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SUBMISSION

to the Parliamentary Joint Committee on Corporations and Financial Services

INQUIRY INTO AUSTRALIA'S INSOLVENCY LAWS

Division 5 – Part 5.3A:

The imposition of time Limits Balancing Speed and Accuracy

1. Section 439A of the Corporations Act ("**Act**") sets out the timetable in which the Administrator after being appointed is required to report his findings to creditors. This requires the administrator to call a meeting of creditors within the convening period, being within 21 days of their appointment.

2. In the document convening the meeting, the Administrator is obliged to provide tyo creditors a report detailing:

   (a) the company's business, property, affairs and financial circumstances;

   (b) A Statement setting out the Administrator's opinion on;

      (i) Whether it would be in the creditors' interest for the company to execute a deed of company arrangement;

      (ii) Whether it would be in the creditors' interest for the administration to end;

      (iii) Whether it would be in the creditors' interest for the company to be wound up;

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(c) The Administrator's reasons for holding those opinions; and

(d) If a deed of company arrangement is proposed, a statement setting out the details of the proposed deed.

3. Pursuant to section 439A(6) of the Act any application to extend the convening period **must** be made to the court within the convening period, in other words within 21 days of the Administrator's appointment.

4. The Harmer Report which recommended the introduction of the current insolvency provisions into the Act, had criticized the old regime as overly time consuming, and found that the imposition of time limits was a necessary component of the Administration regime, thereby ensuring that decisions were made quickly and efficiently, in order to maximize the chances of the company to continue its existence, or to get a better return for creditors and members than would have otherwise been received if the company had gone in to immediate liquidation.

5. We agree that imposing a limited time frame for Administrators to make an assessment is perfectly valid. In a situation where a company is on the brink of liquidation, time is of the essence.

6. However, we are concerned that the time frame is too short, particularly where an application to a court to extend the convening period is refused. In that event, as an extension is refused, an Administrator may still be required to convene a meeting with all required reports.

7. In order to comply, therefore, we are concerned that Administrator's may not properly exami9ne and report, but rather will rely upon the advice of the Company's directors.

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9. In that event, the purpose of the independent examination of the Administrator is defeated.

10. Although the time limits are necessary, in practice, those time limits can lead to an administrator being forced to cut corners to comply with their obligations, and reasonably relying upon information to hand, rather than undertaking a thorough independent examination of the company's position, and particularly, whether there are merits in placing the company into liquidation and recovering preferences paid to other creditors.

11. As held *Commission of Taxation v Portinex Pty Ltd* (2000) 156 FLR 435; 34 ACSR 391, 'the balance between speed and accuracy is a delicate one. An administrator who accepts company's information uncritically and without exercising judgment, cutting corners to complete the administration and receive his fee, will be treated harshly by the court, since the whole scheme of Pt 5.3A depends upon the independence, competence, professionalism and hard work of the insolvency practitioners...'.

12. There has been, as a result of the legislative administration provisions, a number of actions launched against administrators by creditors alleging negligence and a breach of their duty under Pt 5.3A of the Act.

13. In the leading case of *Hagenvale Pty Ltd v Depela* (1995) 17 ACSR 139, the court said that "the administrator's actions must be looked at in the light of that more restricted range of activities which are available to him.'

14. We propose therefore that either;

    (a) the Court, to whom the administrator applies to seek an extension of the convening period, who is unsuccessful, be provided with the ability to allow the Administrator

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an extension of the period within which to call the meeting; and/or

(b) where an application is made without success, that the Administrator be provided with a further short period in which to convene the meeting, allowing for the time lost due to the making of the application to extend the convening period.

15. Whilst we accept that such orders need to be rare rather than ordinary, the Administrator seeking an extension of the convening period due to the complexities of the administration or the companies situation ought not be unreasonably prejudiced, or dissuaded from such an application.

16. It is vital that the independence of the administrator be maintained, and that they ought not be forced to rely on advice from persons associated with the Company due to the imposition of the Act's time constraints.

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Division 2 – Part 5.7B

Unfair and Preference Transactions to Creditors

1. Division 2 of part 5.7B of the Act includes provisions which would allow liquidators to recover from creditors money which had been paid to them prior to going into liquidation to the expense of other secured creditors as members.

2. This is intended to ensure that creditors are treated equally and that some creditors do not receive an advantage over others. In other words all creditors receive the same percentage of their debts.

3. S 588FA of The Act says that a transaction is an unfair preference if:

   (a) The company and the creditor are parties to a transaction

   (b) The transaction results in the creditor receiving from the company, in respect of an unsecured debt that the company owes the creditor, more than the creditor would receive from the company in respect of the debt if the transaction were set aside and the creditor were to prove for the debt in the winding up of the company.

4. Problems arise from this section of the legislation where there are not two parties to the transaction i.e. Company and Creditor, but when there is a third party to the transaction. For example if A owes money to the Company and instead of paying it directly to the Company the Company authorizes A to pay the money directly to the Creditor to reduce the Company's debt.

5. The cases of *Nilant v Plexipack Packaging Services Pty Ltd* 21 ACSR 428, *Re Emanuel (No. 14) Pty. Ltd.; Macks v. Blacklaw & Shadforth Pty. Ltd*. (1997) A.L.R. 218; 24 A.C.S.R. 292, and *Tosich Contruction Pty Ltd (in liq) v Tosich* (unreported Federal Court of Australia

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decision, 15 September 1997), have served to expand the reach of the voidable transaction provisions.

6. These decisions cumulatively have meant that 'two corners' of the 'triangle' have been covered and are able to utilize the provisions in Pt 5.7 to recover funds from parties not directly parties to transactions, where those transactions have amounted to the payment to a creditor of what amounted to a preference.

7. However one corner of the triangle, the 'third corner', has not been included either in the legislation or by the recent common law decisions which have expanded the scope of the legislation, despite the obvious need for it to be so.

8. The 'third corner' of the triangle involves a situation where A (an associate of B (ie they have similar directors and shareholders)) accepts goods and pays for them that have been ordered by B from C, and invoiced by C to B. ultimately (and within 6 months of the payment) A has a liquidator appointed. The liquidator seeks to attack the payment to C as a preference on the basis that there is no on-going relationship between A and C (because that is between B and C) and it amounts to C receiving 100% of its debt.

9. C argues however that there is no creditor relationship between A and C, a matter that is necessarily correct on the facts. The relationship of debtor and creditor exists between C and B.

10. C says we do not know or care where the payment is coming from, other than that our relationship is with B. Therefore, liquidator of A, you cannot claim that money back as a preference as there is no creditor relationship, a prerequisite under section 588FA.

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11. Further, when A argues that if not an unfair preference (because of the lack of creditor relationship), then the transaction must be one that amounts to an uncommercial transaction (ie why would A pay for goods that B owns), under section 588FB. In reply C argues that A achieves a benefit because it will receive a credit in its loan account with B, and it therefore receives a benefit under section 588FB(1)(a).

12. Certainly where B remains viable this may provide A's creditors with a right of recovery against B. However, where B is not viable, or has been wound up, A's liquidator may not have the right to take action under section 588FH, or such right may be of no value.

13. In that event, A's creditors cannot share in the money paid to C.

14. Clearly this is not the intended outcome of the division.

15. It is therefore desirable that the legislature provide greater definition as to 'transaction' so as to extend the coverage to these kinds of situations.

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