a code of ethics, on the basis of the devil being in the detail. Was that the phrase you used?

**Mr Jones**—Yes—the devil is in the detail.

**Senator WONG**—Given that we have had a reasonable amount of evidence about the perceived or actual lack of independence of administrators, which Senator Chapman has referred to, and given that the independence of the administrator is probably one of the cornerstones of the system, we are looking at how that can be encouraged. So why would you have such vehement opposition to something like a code of—

**Mr Jones**—It is simply that once you start codifying things—

**Senator WONG**—if I could finish—ethics. Obviously it would need to be drafted in conjunction with the industry, but what in principle is so wrong with setting out ethical standards that the community expects of administrators?

**Mr Jones**—The ethical standards are there, from the Institute of Chartered—

**Senator WONG**—But they are not enforceable.

**Mr Jones**—I suppose they are not enforceable.

**Senator WONG**—That is right.

**Mr Jones**—It really comes down to the broader issue of codification of these sorts of things. Once you start trying to codify these things you then start to reduce the level of flexibility.

**Senator WONG**—But the IPAA has already done it.

**Mr Jones**—As you say, they are not enforceable. It is this whole argument about fuzzy law where if an administrator is not subsequently found to be independent then he will be held accountable by the judiciary.

**Senator WONG**—If someone can be bothered taking action.

**Mr Jones**—If somebody takes it on; that is right.

**Senator WONG**—That is the issue; legal rights are only as good as one's ability to enforce them. Often in the context of administration or liquidation people are not going to throw good money after bad.

**Mr Jones**—Yes, but the devil is in the detail when you start to get that prescriptive about it. I heard Mr Hedge talk earlier about the advanced nature of the insolvency laws in Australia. That is probably right; I have heard that elsewhere. I have heard international commentators say that. Maybe that is because we need them. We were a penal colony, weren't we?

**Senator WONG**—I think we did pretty well on that front. We were probably 10 years ahead of Britain, anyway.

**Mr Jones**—One of the big planks in the voluntary administration regime is its inherent flexibility.

**Senator WONG**—I do not think we are proposing or suggesting changes to that. Having some sort of code of ethics does not seem to me to—

**Mr Jones**—If it is a genuine concern and if the code of practice is simply a codification of something, like what the IPAA has at the present time, and you are simply saying, 'Put something in there that is actually enforceable,' I am not sure that I could really argue with that.

**Senator WONG**—I would not have thought so, but thank you for the concession.

**Mr Jones**—My concern is that, once you hand these things over to legislative drafters, the bureaucratising—

**Senator WONG**—With something like a code, it seems to me that you have to have drafting—

**Mr Jones**—An example where it has gone horribly wrong is in the bankruptcy legislation where some years ago we had the so-called Skase amendments, which were specifically designed to address what was perceived to be a real problem with the Skase administration. Now

we have the conduct of creditors meetings in bankruptcy codified. The agenda is 1½ pages long. To get through the agenda formally is just ridiculous. I put it up on a screen and say, 'There's the agenda, gentlemen. Now we'll go and do the real thing,' because it is just too bureaucratic. It is utterly bureaucratic.

In the Bankruptcy Act we had the part X regime, which was probably the most advanced bit of law in the world. In fact, voluntary administration is really a photocopy of that, rather than anything that was done anywhere in the world, taken a little bit further. But while voluntary administrations for companies grabbed the best of it and went in one direction, the bankruptcy legislators said, 'Look at all these problems,' and started taking the bankruptcy provisions in another direction. We actually lost a little bit of ground there purely by putting a statutory code on certain things. In fact, we probably went backwards because the meeting provisions, for example, by and large followed common law meeting lines. There was good law on how you run meetings—the general conduct of meetings and how resolutions are passed. That has now all been codified and it can be open to more abuse.

**Senator WONG**—But a code of ethics is different to prescribing procedure.

**Mr Jones**—Perhaps.

**CHAIRMAN**—With regard to the issue of the timing of the first and second meetings, we have had some submissions that have said that the time is too short.

**Mr Jones**—Yes. We get that comment an awful lot from creditors. They say, 'We didn't get enough notification.' The problem we have to weigh up is the importance of getting the creditors in front of the administrator very early before he starts doing too much work. If they are going to change the horses then you would want them to do it before the incumbent had dug his heels too deeply into the assets and set the direction in any great amount of cement. I am not sure whether another week would make a difference or not, but we could get a huge improvement without changing the meeting dates by simply allowing electronic notification. That way the creditors would get the notification on day one. They would have five days to get themselves organised.

**CHAIRMAN**—Another issue is the perceived abuse of the voluntary administration system where it is perceived as being used in many instances simply as a means of putting a company into liquidation.

**Mr Jones**—Yes, I vehemently—

**CHAIRMAN**—I guess that also has some relevance to what we were talking about with our earlier witnesses too, in the sense of whether voluntary administration is sufficiently focused on trying to resurrect and turn a business around or whether it is simply a means of putting a company into liquidation.

**Mr Jones**—I think we need to change our mindset about that comment completely. If you are going to put a company into liquidation, there is no better way to do it than the voluntary administration process. Can I elaborate on that?

**CHAIRMAN**—Yes.

**Mr Jones**—If you are going to put a company into liquidation by court application, you have costs, legal fees and all the rest of it and it is at the discretion of the judge. If you are going to do it by the creditors voluntary liquidation regime, it is much cheaper than a court application. However, you have what we call a hiatus period of 10 to 14 days when the notices are all out there and everybody knows this company is going to go into liquidation, but it is not in liquidation and nobody has control over it other than the directors. So the company cannot really function and the directors cannot really function, and you have 10 days to two weeks until there is a creditors meeting that resolves it. You need the shareholders to resolve it as well. If you have a company that is insolvent, directors have personal liability. If they wish to do something about it but they have a shareholder or group of shareholders that do not wish to do something about it—and they, after all, have no responsibility—you cannot actually get a resolution through, because you have to actually have the shareholders pass a special resolution to put it into liquidation first.

With the voluntary administration regime, what happens is that the directors make the appointment on day one and somebody is immediately in control of the company. The five-day meeting simply confirms his appointment. Three weeks later, you have a decision meeting. A whole lot of advantages come in here. First, you have somebody in control of the thing right from the start. Even if there is no plan or even if it is going to go into liquidation, you have somebody responsible who secures the assets. Second, there is a creditors meeting in three weeks time. A creditors voluntary liquidation is a two-week meeting, and this has an extra week. So what is an extra week? The creditors get a complete report done by the administrator as to the assets and liabilities of the company; a report as to affairs; a proposal, if any; and an assessment as to whether the proposal is the right thing for the creditors, and the administrator has to give an opinion on that. In other words, the creditors go into that decision meeting fully informed by the administrator, whereas, in the CVL process, they get a notice in the mail and that is all they get.

So, if you are going to put a company into liquidation, the voluntary administration regime is a supremely better method of doing it. The other spin-off advantages are that the liquidator, the future liquidator or the administrator, as he is up to that point in time, very much has the ear of the directors of the company because it is very early days. So he is able to get cooperation, he is able to get the books and records and he has to get his report out to the creditors. He has access while everybody is really interested. So the creditors get early information, whereas, if it goes into liquidation, there are actually no time limits on when the final report gets done, by which time directors have gone off and got another job or something else, books and records have gone missing and assets have gone missing. By the time the liquidation is finalised, a lot of the impact has actually gone.

**Senator WONG**—I think we are reasonably well aware of why people do choose to use the voluntary administration path. I suppose there is a question that comes to mind which arises from our earlier witnesses. I do not know how much of that discussion you were here for. Because the path often chosen, for the reasons you have outlined, is to appoint an administrator and go into liquidation, there is a criticism that there is a culture, if you like, where people tend not to use voluntary administration for the other purpose that was envisaged for it, which was to try and actually put into place a plan to rehabilitate the company. That is certainly the tenor of the evidence of previous witnesses. They were saying—

**Mr Jones**—I heard that with great interest.

**Senator WONG**—that we need to create a turnaround culture. I do not want to paraphrase and simplify too much, but I think their essential submission is that the current administration laws do not provide for or encourage that.

**Mr Jones**—Yes, I listened to that with great interest. I think what that fails to address is the fact that there is a fundamental difference between saving the business and saving the company.

**Senator WONG**—That is a good point, actually.

**Mr Jones**—A company can go into liquidation and the liquidator can simply sell the business off to a new entity, and the business is saved. It might have different owners or perhaps the same owners, but the business can be saved. Often that is completely ignored. Certainly it has been ignored by the media. The only reason to use a voluntary administration regime is to save the corporate structure. The major motivation for saving the corporate structure is the tax losses, if any, or perhaps something less tangible, such as licences, which cannot easily be transferred out of the company structure.

**Senator WONG**—And, I suppose, the employees, because the contract of employment is—

**Mr Jones**—That usually gets transferred across when a business is sold—

**Senator WONG**—That is true.

**Mr Jones**—and the unions are usually pretty strong about making sure that entitlements are protected. I think it is often forgotten when we are looking at these things that there is a fundamental difference between the two. In fact, in the old days, when we had no voluntary administration regime, we were still saving businesses simply by selling them off to a new entity.

**CHAIRMAN**—Accepting what you say in that regard, in most instances the company structure is in trouble because the business is in trouble, and unless you take some remedial action in relation to the business—

**Mr Jones**—The company is insolvent because it owes more money than it has. If you simply sell off its assets—and its assets could be the business—the new entity that owns the business has no creditors. The old entity gets the asset value and distributes that to its creditors, and the new entity goes off without any liability or debt. There is no guarantee that it will not get into trouble again if fundamental management changes do not take place—I agree with you entirely on that—but at least it starts off with a clean slate. The voluntary administration regime does that using the company structure. It simply does the compromise with the creditors within the company structure. So why are we trying to preserve the company structure all the time? Usually it is because of special reasons—statutorily driven reasons. It is mainly because of the tax laws. The 222 AOE notices, which you would be familiar with, make directors personally liable if they let the company go into administration. That is a primary motivator for directors to use the voluntary administration regime.

**CHAIRMAN**—In a sense, that leads us to the issue of phoenix companies.

**Senator WONG**—Oh, 'The Editor'.

**Mr Jones**—Yes, I made some comments about that.

**Senator WONG**—Mr Jones, you were very strong on phoenix companies.

**Mr Jones**—Yes. We all are.

**Senator WONG**—Does that come from an experience of them?

**Mr Jones**—I will give you an anecdotal example. I did a liquidation some years ago of a company called 35 The Avenue Investments Pty Ltd. It was a building company. The reason it was called 35 The Avenue Investments was that the one before it was called 34 The Avenue Investments.

**Senator WONG**—We should put that in our report!

**Mr Jones**—The creditors consisted of—have a guess!—The Australian Taxation Office, workers compensation—

**Senator WONG**—and presumably the employees.

**Mr Jones**—No, the employees were always looked after.

**Senator WONG**—Were they?

**Mr Jones**—Yes, except for their superannuation. You can transfer the lot from one to the other. You need the staff for 36 The Avenue Investments! For heaven's sake, you have to keep the guys onside!

**Senator WONG**—So they have been through it 35 times?

**Mr Jones**—Yes, apparently. The tax office funded us to do a bit of investigation on that. It was quite a number of years ago. I think it was in 1981 or 1982. Back then, we did not have the legislative regime, even within the tax act, to do anything about it. Everything I talked about before, in terms of saving businesses, does set off alarm bells about the 'phoenixing' of companies. But there is a fundamental philosophical problem: if you start to put restraints on people starting a business, you are actually putting a restraint on people earning a living. We see this fundamental problem down at the bankruptcy level. If a plumber goes bankrupt in his plumbing business, what law is there to stop him being a plumber—or an architect, a doctor or whatever he is skilled to do?

**Senator WONG**—In the case of phoenix companies, directors may have had a long history of engaging in the same conduct over and over again.

**Mr Jones**—That's it!

**Senator WONG**—It is a different issue to personal bankruptcy, isn't it?

**Mr Jones**—No, it is not, because bankrupts do it over and over again. Believe me, they do—except in exceptional cases.

**Senator WONG**—Saying that someone cannot practise their trade to earn a living is different to saying that someone is going to be allowed to continue to gain the benefit of a limited liability legal vehicle to continue to operate over and over again. I think these are quite different circumstances.

**Mr Jones**—What you are touching on is the repetition. If somebody gets into a company structure and they go down once and they regroup and they start again, I do not necessarily think that we should be discouraging people from having another go. But if it is a kind of personality behaviour whereby they are just doing it to rip creditors off time and time again, then I think we need to put some teeth into the act to stop it. We have made some pretty strong suggestions about that.

**Senator WONG**—Yes, there is an automatic ban of three years if they have had three or more failed companies. Presumably, you would have some form of court application process if someone wanted to be exempted from that. There is a bond of 10 grand when new companies are created.

**Mr Jones**—I am pretty hot on the idea of bonds generally. That is driven by my role as an official liquidator where probably nearly everything that comes—

**Senator WONG**—You would cancel trade or professional licences.

**CHAIRMAN**—Would that apply to every company?

**Mr Jones**—Not $10,000 for every company but we thought there should be a bond on incorporation on all companies that liquidators could put their hands on to help them at least partly fund the administrations.

**Senator WONG**—There is the cancellation of trade, professional or building licences. The problem there for us is that obviously trade and building licences are generally state regulated, aren't they?

**CHAIRMAN**—Yes.

**Senator WONG**—They would be personally liable for debts if they engage in phoenix activities.

**Mr Jones**—I think the biggest problem with the phoenix activity is to actually define it, to work out where the cut-off is.

**CHAIRMAN**—Yes, and what is the genuine state of things.

**Senator WONG**—That is where I am attracted more to the idea of bonds and restrictions on subsequent activities as a director because that is a threshold issue that I think is easier to

capture. I think the personal liability idea is attractive emotionally because you think, 'Yes, we should make them personally liable,' but it would be a fairly difficult one to define.

**Mr Jones**—In practice personal liability is actually becoming less and less the issue, funnily enough, because these days directors have found themselves pretty much personally liable for everything anyway, except the exceptions. They are going to be liable to the bank, they are going to be liable for their lease, they are going to be liable for their equipment, they are going to be liable for their personal guarantees and they are probably going to be liable under insolvent trading regulations anyway.

**Senator WONG**—When you say 'liable to the bank' that is because—

**Mr Jones**—They have personal guarantees.

**Senator WONG**—But that is their choice.

**Mr Jones**—Sure.

**CHAIRMAN**—It is the bank's choice usually.

**Senator WONG**—It is not that I am a great defender of the banks but I am saying—

**Mr Jones**—Have you ever had a choice?

**Senator WONG**—But the point is that that is not a function of any legislation that the government has put in place. That is a commercial negotiation between the directors and the bank and the bank using their substantial negotiating market power.

**Mr Jones**—Absolutely, but it is reality. I think the fact that we have such large numbers of unfunded corporate administrations, where very little gets done as far as the investigation is concerned, is a problem and the bonds could help with all companies. A small bond on all companies could help some even basic inquiries to be done when they go into liquidation. Then you could put a penalty bond on someone who has had a history of it. The penalty could grow so that you could have an escalating cost for people that engage in these sorts of activities. It is just an idea.

**Senator WONG**—So what was it called?

**Mr Jones**—35 The Avenue Investments Pty Ltd. I had to have an anecdote. What do you think of my concept of a review of the act as far as efficiency is concerned? Here I am referring to final meetings, annual meetings, form 524s, personal attendance by administrators and all of those sorts of things. They are low-hanging fruit, I suppose.

**CHAIRMAN**—Would you summarise how you would streamline it?

**Mr Jones**—I think there needs to be a think tank of people to actually go through the act almost line by line and target redundant procedures and then put an omnibus bit of legislation through just to clean it all up. They have already done this in the Bankruptcy Act. The

Bankruptcy Act deleted form 33s, which are the same as form 524s, three or four years ago. The Bankruptcy Act does not require personal attendance by the bankruptcy trustee at creditors meetings—deleted some years ago.

**Senator WONG**—But you would agree on that one, and I have heard your comments about that, that there would be many occasions on which personal attendance by the administrator at the decision making meeting would be appropriate.

**Mr Jones**—Of course, and professional responsibility tells you to do it. If you have to get the creditors onside to get your deal through, of course you are going to attend; you do not need legislation to tell you to attend.

**Senator WONG**—Why not? Do you assume that most of your profession is made up of men and women who will honour that?

**Mr Jones**—First, let us ask the question: what other insolvency procedure requires statutory personal attendance by the administrator? The answer is: only this procedure. The ASIC chief in this area has said to me, 'Oh, but that's because there isn't anything like it anywhere else.' But there is. Part X of the Bankruptcy Act is an exact photocopy and it does not require the personal attendance of the bankruptcy trustee.

**Senator WONG**—I suppose that is because of the amounts of money that are involved and the importance that is attached to that meeting and to the role of the administrator in this legislation.

**Mr Jones**—Yes. But the point that should be made is: where this form of activity or delegation has been called into question has absolutely nothing to do with the size of the administration or the importance of those meetings; it is to do with the fact that creditors have been attempting to tip over administrations and have been looking for whatever excuse they can find to do it, or that the ASIC has been subjecting a particular practitioner to review. In practice, it is very hard to pin major offences on a practitioner; if you are the ASIC, you go through and look at the minutiae.

**Senator WONG**—I do not think we have the time today to go through every detail of that.

**CHAIRMAN**—It is all there in the submission.

**Senator WONG**—Your proposal is the process.

**Mr Jones**—No; the bit about efficiencies I have only just touched on and I want to amplify. If that particular part is a problem, I simply say that there would be a benefit in going through some sort of process to look for redundant provisions and change them. That could be part of looking at the electronic communication, for example.

**CHAIRMAN**—Parliaments are not good at doing that. If that is on the statute, whether or not it is relevant, it tends to stay there.

**Senator WONG**—I think this sort of committee can look at the broad policy. But you are talking about going through the legislation with members of the industry looking at particular provisions and whether they can be streamlined and become more effective. I think we understand what you are asking for.

**CHAIRMAN**—We have no further questions. Your input and our discussion with you have been very useful. Thank you very much.

**Proceedings suspended from 10.52 a.m. to 11.03 a.m.**

**FRANCIS, Mr David, Representative, Australian Credit Forum; and Chairman, Law and Legislation Committee, New South Wales Division of the Australian Institute of Credit Management**

**SMITH, Mr Barry James, Deputy Chairman, Australian Credit Forum**

**CHAIRMAN**—I now welcome representatives from the Australian Credit Forum to our hearing. Do you have any comments to make about the capacity in which you are appearing today?

**Mr Francis**—I am the chairman of the subcommittee that is, on behalf of the Australian Credit Forum, dealing with the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into Australia's insolvency laws.

**CHAIRMAN**—The committee prefers all evidence to be given in public, but if at any stage of your evidence or in response to questions you wish to give your evidence in private you may request that of the committee and we will consider such a request to move in camera. The committee has before it the written submission of the Australian Credit Forum, which we have numbered 53, and also a submission from the New South Wales Division of the Australian Institute of Credit Management, which we have numbered 54. Are there any alterations or additions that you want to make to the written submissions?

**Mr Smith**—Yes. On page 2 of the Australian Credit Forum submission, under item 1.32 to 1.36, in the second dot point the last word on the second line is the number 10. It should in fact be seven. My apologies.

**CHAIRMAN**—That is the only change?

**Mr Smith**—That is the only change.

**Senator WONG**—Is that a reduction?

**Mr Smith**—No, it is a typo. If we have a look at the—

**Senator WONG**—Yes, but seven is a reduction from the current provisions, is it not?

**Mr Smith**—This is seven business days after the first meeting. We added the seven and the five, but we are actually remaining consistent with point 1.25.

**Mr Francis**—It is actually a novel provision—it is a new provision that is proposed.

**Senator WONG**—What is the current requirement?

**Mr Smith**—None. We are trying to introduce a new provision—No. 1.25.

**Senator WONG**—This is new; I see. Thank you.

**CHAIRMAN**—I invite you to make an opening statement, after which I am sure we will have some questions.

**Mr Smith**—I am currently employed as a credit consultant. I am here today representing the Australian Credit Forum. I will give you a brief background on that association. The Australian Credit Forum, formerly known as the Australian Credit Managers Forum, is an organisation that was formed some 25 years ago. Its purpose is to review and make submissions on credit related matters, with its membership predominantly national credit managers and people from associated professional areas, such as accountants, lawyers, insolvency practitioners, mercantile agents and credit reporting agencies in both consumer and commercial areas.

The group meets on five or six occasions per annum but the majority of our submissions are taken on by subcommittees that meet outside those meeting dates. This issue was first raised in September—unfortunately very late—but a subcommittee was formed, which involved a total of seven people. To give you some background on the submission that has been provided, as David mentioned previously he is a lawyer and was nominated to be chairperson of that subcommittee. Michael Woodward, who is a credit insurance specialist, was also on that committee. Geoffrey McDonald is an insolvency practitioner and barrister. We decided that we wanted a focus from a credit perspective and hence we called on the services of four people actively involved as credit managers in large companies. They were James Reed, Gail Bebber, Roger Bates and myself. Collectively the focus was on that credit management team and their review.

The initial meeting was held on 16 October, with members having read in advance the discussion paper of May 2003. The meeting focused on major issues affecting creditors. Participants then discussed each of the areas. Where we could agree on a particular line, that then formed part of the submission. Hence you will see in the submission that there are certain areas where we have just said, 'We will make no comment at this point in time.' Our formal submission was completed and forwarded to Canberra on 30 October. As there is a subcommittee involved, we would seek to be able to come back to you with a written submission on any questions that I am unable to answer on their behalf or on any areas that it is felt relevant. Thank you.

**CHAIRMAN**—Thank you very much. Mr Francis, did you want to say something?

**Mr Francis**—The committee can deal with Barry now, and if there is anything supplementary then I can comment on that.

**CHAIRMAN**—We have not really had a chance to look at submission 54, which was received formally by the committee this morning.

**Mr Francis**—It is substantially similar.

**CHAIRMAN**—It covers the same issues?

**Mr Francis**—It does cover the same issues but there are some variances. It might be convenient to leave that until after you have heard from Barry and asked as many questions as you like.

**CHAIRMAN**—Can you enlarge on this committee of inspection?

**Mr Francis**—Is that the 1.36 point on page 2?

**CHAIRMAN**—It is point 1.25, with regard to the removal—

**Senator WONG**—Is that committee of inspection able to be appointed under the current act?

**Mr Smith**—Under the current act, at the first meeting the administrator is able to appoint a committee of inspection.

**Senator WONG**—The creditors can with the administrator.

**Mr Smith**—Yes.

**Senator WONG**—Just to clarify this, you are proposing certain changes regarding the powers and composition of the committee of inspection.

**Mr Smith**—Correct. We are trying to, if I may, just give them some extra incentive to be on that committee of creditors or committee of inspection. Our past experience has shown that people feel that it is just an appointment, they do not receive any additional benefits and they are not called upon for their so-called expert advice.

**Mr Francis**—It is also a question of it being useful in larger administrations as a body of expertise for the administrator in the particular industry and as a check and balance in the sense of keeping a watch on the administrator. Part of the reason for giving it those additional powers is that, if the committee of inspection are dissatisfied with the performance of the administrator on the creditors' behalf, they ought to have the right to call a meeting to replace the administrator; otherwise, the general body of creditors is stuck with the director's nomination.

As you know, there are only two items of business at the first meeting—that is, to replace the administrator or to appoint a committee of inspection. But practicalities are that, if a director knows that there are unfriendly creditors, somehow or other their names inevitably get left off the list of creditors, so they do not have the opportunity to attend. If there is that sort of malpractice then one way of intercepting that is by the committee of inspection. If they are unhappy with a director's nomination, they can call a meeting so that the director's nominee can be removed. It is a safeguard against abuse. That there are abuses, I cannot provide you with any anecdotes. We hear enough suggestions that some administrators—remembering that administrators are not only members of the professional association but also people who are not—are too closely identified with directors' interests rather than with creditors', and that is an abuse. That is not what is intended by this scheme. The additional powers to the committee of inspection are seen as a check on that potential abuse and a safeguard on creditors' rights. That is the rationale, isn't it?

**Mr Smith**—Yes.

**CHAIRMAN**—I notice you do not support the proposal put to us by some that corporate and personal insolvency laws should be merged. Do you want to keep them separate?

**Mr Smith**—We believe that the current VA—and this is from a credit manager's perspective—works well now with some minor changes and some possible additions. The Bankruptcy Act appears to work very well. We are really concerned that to try and merge those two pieces of legislation into one would become extremely costly and would probably be debated for many years into the future. I do not know if it would ever gain any exceptional or increased powers.

**Mr Francis**—It is fair to say that it is a matter of just being not pragmatic—the thought is that it is unlikely ever to be achieved—but also something that our constituents and fellow members of the committee did not think worth spending any time on. They were more concerned with the way the current legislation impacted on them as practitioners.

**CHAIRMAN**—Another issue that we have discussed—and you may have heard some of the evidence earlier from Mr Jones—was the way in which the voluntary administration procedures are being misused or abused. It is a cheaper way of putting a company into liquidation than the alternatives. It is being used in that way rather than as a means to keep a company going and, if you like, to turn a company around—as perhaps was the original intention of the voluntary administration procedures. Do you have a view on that perception of VAs? Also, do you have any view on whether an administrator is brought in early enough to turn a company around? The view has been put that the current regime does not provide incentives, or certainly does not encourage sufficiently early intervention, to get a company turned around in time to maintain its operation. It always occurs at the end when it is too late to do anything other than, in effect, to liquidate the company.

**Mr Smith**—In answer to the first part of that question, it is possible and it is widely known that certain sectors of the industry and certain creditors use VA as a cheaper means of liquidation. That being the case, it still provides that the assets be placed immediately under the control of somebody who is independent, retaining the directors for that length of period and giving the creditors the final say on whether they accept a deed of company arrangement or allow the company to go into liquidation. So I believe it to be fair.

On the second issue of timing—we have argued this for 10 years—we initially thought, from a credit manager's perspective, five days would be far too early. But in retrospect it works magnificently, with respect to where the notices are despatched to and the time period for receiving those notices. Somebody who is independent needs to take control of the assets, their control to be effective immediately upon the deed being signed, and they have the obligation and the personal liability to make sure that they meet that obligation. We have no problems with the time period. If an extension is needed, there is plenty of time for there to be an extension of a further 60 days. I cannot recall any application for extension being rejected. I think it works very well and I do not think it requires any change whatsoever.

**CHAIRMAN**—Your answer has addressed another question I was going to ask, which was about the time frame for meetings. I was actually asking about the timing of intervention—getting someone into the company to try and sort it out. We have been told that in virtually all instances directors leave it to the last minute to call in an administrator and it is then too late to do anything other than, in effect, in most instances, liquidate the company. This morning the business turnaround people putting their case for regenerating and turning a business around—getting it up and going and surviving and flourishing rather than having it go into liquidation.

When I asked about timing, I was asking about it in that context—whether the current regime encourages sufficiently early intervention to prevent the need for liquidation to occur.

**Mr Smith**—On that point it is my view that intervention by the directors will activate it. The only other alternative is for professional credit management to recognise the problem and bring it to the attention of the directors of a company and use their influence as a supplier to try and promote the company, which is in trouble and unable to pay its debts, to go and seek professional independent advice. It is not up to our profession as a supplier to simply say, 'We feel you're in trouble; we're going to direct you to this VA.' That decision will be made independently by the directors. Good credit management people in the trade will often promote the idea: you need professional advice; go and seek it.

**CHAIRMAN**—Do they do that informally as part of their relationship with the company?

**Mr Smith**—Yes, they do.

**CHAIRMAN**—How often would that advice be picked up and acted on?

**Mr Smith**—I go back to a case where perhaps three or four weeks ago I was invited in to talk to a company with which my former company had a wholesale supplier-client relationship. I went in and spent an hour with the directors; I looked at their financial statements. I noticed that the directors over the past three years had injected $1.8 million out of their personal funds into the company and that the company had over the previous two years lost about $1.2 million. They just kept feeding the company in the hope that it would one day get out of its problems. My professional advice to them was simply, 'Go and get an independent view; go and talk to a VA, because you should have done it two years ago.'

In that particular case the supplier had continued to supply credit well outside its normal terms and, in fact, allowed that debtor company to get into the position where it simply ran out of money. The directors had the interests of the company and its employees at heart. But, after selling their homes and borrowing from their superannuation, they got to the final stage where the $1.8 million they had put in had gone and they no longer had any assets. That company was subsequently put into a VA. The VA was voted on by the creditors with there being only one objection to it. The directors wrote off their $1.8 million but now have control of the company and a deed of company arrangement. Early intervention is what we need to get out there.

**Senator WONG**—You have made some technical suggestions to some of the processes, and I wanted to raise a number of issues in relation to your submission with you. Currently, at that second meeting of creditors, is there a requirement for a draft deed to be provided prior to the decision meeting?

**Mr Smith**—That is correct.

**Senator WONG**—So what you are proposing—presumably because you think creditors ought to have the opportunity to consider it in detail—is this draft deed, and then only the draft as amended at the second meeting can be executed?

**Mr Smith**—Correct.

**Senator WONG**—Is there a concern that that is directed at? What is the mischief that that proposal is directed at? Is it because you feel creditors at that second meeting are often presented with a deed that they have not had sufficient time to consider?

**Mr Smith**—My view is that on occasion the draft deed is not available at the second meeting. It is not supplied to creditors at the second meeting in all cases.

**Mr Francis**—Can I say that that would be the exception rather than the rule.

**Senator WONG**—That problem?

**Mr Francis**—Yes. Almost never do you get the deed.

**Mr Smith**—Correct. Our suggestion is: provide the draft deed pre the second meeting on a web site so that people can call and look at it.

**Senator WONG**—Currently, if it is not provided at the second meeting, what is the requirement in terms of having it executed?

**Mr Francis**—Within 21 days following the meeting, but the details are not known to the creditors. There have been provisions stuck in deeds which have not been approved by the creditors, and that is very cumbersome and expensive to do.

**Senator WONG**—And they become effective regardless?

**Mr Francis**—Yes.

**Senator WONG**—What are the downsides then of having creditors have essentially the veto rights, because that is what is implicit in your proposal?

**Mr Francis**—It is simply a matter of machinery, isn't it. They have got the right to vote on one of the three proposals now—one is to go into a deed of company arrangement—but they are actually going into the deed blind.

**Senator WONG**—Sight unseen. What you are suggesting makes sense to me. In relation to the estimate of fees, currently is there any requirement for fees to be estimated?

**Mr Smith**—It depends on the VA, if I could be so crude.

**Senator WONG**—As a matter of practice, people do, don't they?

**Mr Francis**—Those who subscribe to good practice, yes.

**Mr Smith**—For example, the IPAA suggest it in their code of conduct. At the last meeting I attended less than a fortnight ago, the VA stood up and said, 'I suspect the cost will be $40,000 up to that point in time, but if the DCA goes through, it will be $60,000.' Then, later on when the deed is signed, the add-on was 'Plus disbursements are to be added to that.' But the general body

of creditors or the directors of the company did not hear that statement. So we are trying to say, if you are going to appoint somebody as the VA, give us an idea of what the costs are going to be.

**Senator WONG**—It does not seem to me to be unreasonable. Most professionals have to give you some estimate of your costs.

**Mr Smith**—Correct.

**Mr Francis**—It is a question of transparency.

**Senator WONG**—Yes. In relation to the prohibition on entering VA when the company is in provisional liquidation, I presume what you are trying to avoid there is the directors appointing someone they think is trying to go down the voluntary administration path and appoint someone they would prefer as opposed to a liquidator. What is the mischief that is aimed at?

**Mr Francis**—That is it. That is related to the other suggestion that once the creditors have felt that the company has got to a situation where they have to commence winding up proceedings then it ought to be left in the creditors' hands.

**Senator WONG**—And they do not want, given where the company is at, the directors then having the power to appoint somebody else?

**Mr Francis**—Correct.

**Senator WONG**—I think the seven days notice for the committee of inspection calling a meeting for the purpose of replacing an administrator is reasonably self-evident. What is the prohibition on related parties? Is there no current prohibition against related corporate entities being members of the committee of inspection?

**Mr Smith**—The related parties—

**Mr Francis**—Not that we are aware of.

**Mr Smith**—The short answer is no. I can give you a scenario where the creditors are worth $2 million and the directors have injected $1.8 million. They can simply pass that vote without any other reference to the creditors, providing the administrator or the VA appointed by them confirms that they are entitled to vote at that meeting.

**Senator WONG**—So who would be utilising the definition in 228 capture in those circumstances?

**Mr Francis**—You would exclude family members and their entities, so it is really only going to the committee of inspection. Barry's case is one where there is legitimacy, but it is often suggested that some of the family debts have not appeared in the books before, yet they do at the VA. That can be because people have not documented loans—I agree with that—but there can also be other more sinister reasons in an attempt to control the administration. That is very difficult. It means that the general body of creditors who usually provided the funding to the

company's operations have a chance to have control, to have a check and balance, over the administrator, rather than related parties. Again, it is a question of checks and balances.

**Senator WONG**—What are you referring to when you say there is a need for administrators to put forward realistic deeds of company arrangement?

**Mr Francis**—I will leave that with you, Barry.

**Mr Smith**—There are some deeds that really, in our opinion, just should not get off the ground.

**Senator WONG**—One practitioner commented yesterday that his experience was that there was a deed where he could not see any reason for the deed—and obviously he was acting for the particular creditor involved—other than to subvert the rights of his client. Is that your experience on occasion?

**Mr Smith**—That is what we are getting at, yes. We have found certain deeds that have been presented to creditors on the basis that 'there will be no payment, that personal guarantees be removed and that the company enter into a deed of company arrangement on the basis that on the sale of a friend's property we may receive one cent in the dollar'.

**Senator WONG**—What regulation is there currently of the content of a deed of arrangement?

**Mr Francis**—In broad terms, it is partly in the act. I cannot give you chapter and verse. It is also in the regulations. But that is for more formal matters. Really, Barry is looking at whether a business plan is a goer.

**Senator WONG**—My recollection is that there is regulation as to procedure and formality, but not to the principles around content.

**Mr Francis**—There are some content things. The standard deed, for example, provides that the order for distribution under section 556 of the Corporations Act remains unchanged so that employees have priority. But Barry is talking to the business aspects of it.

**Senator WONG**—That does not prevent a deed that alters that priority being priority executed.

**Mr Francis**—Correct.

**Senator WONG**—What would you be suggesting in terms of legislative change—something purposive or a test as to reasonableness?

**Mr Smith**—I really do not know if you can make it a legislative change. We are saying that, with regard to the professional conduct of the VAs, we need to see that they lift their game a little bit. If your organisation has sales of $80,000 and you are projecting in a business plan sales of $200,000 overnight with a reduction of 80 per cent of your staff, it is not feasible. So we are simply saying, 'Go back to the associations, the bodies, and ask them to take a realistic look at exactly what their codes are.'

**Senator WONG**—My recollection is that you do support the inclusion of some sort of code of conduct or code of ethics in the act, don't you?

**Mr Francis**—Yes, we do.

**Senator WONG**—So that would be how you would see this matter being resolved.

**Mr Francis**—Yes. I do not know whether we said that, but it would probably require that all administrators be members of the IPAA, unless there is some other professional body with a code of conduct—that is, unless the code of conduct is in the regs.

**Senator WONG**—Which is one of the issues that have been put to us. Would you have any difficulty with having an industry code of conduct in the legislation?

**Mr Smith**—I think it would be very difficult to get the workers of the VA to agree on a code of conduct, but I think something has to be done.

**Senator WONG**—The IPAA already has one.

**Mr Smith**—Correct. We have no problem with that.

**Mr Francis**—Not only do we have no problem; we support that.

**Mr Smith**—Correct.

**Senator WONG**—Leaving aside whether or not you could get them to agree, because it is probably not the most important issue, if you could pick up something along the lines of the IPAA and put it in the act or the regulations, would that be a positive thing from your perspective?

**Mr Francis**—Yes, it could be a schedule.

**Senator WONG**—One of the issues that was raised by Mr Jones—I think you were here for that—was directors lodging bonds. That just occurred to me because that would be an alternative to levying incorporation and annual returns.

**Mr Smith**—The view of the credit people was that people are going out there and registering or incorporating companies with $1,000 these days. It is better to have a higher figure on the incorporation, in our view, and let us say it is an arbitrary increase of $200 on an incorporation. Then, again, an arbitrary figure of $20 is put on the annual returns which are going to be submitted in the future. Somebody has to take control of these companies that have no assets—I will go through phoenix later—that take creditors' money and then basically go into a reasonably easy scheme to be put into liquidation.

**Senator WONG**—What would those funds be utilised for?

**Mr Smith**—To make application or a submission to the ASIC, either through the VA or the liquidator of the company, where he feels he has grounds for pursuing the directors for insolvent trading or any of those other director breaches.

**Senator WONG**—So this is essentially to fund litigation for breach of directors' duties?

**Mr Smith**—Yes.

**Mr Francis**—It is not just for litigation but perhaps investigation as well.

**Senator WONG**—Is it your perception, because it has certainly been raised with us, that there are many occasions where there is a possible breach that is not investigated and/or not prosecuted?

**Mr Smith**—It is our view totally, and I think the ASC have confirmed in the past, that it is a matter of funding. This goes back to the Harmer report in 1982 and 1988. We started talking back then, but no-one is taking it forward.

**Mr Francis**—I have been to presentations and I have spoken to ASIC officers and it is a question—like hospitals and triage—of working out what you can do best and not everyone can be dealt with. So they have priorities and they only allocate it to certain matters, and it is usually the large matters.

**Mr Smith**—Not only should it be ASIC, but our suggestion is that part of that funding, if a submission has the correct bells and whistles on it, should allow the VA or the liquidator to do that.

**Senator WONG**—Would you give them right of prosecution?

**Mr Smith**—Yes.

**Senator WONG**—How widespread do you feel the failure to properly investigate and/or prosecute is?

**Mr Smith**—I would say that is a very hard question to answer. I am trying to think of it in numbers rather than dollars.

**Senator WONG**—How about this way: do you think it is more often than not that it is investigated properly and/or prosecuted, if appropriate, or do you think that is the exception rather than the rule?

**Mr Smith**—I do not believe they do anywhere near the amount of prosecutions or investigations.

**Mr Francis**—My experience is that it is very much the exception rather than the rule, and I am speaking as a practitioner. I am a lawyer and insolvency practitioner. I wind companies up, and I have dealings with liquidators subsequently. I would have thought that, in more than the majority of the cases by far, they say these are matters requiring further investigation, that they

did not have the funds, that they have written to ASIC, and essentially they are just going to put it to bed.

**Senator WONG**—When you say 'matters requiring investigation and/or prosecution', are we talking about conduct of administrators, conduct of directors or both?

**Mr Francis**—In a liquidation scenario, generally speaking, being a court liquidation, we are talking about the conduct of directors and whether there is insolvent trading and often preferential payments to creditors.

**Senator WONG**—That was the next issue I was going to raise.

**CHAIRMAN**—Before you do that, Senator Wong, I have a question on the fees. Would you envisage levying those across the board on all companies or only on companies that are engaged in some sort of trading activity? Would you levy it on mum and dad companies that are simply used for investment or holding assets?

**Mr Smith**—I think we would levy it on all. Any company is subject to insolvency or liquidation and therefore every company should meet its dues.

**Mr Francis**—Can I just respond to the suggestion about a bond. It occurs to me that the way that is traditionally done is usually by a bank, and a bank normally requires assets to hold against the bond, unless it is a short-term bond like an insurance bond or a deposit guarantee bond. This is obviously something that is intended to be held long term as a security. One of the real problems we are talking about is people who do not have enough assets in the first place. So effectively whatever sum you set they are going to have to set aside assets to meet that. It just seems unlikely to occur.

**Senator WONG**—But it does avoid the argument that this is an additional tax on business activity.

**Mr Francis**—It does.

**Senator WONG**—What you are essentially proposing is further levying business on what are in the majority of cases legitimate business activities.

**Mr Smith**—Correct. Unfortunately, that is a sign of the times, because we only have to turn around tomorrow and there will be another tax that will come down on us. The whole point is, if you are going to incorporate a company and you want that company to stand alone with personal liability under the shelf of that company, then there has to be some means of protection for creditors.

**CHAIRMAN**—But the fee you pay already should be adequate to cover that.

**Mr Smith**—Yes, it could be.

**CHAIRMAN**—Why should you increase your annual fee?

**Mr Francis**—I guess because there has been no quarantining of the amount. This is a problem that goes back to Saloman's case at the end of the 19th century. It is not a new problem and yet thus far there has been no assetless companies fund, and there have been numerous proposals over the few decades that I have been involved in this sort of thing. So, yes, a bond would do that.

**Senator WONG**—But you are talking about something that is more than an assetless company fund; you are talking about a fund that ASIC can use to investigate and prosecute those matters which you think it currently should deal with but which it fails to deal with, because of the lack of resources.

**Mr Francis**—Well if there were assets in the company the administrator would do it. If the administrator thought that the directors had available assets, then administrators would go to commercial sources for funding to do that.

**Senator WONG**—And currently do.

**Mr Francis**—Yes. That is why I say they are only confined to assetless companies.

**Senator WONG**—Regarding the right of prosecution that you raise, Mr Smith, are you suggesting in relation to assetless companies that this fund would enable the liquidator to take what would otherwise be an uncommercial litigation—is that what you—

**Mr Smith**—Yes, to recover a civil—

**Senator WONG**—Yes. You raise the issue of preferential payments. One of the issues that was raised by a witness yesterday was a suggestion that the current definition of an uncommercial transaction or the current provisions relating to uncommercial transactions require as a threshold that the company is insolvent at the time of the transaction in order for that money to be recovered. His view was that the pre-existing legislation and also the Harmer report actually had not envisaged that threshold issue being required—that you could actually examine uncommercial transactions even if they occurred prior to the company technically being insolvent. It is a rather technical point, but I wondered whether you had any knowledge of it or any comment about it. If you want to take it on notice, I am happy for you to do that.

**Mr Francis**—We actually looked at it and passed over it because I think the view of our particular subcommittee is that we have had no exposure to it.

**Senator WONG**—Okay.

**Mr Smith**—If I could come back to you on that, there is a particular issue here that I think we could bring up.

**Senator WONG**—At some point we might be able to provide you with the submission where this is discussed.

**Mr Francis**—If you can tell us which one it is, we can identify it on the web site.

**Senator WONG**—I am not sure. It was one of the ones yesterday. We will have a look at them.

**Mr Francis**—But I would have a general philosophical question about that and that is that I really think that if a company is solvent then, unless it is doing something that is otherwise illegal, I am not sure why, if the directors want to do something uncommercial, they cannot do it, so long as they do not impact on the rights of others.

**Senator WONG**—I think the point was made that this is actually about fair worth. And if a transaction in which the company has not received fair worth for its consideration has been clearly performed or engaged in then why should the fact that it happens to be before you could technically argue that the company was insolvent alter the nature of what legal rights can attach to the transaction?

**Mr Francis**—A pre-insolvency asset stripping?

**Senator WONG**—Essentially. I think that is what he was directing it at, yes.

**Mr Francis**—Okay.

**Senator WONG**—The peak indebtedness rule—where is that currently? Is that a common-law formulation?

**Mr Francis**—It is common law, yes.

**Senator WONG**—Is it picked up in the statute anywhere? I do not recall it.

**Mr Francis**—No, it is not.

**Senator WONG**—Okay.

**Mr Francis**—I am probably the one to answer this.

**Senator WONG**—Is it currently applied as a matter of practice by administrators?

**Mr Francis**—Yes, it is. Not only that but it is applied all the way up to the Supreme Court and beyond. It actually came out of a decision by Sir Garfield Barwick—

**Senator WONG**—That long ago?

**Mr Francis**—yes, that is right—and it is just a common-law gloss.

**Senator WONG**—Which avoids the parri passu principle.

**Mr Francis**—It does. If I can just tell you a little bit about it for a minute.

**Senator WONG**—I did read this.

**Mr Francis**—It was Rees v. Bank of New South Wales. In one paragraph Sir Garfield Barwick talks about the way you work out the preference, which is that you add up the income, take off the outgoing, and if there is any difference then that is the amount of the preference. In the very next paragraph he says, 'But of course a liquidator can choose a peak indebtedness.' That completely negates—

**Senator WONG**—The first paragraph!

**Mr Francis**—That is exactly right. And the illustrations I have given I think show why it does not work fairly and does not promote what is in fact informal assistance given by creditors to companies to keep them going where they do have short-term liquidity problems.

**Senator WONG**—Is the ultimate effect doctrine, though, tainted by an imprecision that perhaps peak indebtedness is not? Do you think there is any argument that at least you can pick a point and it is reasonably precise and it is transparent?

**Mr Francis**—No, I do not agree with that. You already have an arbitrary period, which is a maximum of six months from the relation back day. So you have an arbitrary period there. You just add up in that period what went out and what came in. The difference, if any, is your preference.

**Senator WONG**—What would an insolvency practitioner say to this? Is it something you have discussed with them?

**Mr Francis**—No, I have not. I am a lawyer insolvency practitioner; you want an accountant insolvency practitioner.

**Senator WONG**—An administrator or a—

**Mr Francis**—When they write to people, they generally just look at the money that has gone out and do not try to work out the difference. I am looking at the commercial effects, in that it is unfair because it promotes an adherence to form. For example, somebody could do cash with order or COD and that would be unchallengeable, whereas if somebody just required people to adhere to their credit terms either immediately or over a period of months, with exactly the same amount of products supplied and money received, they will be penalised for doing that because of the peak indebtedness rule. I do not think that is what is intended by the legislation. It does not treat creditors equally and it is unfair.

**Senator WONG**—On page 4 of your submission, you make a recommendation about point 1.88 of the issues paper. Would that require legislative change—that is, being able to utilise unsecured assets and liabilities of two or more group companies?

**Mr Smith**—That is the pooling of the funds for the associated companies?

**Senator WONG**—Yes.

**Mr Smith**—I believe it does. It was part of one of the recommendations in the discussion paper, but it would not require legislation.

**Senator WONG**—The last thing I want to raise with you is deeds of company arrangement. You say you do not support the ATO suggestion at point 1.36—I do not have their submission here with me. Are you opposing their suggestion that a discriminatory deed—that is, a deed that alters the priority arrangements—ought not be permitted?

**Mr Smith**—Yes.

**Senator WONG**—Why?

**Mr Francis**—That is part of the genius of this particular type of organisation. It will happen that there are companies which go into administration because they might have multi-sites and some sites are trading well but there might be one or two which are trading poorly. In order to be able to keep the company going, the site that is trading poorly has to be got rid of, so you have a problem there with a landlord. As for the problem with the landlord, you are going to have to keep paying the landlord only on the sites that are trading well; otherwise, you will be out of possession of the premises, so there is the discrimination. The proposal must propose that for sites which are trading well landlords be paid in full. As for the sites which are not trading well and you want to get rid of, the landlords just rank with the other unsecured creditors, so that is inherently discriminatory against a particular class of creditors.

**Senator WONG**—You are saying the ultimate benefit makes that worth while. Do you think there should be some sort of reasonable person test that a reasonable person would be of the view that it would be in the overall interests of the company and its creditors?

**Mr Francis**—I think in a sense you have that now, haven't you, because in a reverse way there is a section—I think it is 445D—which allows those to be set aside?

**Senator WONG**—But the problem with that, and this is what has been put to us pretty regularly, is that enforcing their rights requires people to actually engage a lawyer and engage in potentially quite expensive litigation in order to set a deed aside. I am wondering if it would be better to turn it around and have a threshold so that you have some sort of test that you require an administrator to turn his or her mind to.

**Mr Francis**—Assuming you did that and they did not, what is the remedy?

**Senator WONG**—You would still have to go to court, but the issue here is that there is nothing clearly in the legislation which says 'you can only do this if'. To be honest with you, most of the evidence from insolvency practitioners is that their practice would be that they would not recommend a deed that altered the priority of the case currently set out in the legislation.

**Mr Francis**—Certainly as it is affects employees I think that most creditors would feel that way too, but as between other classes of unsecured creditors I think there is a case for it.

**Senator WONG**—Do you think then that in relation to employees, because this has been raised, there should be some protective provision in the legislation that would prevent a deed which altered the priority position of employees unless the majority of employees agreed?

**Mr Francis**—If the majority of employees—who are not related parties—agree, yes.

**Senator WONG**—Yes, we are assuming they are not related.

**Mr Francis**—There is one other aspect of our submission which you have not touched on.

**CHAIRMAN**—I am just working through it now to see what we have missed.

**Mr Francis**—Perhaps we could speak briefly to that.

**CHAIRMAN**—Yes.

**Mr Smith**—It goes back to the RATA, the report as to affairs of the company. It is at point 1.18 on page 1. We have suggested:

> Automatic transition into a creditors voluntary liquidation if the Report as to Affairs (RATA) is not lodged with ASIC within 7 business days from the first meeting of creditors.

So the first meeting of creditors has taken five days and then we have an additional seven business days. A director who is trying to put his company under administration surely has an obligation to have some current detail available on exactly where that company stands. We constantly hear as one of the criticisms from the administrators that they cannot get the directors to lodge their statement, their RATA. We feel that there has to be a stiffening of the rules and the legislation that says that if you, first of all, wish to appoint an administrator you must be able to provide him with certain information and that that information, if not available at the first meeting of creditors, should at least be able to be discussed; if it is not available within seven days after that period, then the company should be placed into creditors voluntary liquidation. That may be deemed as hard, but how can a director of a company who believes he has a problem—that he may be insolvent—but that he may be able to trade his way out make that assumption without having a report as to affairs?

**Mr Francis**—I was going to take this up in the answer to the chairman's question about early intervention. Our observation as people involved in the credit granting industry is that the majority of administrations are for relatively small companies. They probably come about as a result of the serving of notices by the Australian Taxation Office, making directors personally liable for unpaid group tax. This provision may well be limited to that as perhaps a by-product, but in those circumstances the directors are seeking to avoid personal liability. If they are doing that, as Barry said, it is incumbent upon them to provide creditors with enough information to be able to make a realistic decision.

If it is a tight time frame, so be it, because they are the ones that are getting the benefit. The benefit is in avoiding not only personal liability for that notice but also investigation of whether there have been insolvent trading actions and the like. So there is a definite benefit to directors. There also ought to be a concomitant responsibility to lay all the information before creditors. It is a provision which has teeth. I can see that in major administrations, such as Ansett, One.Tel or something like that, that could be a problem. As I understand it, Mr Packer had his own investigating accountant in One.Tel and they still could not work out what was going on, so there may be circumstances where it could be a problem.

It may be a situation of a director seeking to get the benefit of it as a result of being served with a personal notice from the ATO. It might be restricted. I am just saying that as a personal view, but it is a common complaint that creditors are feeling that they are left in the dark. The directors are the ones who have got the information and, as creditors, we are not being given it. The directors want the benefit of the VA, which avoids personal responsibility. That can mean that they have got more time and they can get on to their accountant. Often these administrations are preceded by meetings with the VA, as you would appreciate, and the first thing the potential administrator will say is, 'Your accountant will have to get your books up to date.'

**Senator WONG**—What is the current sanction?

**Mr Francis**—There is none.

**Senator WONG**—None at all?

**Mr Francis**—There may be an administrative sanction by ASIC for failing to lodge.

**Senator WONG**—Yes. I was going to say that. I assume there must be a failure to lodge or something.

**Mr Francis**—Yes.

**Senator WONG**—But it is insufficient in the circumstances.

**Mr Francis**—It does not get the information before creditors.

**CHAIRMAN**—I note in your submission that you support the Cole recommendations with regard to phoenix companies. Do you have any first-hand experience of phoenix companies? If so, could you perhaps enlighten us on those experiences?

**Mr Smith**—We do not have any currently but we have seen it in a supplier retail environment on many occasions. The forum puts up submissions to different bodies every time the word 'phoenix' comes around. It is the inevitable happening all over again. Admittedly, directors' responsibilities have been very much tightened in the last few years, and I think that has a tendency to get the pressure off when it comes to these people being able to open up shop. But, more importantly, the creditors have got to decide whether they want to go back in and provide credit facilities to these people and companies again. The reality is that, invariably because of competition or need, they just seem to go back in. They feel as if they are comfortable. They might have guarantees or some other financial security, but invariably anybody who sets up to defraud creditors should be prohibited from becoming a director. The current rules are adequate. We have made that commitment from a practical point of view. We have just got to try to keep an eye on these characters.

**CHAIRMAN**—Do you have any additional comments, Mr Francis?

**Mr Francis**—Not on that, no. Most of my experience of that relies on the anecdotes of others or seeing the same names cropping up as directors of companies.

**CHAIRMAN**—Will the Cole recommendations be adequate to deal with the issue?

**Mr Francis**—It is looking at it from many modes and cross-linking and networking it where you have got some sort of intelligence network and a chance perhaps to nip that sort of activity in the bud. Credit grantors do it informally now. They have been a little constrained by the Privacy Act, perhaps, but certainly they try to do that. But the first thing I learnt in first-year law school was that the most successful con artists are always the most plausible. The more difficulties you place in the way of people indulging in fraudulent activity, I imagine the greater the chance is that you will prevent that activity.

**CHAIRMAN**—I do not have any further questions.

**Mr Francis**—I would like to put on my other hat for a minute and, for the purpose of the record, announce that I am the principal of Francis Commercial Lawyers. I am a lawyer insolvency practitioner and a fellow of the Australian Institute of Credit Management. I appear as Chairman of the Law and Legislation Committee of the New South Wales division of that institute. I think you are probably aware of the work of the Institute of Credit Management on its national basis, and I will not go any further on that. The only matter in addition to what has been covered by the ACF that I would like to draw your attention to is that the institute, unlike the forum, thought there was some scope for extending the initial period because of the pressure on timely gathering of information and notification of creditors. They proposed that it be extended.

**CHAIRMAN**—Eight days, is it?

**Mr Francis**—Yes, that is right. But they were a bit tighter on the requirement. They also said that if the RATA were not filed by seven days then the only item at the first meeting was to put the company into creditors voluntary liquidation.

**Senator WONG**—A big stick!

**Mr Francis**—It is a big stick, but this provision of information is vital. Creditors are not getting it. It helps administrators. If there is fraudulent use of the system then that sort of sanction is probably needed. The only thing I might go back and speak about is the peak indebtedness ruling and point out that the current legislation—and I know this will not come out in the transcript, but the only way I can do it is to use my hands—is to say that it provides for a single transaction. If all transactions—and it is referred to in the submission—for the relevant period, which might be up to six months, are treated as a single transaction then that must be the ultimate effect that you are looking at for that single transaction. It introduces an element of artificiality to say, 'We know we have a single transaction but, somehow or other, notwithstanding what the legislation says, somewhere in there we are just going to pick the point of peak indebtedness.'

It may well be resolved judicially. As soon as I have the opportunity, I will certainly try to do that. But it seems to me that it is a gloss. It creates unfairness where creditors are trying to help a debtor in short-term financial difficulty, and those who are perhaps not as diligent in monitoring their credit limits or for example are persuaded to allow it to blow out are then going to be penalised as the company then goes into liquidation. I do not believe that serves anybody's interests.

**CHAIRMAN**—Thank you for that additional evidence, Mr Francis. Mr Francis and Mr Smith, on behalf of the committee, I thank you very much for your contribution to our inquiry.

**Subcommittee adjourned at 11.58 a.m.**