

INQUIRY INTO AUSTRALIA'S INSOLVENCY LAWS

Yarra Room Melbourne Town Hall

2.15 p.m.

7th August 2003

At the present time, related party creditors (parties related to the directors and officers of the debtor company) are allowed to vote on all items of business at all meetings of creditors of a company in Administration and under a Deed of Company Arrangement.

Unfortunately, this ability lends itself to abuse in some instances.

Third party creditors may have good reason to exercise their right, at the first meeting of creditors held pursuant to Section 436E of the Act, to replace the administrator appointed by the directors. These reasons may include lack of independence of the administrator and/or the particular administrator not being known for vigour in acting in the interests of creditors.

The votes of related party creditors can be and sometimes are used to keep the administrator in office against the wishes of many of the third party creditors at the meeting.

Directors of a company in administration may offer creditors a Deed of Company Arrangement which has as its main object the prevention of the company being liquidated and its affairs investigated by a liquidator. Commercially, there is nothing wrong with such an object provided that the return to creditors under the proposed Deed returns them more than would be available to them under a liquidation of the company.

However, it is now possible, with the votes of related party creditors, for directors to carry a resolution accepting a Deed that does not return creditors as much as a liquidation would return to them.

I appreciate that creditors who feel their interests have been prejudiced by a vote at a creditors meeting have the right to apply to the Court for a remedy, but in reality this right is rarely used by creditors because to do so means spending more time and money on a customer they have already lost money on.

I think this onus should be reversed; that is:

- **The motions at meetings of creditors concerning replacement of the administrator and acceptance or otherwise of Deeds should be determined on the votes of third party creditors only.**
- **If directors of the debtor company and/or the related party creditors feel they have been/will be aggrieved by the exclusion of the votes of related party creditors, they should apply to the Court for a remedy.**

This suggestion is not intended to prevent related party creditors from participating in the proposed Deed if it is accepted by third party creditors; only from unfairly carrying the vote.

If motions on Deeds cannot be carried by related party votes, then only those Deeds which are genuinely in the interest of creditors as a whole will be accepted by creditors. Further, if a Deed is genuinely in the interest of creditors as a whole, it will also, by definition, be in the interest of related party creditors so they will not be commercially disadvantaged.