Jones Condon

Our Ref: MGJ/16/030617 ASIC/JT:AB
Reply to: SYDNEY OFFICE

18 June 2003

The Secretary
Parliamentary Joint Committee on Corporation & Financial Services
Room SG.64 Parliament House
Canberra ACT 2600

Attention: Kathleen Dermody - Committee Secretary

Dear Ms Dermody,

Re: Inquiry Into Australia Insolvency Laws

We refer to our previous communications and in particular your paper dated May 2003.

Our examination of the submissions and issues referred to in your paper discloses that my submission is submission 12.

Our submission mainly focused on the *"Appointment of Administrators by Directors"* and came to the conclusion that the status quo is preferable because not only does it work but, in spite of certain concerns which we consider to be minor, is the best system.

Our reading of your May paper has not changed my mind in this regard and in particular we wish to note the following:-

1. The submission by the Australian Taxation Office (*"ATO"*) that consideration should be given to a Roster System in the appointment of an Administrator is, with respect archaic and would lead to the destruction of the main purpose of Ron Harmer's amendments to the old Corporations Act. Among other things, even the Supreme Court has in most cases abolished the rotation basis for selecting Official Liquidators and is encouraging petitioning creditors to obtain the consent of Liquidators regarding their applications. Furthermore, the main theme of the Harmer report is to encourage directors to appoint Administrators who are not only independent and capable but also those with whom they can comfortably work. We must emphasise that these are not conflicting points because for an administration to succeed the co-operation of all parties is vital.

   Further, a roster system will not necessarily result in a firm with the available resources and necessary capabilities being appointed to a complex and large matter. There is a misguided view that an appointment of an Administrator by a Director results in a biased appointment and compromises the position of creditors. Our prior paper discusses this issue and came to the opposite conclusion. We reiterate that this method is not perfect but is the best of those available. To emphasise our point, we enclose a copy of an extract of a case called "*re Biposo; Condon v Rodgers (1995) 13 ACLC 1,271*".

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2. The Director in this case before Young J of the Supreme Court of NSW successfully challenged the appointment of an Administrator/Liquidator by a major creditor. The main issue being that the Liquidator/Administrator was working too closely with the major creditor and was not acting in the interest of creditors as a whole. In essence, it is only common sense to expect that a major creditor or any creditor would focus on their self interests and the reasons for them appointing an Administrator/Liquidator would be to ensure that their interests are protected. A major concern is always voidable transactions in which the major creditor could be a party. To even take this point one step further, secured creditors/banks are re-known for protecting and focusing on their own interests and not the interest of any other parties. We don't mention this with any disrespect but to emphasise the commercial realities of creditor self interest. The probabilities are that Directors who have strong duties and responsibilities to Administrators/Liquidators pursuant to Corporations Act are more willing to co-operate. We reiterate that the Courts are quite stringent in relation to any indication of bias or conflict of interest by Directors and their Appointees.

3. We also emphasise that your May 2003 paper mentioned supervision of Administrators/Liquidators appointed by Directors by creditors, Australian Securities and Investments Commission (*"ASIC"*) and the Courts. With respect, this is only part of the supervision. What was also stated in our recommendation was that there are quite forceful guidelines and statements of best practice by the Institute of Chartered Accountants, the CPA and the IPAA in relation to questions of independence and ethics. To endeavour to codify same in the Regulations or the Act is fraught with ambiguities and complexities as *"the devil is in the detail"* in trying to codify such issues. We reiterate that issues of bias and conflict of interest should be considered on the facts and no one is in a better position to make a fair determination of same than the Courts which have shown strong leadership and direction. The stringency of Court rulings in this regard is emphasised by their consideration of "*perception*" as being as important a factor as any actual bias/conflict of interest.

   We are in favour of sending a statement of independence to creditors prior to the first meeting of creditors. This is a practice which most firms, including ours, follow.

Should you wish to discuss this matter further please contact Mr John Tanna or myself.

Yours faithfully,
Jones Condon
Chartered Accountants

MICHAEL G JONES
PARTNER

(1995) 13 ACLC 1,271

Re Biposo; Condon v Rodgers

RE BIPOSO PTY LTD; CONDON v RODGERS

[1271]

Supreme Court of New South Wales (Equity Division). Judgment handed down 2 August 1995

Companies — External administration — Winding up — Removal of liquidators — Over-fraternisation with major creditor — Probability of preference dispute with creditor in future — Whether order removing liquidators should be stayed pending appeal — Corporations Law, sec 446A, 491, 503, 596A.

A company gave post-dated cheques to its largest creditor, C.A. Australia Ltd ("CA"). Two months later, the directors of the company appointed an administrator. At a creditors' meeting of the company, the administrator appointed by the company was removed and replaced by administrators recommended by Mr Gruzman, a barrister retained by CA.

CA's legal advisers supplied the new administrators with draft documents to enable them to obtain an order for the examination of the directors of the company under sec 596A of the Corporations Law. It appeared that Mr Gruzman held the brief for the examination of the directors.

CA had commenced proceedings against the company for an injunction to prevent disposal of goods the company held subject to a Romalpa clause. A meeting was held between Mr Gruzman and one of the administrators of the company who subsequently became a liquidator. At that meeting, Mr Gruzman apparently gave the opinion that CA's Romalpa clause was the best he had seen.

At a second meeting of creditors, it was resolved that the company be wound up. Because of the operation of sec 446A and 491 of the Law, the administrators became the liquidators. The liquidators provided CA with documents which would assist it in proceedings against the company. One of the liquidators said that the documents would have been available through compulsory process, and he did not want to waste time and money in compelling CA to go through this process.

The directors applied to have the liquidators removed under sec 503 of the Law. They said that the liquidators had demonstrated a lack of independence in the liquidation and that they had acted with improper motives. When the case came before the Court, the liquidators had been in office for less than a month.

[1272]

Held: liquidators ordered to be removed.

1. The question for the Court was whether in the interests of the public, the removal of the liquidators would be for the general advantage of persons interested in the winding up.

2. It was likely that there would be a dispute as to whether the post-dated cheques handed to CA constituted a preference. If this did occur at a later stage, a court would be reluctant to remove the liquidators because they would be much more involved in the liquidation. That was a good reason for acting now rather than later.

3. The probability that Mr Gruzman would be briefed for the examination of the directors showed that the liquidators did not appreciate their duty to act as the delegate of the Court in an independent manner to assist the winding up.

4. The matter involving the compulsory examination, the closeness in correspondence between the liquidators and CA, the provision of information to CA by the liquidators, the probability that there would be a preference suit between the company and CA and the litigation between the company and CA, combined to show that a reasonable bystander would consider that the liquidators were too close to CA and their impartiality was impaired.

5. It was in the public interest that the liquidators be removed.

[Before an order was made removing the liquidators, the liquidators applied for a stay of that order. They argued that the appeal which was likely to be lodged would be rendered nugatory if a new liquidator was appointed. The liquidators undertook to do nothing other than receive moneys from debtors for the duration of the stay.]

6. The Court ordered that the liquidators be removed. A stay was granted for a number of weeks to enable the liquidators to appeal against the decision that they be removed.

7. The costs of the liquidators and the directors were to be paid out of the assets of the company.

Headnote by the CCH CORPORATIONS LAW EDITORS

ME Boyd (instructed by Lane & Lane) for the plaintiffs.

BA Coles QC (instructed by Dunhill Madden Butler) for the defendants.

Before: Young J.

Young J:

This is an application by the former directors, who are also creditors of the company, under s 503 of the Corporations Law to remove the liquidators. That section, as have corresponding sections in previous versions of the Law, simply says:

> "The court may, on cause shown, remove a liquidator and appoint another liquidator."

The company, Biposo Pty Ltd, had two businesses during its lifetime, one was to deal in soft plush toys and the other was to sell goods of general description to service stations and the like. Early in 1995, the company decided to split its activities into two, one of which would continue to be run by Biposo, and the other would be conducted by a new company, G&T Distributors (Australia) Pty Ltd.

A major supplier of soft toys to the company is C.A. Australia Pty Ltd, which I will simply refer to as "CA" . The company owed considerable moneys to CA and, according to the chronology that has been supplied to me, during March and April 1995 some pressure was put on Biposo by CA to reduce its debt. CA's terms of trade include a Romalpa clause. During March and April 1995 Biposo gave post-dated cheques to CA totalling $242,000.

In early June 1995 the directors of Biposo appointed a Mr Ellison as administrator under Pt 5.3A of the Corporations Law. On 13 June 1995 at the creditors' meeting under s 439A of the Law, the creditors, pursuant to s 441A(2) resolved that the defendants be appointed administrators in lieu of Mr Ellison. The defendants were introduced into the matter by being contacted by Mr Adrian Gruzman of counsel, who was acting for CA.

[1273]

Biposo had in its possession at about this time a large quantity of soft toys, the title to which were claimed by CA because of the Romalpa clause. CA commenced proceedings in this Court in proceedings 2476/95 for an injunction to prevent disposal of those toys. Santow J granted interim relief on 2 June 1995 in those proceedings. It will be observed that this was a time before the defendants became administrators of Biposo.

On 30 June 1995, when still administrators, the defendants obtained an order from Registrar Berecry under s 596A of the Corporations Law to examine the plaintiffs. This examination is set down for 14 and 15 August next.

On 5 July the second meeting of creditors in administration resolved that the company be wound up. Because of the operation of ss 446A and 491 of the Law the defendants became the liquidators. At the meeting the plaintiffs urged another person to be appointed, but the chairman very properly said that the way the law was structured the administrators became the liquidators.

The plaintiffs say that the defendants should be removed as liquidators for the reasons which are set out in the particulars which have been marked MI179. Although greater details are given, essentially the case is that (1) the liquidators had clearly demonstrated a lack of independence in the liquidation; and (2) that they have acted with improper motives, as a result of which it is said that the removal of the liquidators would be for the general advantage of persons interested in the winding up.

CA is said to represent about 80 per cent in value of the creditors of the company. However, when one looks at the evidence a little more intently what this statement really means is that CA represents about 63 per cent of the creditors. According to the report to creditors under s 439A, signed by the defendants on 28 June, the secured creditor was owed $36,000, the Australian Taxation Office $152,500, the directors $42,000 and unsecured creditors $384,300. It would seem that CA represents about 80 per cent in value of this last figure.

It can be seen from what I have just said that the liquidators have only been in office less than one month. It is