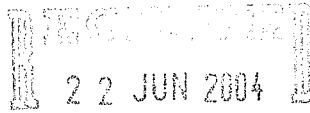




Ref: SDP:ADMIN

18 June 2004



BY: *Gillian Gould*

By Email: laca.reps@aph.gov.au

Honourable Bronwyn Bishop
Chairman
House of Representatives Standing Committee
on Legal and Constitutional Affairs

Attention: Ms Gillian Gould

Dear Ms Bishop,

**SUBMISSION AS TO BANKRUPTCY LEGISLATION AMENDMENT
(ANTI-AVOIDANCE AND OTHER MEASURES) BILL 2004 EXPOSURE
DRAFT**

BACKGROUND

I am a chartered accountant practising in insolvency, a registered trustee in Bankruptcy and an Official Liquidator. I attach a copy of my short form CV as annexure B. I was encouraged by the Ministers speech announcing improvement of trustee's recovery powers aimed at voiding financial arrangements designed to shield assets from creditors.

The purpose of this submission is to comment on the operation of the provisions of the Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004 Exposure Draft ("the Draft") in light of the above goal rather than any policy considerations. In the time available I have only been able to comment on Schedule 1 of the Draft (amendments to the Bankruptcy Act ("the Act") relating to tainted property and tainted money).

The method of examining these provisions was to conduct a workshop at my office with specialist accountants and solicitors using a case study of an actual bankrupt estate and applying the Draft to the case study. I acknowledge the assistance of Philip Parker of Kemp Stang Lawyers, Ken Schurgott of Thomson

Business Recovery,
Reconstruction and
Insolvency Services

- > Corporate Insolvency
- > Bankruptcy
- > Investigative Reports
- > Security and
Pre-Lending Reviews
- > Turnaround Consulting
- > Work-outs & Restructures
- > Litigation Support
- > Government Consulting

Sydney

Level 24, Australia Square
264 George Street
Sydney 2000
New South Wales
GPO Box 5151
Sydney NSW 2001
Telephone 02 9241 3422
Facsimile 02 9241 3922
syd@simspartners.com.au
www.simspartners.com.au

Sims Partners' Offices

Brisbane

Level 11, 145 Eagle Street
Brisbane QLD 4000

Grafton

Level 1, 69 Victoria Street
Grafton NSW 2460

Port Macquarie

Suite 6A, Ground Floor
10-12 Short Street
Port Macquarie NSW 2444

Independent Firms
Affiliated with Sims Partners

Adelaide

Level 6, 12 Pirie Street
Adelaide SA 5000

Canberra

Unit 8, Rowland House
10 Thesiger Court
Deakin ACT 2600

Melbourne

Level 2, 446 Collins Street
Melbourne VIC 3000

Associated Independent Firms

Jessup & Partners
Townsville & Cairns QLD

Mc Donald Vague
New Zealand

www.simspartners.com.au

Liability limited by the
Accountants Scheme, approved
under the Professional Standard
Act 1994 (NSW).

Page 2

Playford Lawyers and Michael Studman of Sims Partners in conducting this exercise.

EXECUTIVE SUMMARY

My conclusion based on the discussion contained below is that the Draft fails to achieve the above goal in a number of significant respects.

Draft section 139AL is unlikely to have application where the bankrupt's services are mixed with other inputs, for example in industry or the majority of professional practises.

Draft section 139AI is easily avoided by investing in non personal use assets in a related entity's name.

The anti-avoidance provision (139AM) does not address either of these deficiencies.

Sections 139A, 139D and the Commencing provision also require minor amendment.

THE BANKRUPT ESTATE

I attach as Annexure A, a summary of the background to the estate of an actual bankrupt (all names have been changed for privacy reasons). As can be seen the bankrupt is employed by a private company owned and allegedly directed by his estranged wife. He is paid a below market salary of \$20,000pa. The bankrupt's wife also owns the family home, an investment property and the factory from which the business is conducted.

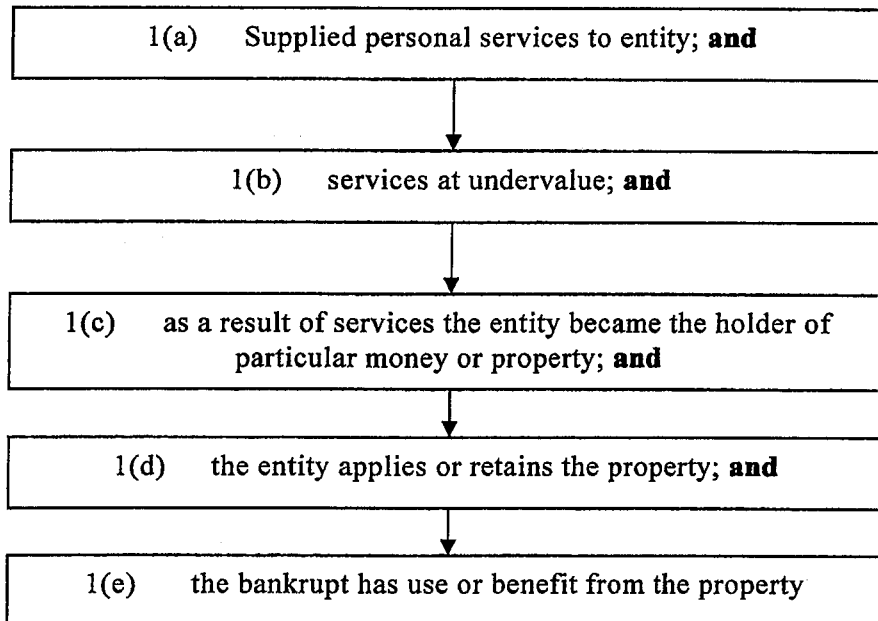
Under the current Act, as trustee I have been able to require the bankrupt to pay income contributions of approximately \$20,000 pa based on an equivalent market

salary. I have been unable to recover any of the other 'family assets' identified above.

SUPPLY OF PERSONAL SERVICES BY BANKRUPT

The starting point for recovery action is the Draft provision Section 139AL "supply of personal services by bankrupt".

The provision has the following code to establish whether property is tainted:



I have described the clause as a code as it requires that each of the 5 elements must be satisfied in turn for the provision to apply.

In the case study, the bankrupt admits to satisfying clause 1(a). I am satisfied that by reason of a review of my income assessment by the Inspector General, that I am able to satisfy clause 1(b).

The major difficulty however is satisfying Draft clause 139AL(1)(c), which reads

“at a particular time (the original acquisition time), the entity became:
(i) the holder of particular money (the original money); or
(ii) the owner of particular property (the original property);
as a direct or indirect result of, or of matters including, the supply by the
bankrupt of those services; and”

Accordingly the clause appears to require a tracing of monies received by the entity which are attributable to the bankrupt's supply of undervalue services. In the case of this entity, a plastics manufacturer where the bankrupt is employed as a manager, the manager's services form part of the company's overheads. The company ships quantities of products to customers and invoices them for these products. The invoiced prices reflect the company's costs of materials, labour, overheads and administration costs together with a profit component. The bankrupt's component of administration services is an unidentifiable fraction of the administration costs. Accordingly, upon receipt of payment for the company's invoices it is not possible to identify any **particular** money attributable solely to the supply of services by the bankrupt.

The further mixing of those funds upon receipt into the company's trading account from which payments are made for day to day expenses will make the identification of **particular** property a commercial impossibility.

Similarly if the link to original property cannot be established replacement property cannot be identified under clause 1(d).

It therefore appears that in the case of manufacturing entities, trustees will be unable to apply Section 139AL to make recoveries for the benefit of creditors.

If the Draft is to be amended to enable recovery in these circumstances **I submit that the drafters must remove the that the entity will hold particular (traceable) property as a result of the supply of services** such that if the

Page 5

bankrupt provides undervalue services and the entity holds property and money that property and money may be tainted.

At the very least I submit that the word “particular” should be deleted from the provision. The word particular must refer to an undesirable tracing exercise.

Clause 139AL(1)(e) is also problematical in the case study example because the bankrupt’s spouse is the owner of the shares in the company and accordingly she benefits from the company’s money, property and profits and the bankrupt does not.

PROFESSIONAL PRACTISES

Having determined that the Draft is unlikely to effectively enable recovery in manufacturing situations we then examined whether the flaws identified would also create limitations in recovering from high income professionals in practise.

Typically in relation to the majority of practises (other than sole traders), professional practises comprise several entities, for example, a partnership, a practise company, a service/assets company or trust etc. The service company typically owns the fixed assets and equipment utilised by the practise, charges a fee to the practise for this equipment and makes a commercial rate of return. Generally the professional’s spouse or family trust owns the shares or units in the service company. The practise company may also distribute dividends to family trusts and spouses.

The bankrupt does not provide personal services to the service company and accordingly income distributed through the service company cannot be tainted money (section 139AL(1)(a)) even if it is used to derive a benefit for the bankrupt.

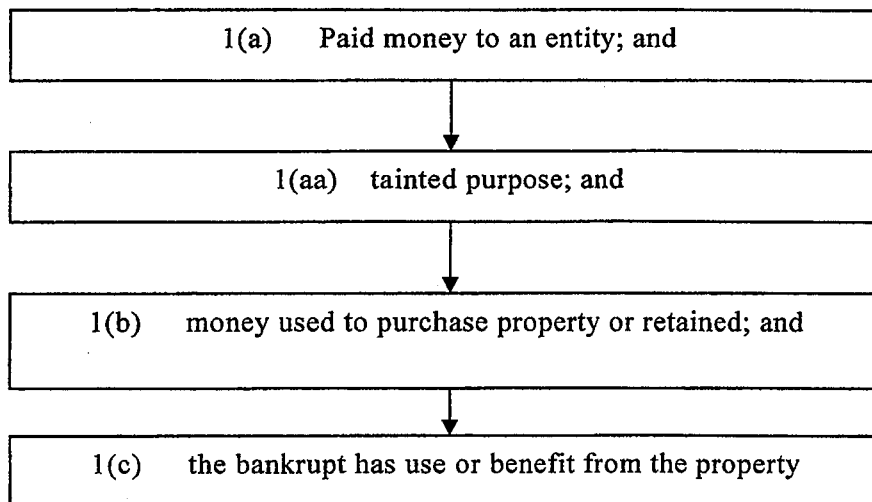
In relation to income from the partnership or practise company, again the real difficulty appears to be identifying money or property resulting from the

bankrupt's undervalue services. That is, invoices rendered will usually include both the services of the bankrupt and other fee earning members of the bankrupt's partnership and employees. These amounts are not necessarily identifiable in the invoices issued to clients. Upon receipt and banking to the practise's general account where the monies are mixed with other funds no **particular** money will be identifiable.

It therefore appears that **particular** money or property will only be traceable (and therefore recoverable 'tainted property') in circumstances where a practise has only the bankrupt as the fee earner.

TAINTED PROPERTY OR MONEY

Draft section 139AI provides a code for identifying tainted property and money. Again the code requires each of the conditions to be satisfied as follows:



Because the definition requires that **each of the elements must be satisfied** a simple avoidance mechanism is to ensure non-compliance with Section 139AI(1)(c). This can be achieved by simply purchasing an investment (for example shares) in the name of a spouse or trust where the bankrupt is not a beneficiary and ensuring the income from the investment is reinvested or paid to the spouse/trust. The Section will not operate in these circumstances even where the bankrupt is insolvent or has the intention of defeating creditors. **An indirect benefit should be implied where property is simply held by a related party with intention to defeat or delay creditors. Alternatively the property should vest to the extent that it would be divided in Family Court property proceedings.**

As a result the draft section 139AI has the effect of providing greater asset protection to investments made by the bankrupt on behalf of a spouse than payment towards the mortgage of the family home. This will distort investment decisions for the well advised. The definition of tainted property is therefore only likely to affect the naïve and poorly advised rather than the targeted high income professionals who have sought asset protection advice.

ANTI-AVOIDANCE

Draft section 139AM contains the anti-avoidance provision. Whilst this provision applies to any type of arrangement entered into for avoiding creditors or while the bankrupt is insolvent, **it also suffers from the 'tracing' deficiency in that it only applies to particular property or money. It also contains an identical benefit test** making avoidance under section 139AI simple. In my submission it therefore fails to overcome the deficiencies in section 139AL section 139AI.

OTHER AMENDMENTS

Section 139A

Section 139A provides for the trustee to commence action at any time within six years after the date of bankruptcy. **I submit that this time period should be consistent with the timeframe for the trustee realising other property.**

Section 129AA(3) defines the re-vesting time for property as 6 years from the date of discharge. The definitions could easily be aligned.

Section 139D

Draft section 139D provides for the types of orders which are available with respect to tainted property. This section allows for only the vesting or sale of the property and there is no provision for an Order for the payment of money. **I submit that section 139D should provide monetary orders as an available alternative.**

For example where the trustee is able to establish only a minority interest in jointly owned property Section 139D provides no discretion for an order to pay the trustee the value of the interest. In this circumstance the sale of the property may be forced on the spouse or other entity in order to realise a sum that the spouse could finance or pay. This is inequitable. The costs of sale, interest and other holding costs may also diminish the recovery to the detriment of the creditors.

Application of Amendments

I agree with the explanatory memorandum that the provisions will need to be retrospective to operate effectively. I note the application provision however provides for the Draft to apply to "all bankruptcies current on or after commencement of this item." The term current is not defined, inconsistent with other terms in the Act and likely to be the subject of different interpretations. **I**

Page 9

submit that "current" should be defined or the meaning aligned with other expressions in the Act.

I appreciate the opportunity to make these submissions and trust they will be of assistance. Unfortunately time constraints do not allow a more thorough examination of the provisions.

Yours faithfully

Sims Partners

A handwritten signature in black ink, appearing to read "S. Pascoe", written in a cursive style.

Scott Pascoe

Partner

Registered Trustee in Bankruptcy.

ANNEXURE "A"

Ref: SDP:CB:REDS01

Example of Bankrupt Estate and the Proposed New Amendments

The Background - Prior To Appointment

The major creditor, a chemical manufacturer, held patents and moulds for plastic bottle production. In about 1992, it incorporated a company ("company B") for the purpose of producing plastic bottles in non-alcoholic drinks across New South Wales. The Bankrupt was employed to undertake the operation on a salary package of approximately \$100,000 plus shares in company B.

By 1997 the relationship had deteriorated. On or about 20 March 1998 the Bankrupt left the company B premises with a substantial amount of plant & equipment which made the production of plastic bottles, normally 24 hours 7 days per week, inoperable until 1 April 1998. The major creditor commenced proceedings in the Supreme Court NSW on 26 March 1998 against the Bankrupt which were "substantially successful", which found that the Bankrupt was not a witness of truth. The judge found that the Bankrupt's evidence could not be relied on unless corroborated by written documentation. He said that the Bankrupt was plainly dishonest in accepting secret commissions, in seeking to conceal the commission from the company and the major creditor, in attempting to explain his reference to supposed services previously supplied to the payer of those commissions, and in falsely denying on oath that he received a secret commission.

Against the background of the deterioration of the relationship between the major creditor and the Bankrupt in 1997, the removal of plant & equipment from the company B premises and the subsequent legal proceedings in early 1998, the Bankrupt's wife incorporated a company ("company A"). Company A undertook the manufacture of plastic bottles in direct competition to company B. The bankrupt admitted that he controls all marketing, sales, invoice preparation and technical management of company A. Company A's gross manufacturing income increased rapidly from approximately \$68,000 in 1998 to \$880,000 in 2001. By 2003, the gross turnover is almost \$2 million.

Judgment against the bankrupt was obtained on 12 March 2001, a Bankruptcy Notice was served on 7 August 2001 and a Creditor's Petition was issued, returnable on 11 October 2001, but unable to be served on the Bankrupt. On 9 October 2001, the Bankrupt presented his Debtor's Petition and a Consent to Act for trustee G.

During the period 9 October 2001 to my appointment on 10 April 2003, trustee G repeatedly requests, but does not obtain, the income tax returns of the Bankrupt from 1999 to 2001. The Bankrupt still has not prepared or provided his income tax returns. Trustee G also did not obtain the

financial statements of company A or any financial or accounting documentation for company A. No statutory notices are issued and no further action is taken by trustee G.

My Appointment

The major creditor requested a meeting of creditors to approve my appointment, which is approved by ITSA on 10 April 2004. Relatively confident of realising potential assets and income given the information and documentation provided, I proceeded without any funding for investigations, arranging the issue of section 77C Notices in July 2003 to the Bankrupt, the Bankrupt's wife, company A and the accountant for company A. As none of the recipients complied, they were referred to Bankruptcy Fraud Investigation ("BFI"). BFI investigators visited the Bankrupt's wife at 11 am on a Wednesday in October 2003 to find her in slippers and a dressing gown at home, apparently contrary to her assertion that she worked 60 hours per week. The Section 77C Notices were ultimately partially complied with.

A number of other Section 77C Notices were issued to companies associated with company A. Documentation provided by company A's single largest client for the financial years ending 2000 to 2003 revealed that the Bankrupt signed all faxes (several hundred). The general manager and accountant for the largest client stated that all verbal and written communications were with the Bankrupt and no other person from company A.

Documentation provided by a bank revealed a copy of a Residential Tenancy Agreement by the Bankrupt and his wife as Landlords dated 7 June 2002 for undisclosed real property at Hamlyn Terrace, subsequently revealed to be in the sole name of the Bankrupt's wife but with the mortgage guaranteed by the Bankrupt.

The bank also provided a copy of a facsimile from commercial leasing brokers to the bank dated 30 August 2002 acting as agent for the credit application for a sale/hire/back to company A for equipment worth approximately \$600,000 stating as follows:

"Female Director has some 17 years experience in the Plastics Industry being a Foreperson and Quality Control Manager with both Vanleer Plastics at Blacktown and Minstral Plastics at Rydalmere.

Her husband (the Bankrupt) has some 30 plus years in the industry being a 'Technical' engineer having held Management positions both locally and overseas and has been involved in design and production of plastic extruding/blowing machines.

The (Bankrupt and wife) have married in past 10 years both being previously married, (the Bankrupt) is neither a Director or Shareholder the reason being he is a past voluntary bankrupt being discharged in 2001. The history behind this is that he was a minor shareholder/director in a company and he believed

the company had misrepresented the financial returns. He sued the major shareholder/director which set him back \$300k in costs plus lost the case on a Technicality and was in turn sued for other parties costs of \$450k. As a result he decided to seek voluntary bankruptcy, we believe all this can be substantiated by his solicitor.

Although properties in Asset statement are not in his name, wife only, he is prepared to sign Guarantee as he is heavily involved in the running and success of the enterprise.

We also mention the Factory houses machinery valued far in excess of that in 2001 Balance sheet as the Bankrupt has obtained machines worthy some \$1m from overseas contacts by way of 'Barter system' that owed him for design/construction of machinery in recent years."

Documents attached to the facsimile (and later investigations) show the wife's registered ownership of the residence at Green Point and the factory premises at Somersby Falls, in addition to the investment property at Hamlyn. You will find that the bankrupt is a guarantor of all mortgages on all three real properties registered in the Bankrupt's wife's name.

The documentation eventually provided by company A's accountant included, in particular, the personal Income Tax Returns ("ITRs") of the Bankrupt's wife for the years ending 30 June 1998 to 2002. Please note that the Bankrupt's wife disclosed her occupation in all five 's ITRs over a period of five years as "office secretary".

An agreement between a supplier to company A and company A dated 29 April 2000 was signed by the Bankrupt next to the company A seal.

A search of the Bankrupt's credit records held by Baycorp Advantage Information Services Limited on 14 May 2003 revealed that the Bankrupt is reported as the director of company A and has six entries for commercial credit applications totalling approximately \$541,000 from 10 July 1998 to 9 September 2002.

The Bankrupt lives at the company premises, which operates 24 hours a day 7 days a week.

SCOTT PASCOE

Scott Pascoe holds a Bachelor of Economics degree from the University of Adelaide. He was admitted as a Chartered Accountant to the Institute of Chartered Accountants in 1994, is a member of the Insolvency Practitioners Association of Australia (currently honorary treasurer of the NSW division). Scott is an official liquidator and a registered trustee in bankruptcy.

Scott is the author of Sims Partners' in house publication 'Insolvency Matters' and has written and published articles relating to bankruptcy and insolvency matters in various journals and publications. A schedule of published articles is attached.

Scott is a partner of SimsPartners and has practiced in the areas of corporate and personal insolvency and litigation support since 1991. Scott has prepared numerous expert's reports for the purposes of litigation, including economic loss calculations, valuations and solvency reports. A schedule of significant litigation and insolvency assignments is attached.

In the course of these assignments and as an insolvency practitioner Scott has been required to investigate and reconstruct the affairs of complex group structures and accounting entries.

SCOTT PASCOE

LITIGATION SUPPORT ASSIGNMENTS UNDERTAKEN

<u>Matter</u>	<u>Engaged By</u>	<u>Details of Assignment</u>
Eather v Advisor Investments Services & Cutler	Michelle Sillar	Calculate economic loss
Wily & Business Barter Exchange v Bartercard Limited	The Argyle Partnership	Valuation of Goodwill
Dyer v Guildford Rugby League Club	Moray & Agnew	Calculate economic loss
Applied Power Australia Limited v Abbey Hill	Baker & McKenzie	Valuation of Goodwill
Gordon Cockin	Baker & McKenzie	Examination of accounts
National Brake & Clutch Pty Limited	Argyle Partnership	Examine intercompany transactions
Active Care Pharmacies Pty Limited v Interach Australia	Walker Law Group	Quantification of loss
Allied Express Transport Pty Limited v Metal Manufactures Limited	Baker & McKenzie	Calculation of economic loss
Jual Pty Limited v G & P McElwaine	Dibbs Barker Gosling	Forensic review and loss calculation
Hudson Resources Limited v Australian Diatomite Mining Pty Limited & Anor	The Argyle Partnership	Calculation of economic loss
Body Corporate Services (NSW) Pty Limited	Liquidator	Solvency Report
Lewis and Doran Constructions v Doran and Ors	Turnbull Hill Lawyers	Solvency Report

LIST OF PUBLISHED ARTICLES

Title	Journal/Periodical	Date
What are Company Proxies For?	Australian Insolvency Journal	December 2003
Getting Noticed	CA Charter	December 2003
Should Administrators Preside in Person at the Second Meeting of Creditors? Section 439B(1)	Submission to Joint Parliamentary Enquiry	November 2003
Insolvent Trading: Director uses Garcia Defence	Journal of Banking and Finance Law and Practice	March 2002
Court Clarifies Quorum	New Directions in Bankruptcy	October 2001
Double Proof? Surety Not!	New Directions in Bankruptcy	March 2001
Bankrupts Behaving Badly – s153B Annulments	Insolvency Law Bulletin	April 2001
Consent Lament	Australian Insolvency Journal	December 1999
Tax Office Ordered to Split	Journal of Banking and Finance Law and Practice	June 1999
Divideth the Spoils – Recent Developments in Litigation Funding Insurance	Australian Insolvency Journal	September 1998

SIGNIFICANT INSOLVENCY MATTERS

As registered trustee in bankruptcy Scott has been appointed trustee in bankruptcy in more than 270 bankrupt estates since 1998. Together with appointments as receiver and manager and administrator, as an Official Liquidator Scott has been appointed liquidator by the Court in approximately 140 liquidations since 2000.

Recent significant assignments are listed below.

Matter	Tasks undertaken
Comark Pty Limited	Directors dispute involving the sale of restaurant
Galaxy Operations (LPW) Pty Limited	Shareholders dispute, trading and sale of three video arcade sites
Charterbridge Davey Limited	Administration of significant financial planning entity, sale of business and deed of company arrangement
Sydney Gay and Lesbian Mardi Gras Limited	Administrator of significant cultural event, deed of company arrangement
Pegasus Leveraged Options Group Pty Limited	Liquidator of managed investments scheme
Deceased Estate of Kut Szetu	Beneficiary dispute, significant assets and tracing of beneficiaries' interests
Fesca Pacific Gears Pty Limited	Negotiate with multiple secured creditors to settle litigation for the benefit of employees
Sports Australia Media Group Limited	Administration/liquidation of ISP, ASIC investigation into capital raising
Energy Equipment Engineering Pty Limited	Negotiate deed with administrator of related company, insolvent trading claim
Enterprise Versace Pty Limited	Trading exhibition, deed of company arrangement

Body Corporate Services (NSW) Pty
Limited

Investigations, Examinations and
preference recovery action against listed
parent

Northern Spirit Football Club (2000) Pty
Limited

Winding Up and trading National Soccer
League club