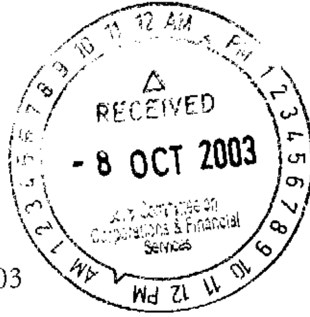

Tuesday, 7 October 2003

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

Strictly Private & Confidential

Attention: Ms Kathleen Dermody – Committee Secretary

Dear Ms Dermody

Re: Inquiry into Australia's Insolvency Laws

Enclosed is our submission to you regarding your Inquiry into Australia's Insolvency Laws.

We are the largest credit insurer in Australia and protect Australian businesses against the risks and costs associated with bad debts, essentially the risk of not getting paid by debtors. We have represented a substantial base of unsecured creditors to insolvent companies in the Australian economy for the last 40 years.

We exist in the market place for the benefit of unsecured creditors. The primary/major cause of claims on our credit insurance policy is that of insolvency of corporates. We are therefore vitally concerned with both the insolvency process and thus the distribution of an insolvent company's assets to unsecured creditors in the event of formal insolvency.

We have read with interest many of the submissions by other interested parties and support many of the suggestions contained therein.

We request that our submission is kept confidential.

Yours faithfully

Dudley Bray
Manager Claims & Compliance

Submission by QBE Trade Credit to the Parliamentary Joint Committee on Corporations & Financial Services on their Inquiry into Australia's Insolvency Laws

Preface/introduction

In our judgement, effective insolvency laws and processes are fundamental to any well run and disciplined economy and such are required to ensure the efficient allocation of resources. Insolvency laws are indeed required and mandatory in order to maintain good corporate governance, compliance and ethics. A well-constructed insolvency system plays a pivotal role in both the operation of capital markets and the economy as a whole.

The appointment, removal and functions of administrators and liquidators

In our view it is vital that the total independence of Voluntary Administrators ("VA's") need to be strengthened by introducing laws that severely limit, or even prohibit, directors appointing any person as a VA that has had any dealings with the company or its directors (in any way) within the last three years, excepting a short period (say 2 weeks) prior to the appointment of the VA.

In addition we would applaud some sort of statement of independence of administrators to be provided to creditors prior to the first meeting being held.

The holding of this first meeting of creditors within 5 business days of the appointment of the VA is too short a time considering the distance many creditors need to travel to attend. In fact in many cases that we have encountered often the notice of appointment and advice of the first meeting hasn't reached the creditor in time to attend. This first meeting affords creditors their one and only real opportunity to remove the VA if the creditors suspect that there is not total independence between the Insolvency Practitioner and the company.

To ensure that the VA process is to be transparent the period of time for the first meeting should be extended to at least 8 business days to allow all creditors to be sufficiently advised in time. This would also allow the administrator to conduct some limited investigation into the companies affairs and records to ensure that all creditors were adequately informed.

The second meeting of creditors currently must be held within 28 days of the VA appointment. This effectively requires that notices and information for creditors regarding any proposal or recommendations must be sent out 21 days after the initial appointment. This means that the VA has only 15 days after the first meeting to: -

- investigate the company's affairs
- provide a sufficiently detailed report to creditors detailing:
    - a brief history of the company
    - the circumstances leading to the VA appointment
    - an analysis of its financial position
    - an assessment of any proposed deed

We believe that 15 days is too short a time and should be able to be extended, when required, in an efficient and cost effective way.

A Voluntary Administrator does need time to put a proposed scheme or Deed of Company Arrangement together as well as making all necessary enquires in order to inform creditors satisfactorily enough to make a decision on the future of the company. In our view 21 days between the first and second meetings is too short a time to properly complete all the necessary enquires, especially in certain complex companies.

We submit that the first meeting should be held within 8 working days of the appointment with an allowance of at least 40 working days (eight weeks) between the first and second meetings. This extra time would allow VA's to conduct a fuller review of the company including possible recovery actions available to creditors and the canvassing of alternative DOCA's.

This extra time is especially needed in the more complex company/business situations – although there will always be a need for either the courts or creditors to allow extensions of this time. This is particularly relevant in large retail businesses (ref: Harris Scarfe, Surf Dive 'n Ski) and businesses that have many complex and varying legal issues (ref: Ansett, Pasminco).

In addition, the requirement for calling the second meeting of creditors should be extended to at least 60 days without the need to obtain formal court approval (as is currently required). This would certainly allow more meaningful proposals to be sought from directors/interested parties, better investigation into the company's affairs by VA's and, more importantly, possibly more time for creditors to assess the various alternatives with more complete and accurate information.

This would significantly result in cost savings in the administration process and, importantly, may actually improve returns to creditors as a result of improved proposals (by reason of more time given to allow VA's to negotiate better deeds on behalf of creditors).

We, as representative of unsecured creditors, would seek that all creditors should have the right to appoint a different person as liquidator in place of the incumbent Administrator at the second meeting. This should even extend to when the Deed Administrator (of a DOCA) seeks to place the company into liquidation on the failure of the Deed at a later date.

Information available to creditors

Since the introduction of the VA process some 10 years ago, the insolvency fraternity has barely dealt with reporting to creditors on a quality consistent basis.

We would recommend that ASIC and representative associations produce a "best practices guideline" in order to ensure that reports sent to creditors are in an ordered and prescribed basis. This together with changes in the insolvency law that VA's must include any other information that creditors would reasonably expect to be material to their decision, would certainly improve the ability of creditors to make a valued assessment of the business, especially from a viability viewpoint and the financial return to themselves.

The duties of directors

In our view, directors must be held accountable for the failure of companies where gross mismanagement and/or breaches of the law have been committed. Specifically,

directors who do not fully cooperate with Insolvency Practitioners or who fail to keep adequate books and records of a company, or fail to provide a Report As To Affairs ("RATA"), should be barred from holding the position of company director, at least for a period of time. Furthermore ASIC needs to enforce compliance in this area and make it an offence to remain or become a director where that director has clearly failed to comply with their obligations and duties. This clearly doesn't prevent the initial insolvency, but should avoid further corporate failures by that person and protect others, at least for a period of time.

The rights of creditors

Voting by creditors should be on a clear majority (say 75%) by value, in preference to the current casting vote by the Chair, usually the administrator, which should be removed entirely.

This would simplify the voting process at creditors' meetings and enable the creditors that are most financially affected by the administration to have the destination of the on-going affairs of the company in their hands. After all the creditors who stand to lose the most should have in equity the most say regarding the outcome of any administration.

Chapter 11 process

The debtor in possession business rescue model, similar to a Chapter 11 process of the US Bankruptcy Code is, in our view, entirely inappropriate for the Australian economy.

Our current VA process, while it may need some modifications to provide a more cost efficient system, enables the vast majority of VA's to either achieve the rehabilitation of the business or the orderly winding up of the company in a relatively short space of time.

It is our view that the Chapter 11 process is too long and more expensive and further, it allows the incumbent company management, who have already badly managed the existing business and who are in desperate need of outside assistance and expertise, to continue in control. This is most unsatisfactory and should be avoided.

In addition, under the Chapter 11 model unsecured creditors have little chance to have their voice heard and indeed have to wait at least 12 months and sometimes even years before any proposal to repay debts is provided. During this extended period of time the creditors often see the value of the business assets reduced through continued mis-management and trading losses.

The shorter process of the Australian VA system, although somewhat tight on some timing issues, does at present at least provide for a relatively quick outcome and return of dividends to creditors. Indeed it is our experience that the sooner a company enters into official administration the better the returns are to all stakeholders.

Solvent group companies

It is our view that where an insolvent company is contained within a solvent group of companies (subject to some rules) there should be clear legislative requirement for such solvent companies in the group to contribute to the insolvent company's debts. The law should permit liquidators (in certain circumstances) to take control of the

"solvent group" and therefore be able to pool all unsecured assets and liabilities of the entire group. This would be a fairer way of dealing with groups of companies who endeavour to quarantine and separate assets and liabilities for their own advantage. At present creditors are at a distinct disadvantage in such circumstances.

E-commerce initiatives

We would certainly support the use of e-commerce alternatives and initiatives in the insolvency administration process. The recent use of this in the Ansett insolvency is applauded. Not only has this delivered cost savings to the administration, it also ensured that creditors would receive all information and avoid mis-directed mail. A process whereby all administrations could use a Public Notices web page for the placing of all advertisements and thereafter placing future reports on their own web page would certainly be a distinct advantage for all creditors in this electronic age. This would be particularly helpful to creditors in country places. With the advent and high use of automatic e-mailing systems, we are confident that an initiative such as this would be of enormous benefit to all creditors.

The cost of external administrations

We consider that a maximum hourly rate for insolvency administrators should be set down as a guide, similar to that which existed a few years ago. There are many different approaches that may be considered, but at least there should be a guide to the maximum hourly rates able to be charged.

Although currently creditors can fix the remuneration of the administrators, creditors are often not in a position to effectively argue or understand the quality or quantity of work that Insolvency Practitioner's perform, especially in the more complex insolvencies. A better alternative may be to link reimbursement to the percentage of funds distributed, or even to the dividend paid to creditors in some way.

The treatment of employee entitlements

Employees certainly need protection of their entitlements in the unfortunate event of their employers' insolvency. We would advocate an insurance scheme to which businesses or employees contribute to and is then called on to provide reimbursement of a certain proportion of employees' entitlements.

Directors and company secretaries/officers and their immediate families should be excluded from participation in such a scheme.

In addition, superannuation should not, perhaps, be included as an entitlement under the scheme except in cases where the outstanding superannuation payments are in excess of a certain amount per employee. Superannuation contributions should be better regulated and controlled. This would be a much more cost efficient method to ensure compliance rather than any superior priority to be granted in an insolvent event.

Compliance with, and effectiveness of, deeds of company arrangement

Certainly there are some deeds which are not enforced rigorously enough. Late payments and non-compliance to contracts are "normal" business behaviour however unacceptable or unpalatable they may be. Insolvency Practitioner's must take a materiality view of the various breaches of the DOCA and within normal business

decision making process come to a view of accepting or otherwise such failures. There must be, though, a cost-effective process for creditors to be made aware of all material circumstances of non-compliance and an ability to terminate a Deed by way of a majority decision of the creditors involved.

Whether special provision should be made regarding the use of phoenix companies

We advocate that much stronger legislative measures must be taken to reduce the incidence of both fraudulent phoenix companies and the recurrent incidence of directors and company officers setting up in corporate entities time and again using the same assets "sold" or "acquired" by a new "phoenix" corporate entity.

Directors should be automatically banned from acting as directors or officers for a period of time immediately following their involvement in any insolvency that does not provide for a return to all creditors of at least 50 cents in the dollar. Although this may be difficult to legislate effectively and will not prevent multiple insolvencies in may specific cases (for example DOCA's), we believe it would send a strong message and act as a deterrent to all company directors.

Further, we would comment that the regulators really need to enforce the law in situations where bankrupts are not eligible to continue as company directors or officers immediately they become bankrupt. There are numerous cases currently where the regulators have continued to allow bankrupts to be company officers and directors. Laws may not prevent crimes but the law should make these actions an offence and maybe some business operators would think again.

Voluntary liquidation process

The voluntary liquidation process should allow directors to immediately place their company into liquidation. Reporting requirements of the voluntary liquidator should then be mandatory and legislation enacted to ensure that creditors are kept fully informed via regular mandatory reports and/or meetings. All possible recovery actions must be reported on by the liquidator within (say) the first 60 days of the appointment.

Accounting requirements

We do believe that more stringent accounting requirements, including the lodging of company accounts each year, needs to be re-introduced. Large private corporate entities should be obliged to have audited accounts prepared and made available to public scrutiny. This may then lead to the alleviation of extended and the unsustainably high amount of credit that is currently being granted to companies with little if any real net worth.

This of itself would not prevent insolvencies but would, in our opinion, lead to a reduced cost on the Australian Economy as a whole by the effect of reduced levels of bad debts.