Comments on the Exposure Draft – Corporations Amendment (Insolvency) Bill 2007

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We submit the following comments in relation to the proposed Bill.

In general we believe that the Bill provides desirable changes in the legislation although in some areas such as pooling for example there may have been greater room for more significant changes.

It is appreciated that there has been a long period of consultation with professional groups although we submit that laws regulating insolvency should not be established purely for the benefit of the insolvency industry. A broader policy perspective must always be considered so that the legislation does not unduly affect general economic activity by causing stakeholders to engage in non-productive strategic behaviour that is undertaken purely to enhance their position in the event of insolvency. We submit therefore that at all times the cost of administering insolvent estates needs to be minimised so that court applications and regulatory requirements are as few as required. In general the Australian corporate insolvency provisions work well in this regard and hence there is no need for extensive changes to the legislation.

Improving Outcomes for Creditors

Enhancing Protection of Employee Entitlements

The proposal to give better protection to employee entitlements under a deed of company arrangement is to be welcomed given the inability of employees to adequately bear the risk of insolvency of a company because of their restricted rights to diversify. Exceptions are provided for in proposed s 444DB (2). It provides for a meeting of eligible employees

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yet there appears to be few details about how such a meeting might be conducted and what information might be given. Practically, unions may provide assistance to employees. However, not all employees will necessarily be able to access such services.

In addition (from the perspective of voting) how will such a vote to be carried? There does not appear to be any specific provision for the meeting. Is it a matter of number of applying the rule that votes will be carried by number and value? If so there appears to be an argument as to whether a person who is owed more as an employee should be entitled to greater say on this issue as the impact on a low wage earner who has debts unpaid may be greater than on a high income earner. Alternatively, is it sufficient that an employee who is owed even a small amount – say a part-time worker is entitled to the same weight in voting as a long term employee? We do not suggest resolutions to these issues however there is an argument that exists in favour of making special provision for the manner of conducting such a meeting.

Further in proposed s 444DB(3) the court is given a wide discretion to overturn the non-inclusion of such a provision on the basis that the *"non-inclusion would be likely to result in the same or better outcome for eligible employees as a whole"*. This will be a difficult matter for courts to judge and it leaves open the possibility of oppression of minority employees. It appears that this might be designed to specifically override the provisions of s 445D(1)(f) although it is not made clear.

It is unclear if an application may be made to the court after the decision is made by the meeting of employees. If it can be made later, as the application may be made by the administrator or other "interested persons" it may well be that better organised stakeholders and wealthier creditors may challenge decisions of employees who are then obliged to undertake court proceedings to defend their decision.

It may be preferable to place limits upon the manner in which the court may overturn a decision of the meeting or approve the non inclusion. For example s444F(3) requires the court not to allow a deed of company arrangement to interfere with a secured creditors

rights unless the creditor's interests are "adequately protected". Overall it is suggested that looking at the employees as a whole is far too broad a perspective to successfully protect individual employees in the manner sought, even though the proposed provisions will improve the current situation for employees..

Better Informing Creditors' Decisions

Administrator's statement of independence

Whilst the attempt to provide a more transparent appointment procedure for administrators is welcome there appear to be some gaps. For example there appears no specific provision requiring an administrator of a deed of company arrangement to provide such a statement. Whilst it may be usual to have an administrator continue through from a VA this will not always be the case so it would be prudent to specifically cover this possibility.

Generally the declaration will only be of use if creditors are able to fully utilise the first meeting of creditors as that is essentially their opportunity to replace an administrator. Therefore the manner of use of the declaration at the meeting is a critical matter. Where the administrator needs to update the declaration, it is stated that the copy must be tabled at the next meeting of creditors yet it is difficult to see how this might then affect much at all if there is considerable delay between the first and second meeting of creditors. Further once the second meeting of creditors is held there are not necessarily any further meetings of creditors where a deed of company arrangement is entered into.

Fine Tuning the Voluntary administration process

Many of these changes are matters that have long been recognised as being required following the initial introduction of the procedure.

It is proposed to amend s445C by the insertion of s445CA. This provision is based upon the concept that a deed should not be terminated by the creditors unless there is non-compliance. Whilst it may be possible to find relatively technical breaches of a deed it is a provision that seems to run counter to the notion of a voluntary administration. If there

is a manipulation of the voting system such that small numbers of creditors could effectively call a meeting and cause the deed to be set aside because not enough creditors bother to vote, then that is a reason for altering the voting system. The blanket provision here goes to effectively prevent creditors from changing their mind about a deed if they foresee difficulties arising in the future. Whilst the court option is always available it detracts from the general thrust of the provisions to place this limitation upon what may be the general wish of creditors.

The Proposed Pooling Process

The pooling proposals represent a welcome attempt to deal with the problem of insolvent corporate groups and we support the broad aims of the proposals. They are required to give insolvency practitioners an opportunity to deal with insolvent companies in a group situation without placing strain upon the existing provisions.

The fact that pooling may take place with effectively the consent of the creditors without the need for a court order is a welcome initiative. At the same time it is recognised that there are many policy issues that arise in relation to the issue such that the legislation may represent some compromise between these issues or interests. Nevertheless we submit that the pooling provisions could be improved and do require broadening to cover all of the companies in the group.

Pooling under either proposed Division 8A (where group companies have entered into voluntary administration[2]) or proposed Division 8 (where group companies are being liquidated[3]) excludes solvent companies. In this respect the draft Bill has rejected CAMAC's recommendation 41 that "solvent group companies should be permitted to enter into an administration with other group companies where at least one of those companies satisfies the voluntary administration prerequisite."[4] CAMAC considered that in certain circumstances where the affairs of the solvent group company are so

[2] Sub clause442G(1)(a) & s442H(1)(a) *Corporations Amendment (Insolvenc) Bill 2007.*
[3] Sub clause 572(1)(a) *Corporations Amendment (Insolvenc) Bill 2007.*
[4] Op cit CAMAC Rehabilitating large and complex enterprises Report 2004 para 6.4.2.

intertwined with those of other group companies, for example, where the solvent group company relies on information technology or other logistical or financial support from an insolvent group company, then pooling within the voluntary administration may be beneficial. However, explanation for the draft Bill argues that this potential benefit was outweighed by the need to protect the interests of the solvent company's shareholders.[5]

The fact that only the companies in voluntary administration or in liquidation are able to be part of the process suggests that creditors could potentially be disadvantaged where (to the extent that it is commercially possible) assets are available in a solvent company that is part of the group. The New Zealand experience shows that at least some form of provision could be written to enable a contribution order to be made from companies that are part of the group but not in liquidation or administration and that it need not require fundamental changes to the position of shareholders.

The approach in the proposal shows a reluctance to deal with the broader issue of corporate groups in a more holistic manner at this time. What has been proposed is a pragmatic solution to a procedural issue without attempting to deal with the more fundamental factors that may cause the problems to arise in the first place.

It appears on the face of the draft proposals that each company whose liabilities will be pooled need to be within the same form of insolvency administration. It is not clear why that is required if that is the intention. Consideration should be given to merging the separate provisions which appear to repeat the same conditions to enable the pooling to occur.

Fundamentally the term "group" is undefined but there are conditions laid down as a requirement for pooling to occur. It is interesting that the approach is to provide clear cut situations where the intertwining is readily identifiable. Administrators/liquidators or the court may consider *"companies that jointly or singly own or operate particular property*

[5] Explanatory Memorandum to Part 4 Facilitating Pooling in External Administration *Corporations Amendment (Insolvency) Bill 2007* page 53.

that is or was used, or for use, in connection with a business, a scheme, or an undertaking, carried on jointly" as forming part of a group eligible for a pooling determination.[6] Thus, it is enough to be joined into the pooling if:

- There is a business, scheme or undertaking that is carried on jointly and
- The relevant company owns or is a part owner of any property that is used in that business scheme or undertaking.

By not having a general term as in the New Zealand legislation where the pooling may be ordered where "*the business of the companies*" has been carried on in a way that the separate business of that company (or a substantial part of it) is not "*readily identifiable*". is it possible that situations where there are no real identifiable records of transactions in separate companies will fit within the Australian provisions? A more general phrase may result in a less technical approach as to when pooling may occur.

Another feature of the provisions is that the administrator or liquidator is able to modify the application of various provisions in terms of their application to the group. It is suggested that such an expression is strange as it suggests that the insolvency practitioner is effectively being given powers akin to the court in s447A.

In addition to these general issues, the following comments are made as regards each of the proposed divisions.

Under Voluntary Administration – Proposed Division 8A

Initially it can be noted that with respect to the proposal where the companies are in liquidation any other company in the group who is a creditor is excluded from being an eligible unsecured creditor by virtue of proposed s 571. Such companies are then excluded from objecting to the pooling proposals in liquidation under s574. However there is no such exclusion in relation to pooling proposals under either a voluntary administration or a deed of company arrangement. This seems inconsistent because it is

[6] Clauses 442G (Administrator), 442H (Deed Administrator) *Corporations Amendment (Insolvency) Bill 2007.*

probably less likely that an administrator would seek to challenge an objection to a proposal in a voluntary administration or a deed of company arrangement because of time pressures which are generally non-existent in a liquidation situation.

The proposal argues that the notification requirements under proposed Division 8A are no more onerous upon administrators as this type of analysis is currently undertaken by those administrators seeking creditor approval of a Deed of Company Arrangement which includes the pooling of group companies' assets.[7]

However, it is not possible for the administrator under clause 442K of the draft proposed Bill to provide to creditors written notice of an Internet site where creditors could view a copy of the proposed determination.[8] This a rather strange omission which may just be an oversight in the proposals given the recognition of this method in relation to pooling in liquidation and the general acceptance of this form of notification.

If any creditors object to the making of the proposed determination,[9] it can only proceed if in the opinion of the Court it is just and equitable to do so.[10] The administrator can apply to the Court for an order approving a pooling determination in such circumstances but must inform the creditors of the companies within the group of such an application.[11] Such notice may be given by notifying creditors of the website address where creditors can view a copy of the application.[12]

When the issue is brought to the Court by the administrator, the court may approve the determination by the administrator if it is "just and equitable" to do so. The matters that

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[7] Opcit. Hoser, P *Examining the legal and practical aspects of "pooling" in insolvency contexts*.
[8] Compare clause 442K with the notification requirements to creditors in sub clause 442L(4) *Corporations Amendment (Insolvency)Bill 2007.*
[9] And the prescribed form to be used by the creditor if objecting is included within the original notice: Clause 442K(3)(a) *Corporations Amendment (Insolvency) Bill 2007.*
[10] Clause 442K(5) *Corporations Amendment (Insolvency) Bill 2007* Requires the creditor's objection to the proposed determination to be given on the prescribed form, within the prescribed period and in the prescribed manner as detailed under s442K(3) *Corporations Amendment (Insolvency) Bill 2007.*
[11] Sub-clause 442L (4) & (5) *Corporations Amendment (Insolvency) Bill 2007.*
[12] Sub-clause 442L(4)(b) *Corporations Amendment (Insolvency) Bill 2007.*

the Court may take into consideration in determining this are open-ended and include such factors as:

(1) The extent that a company in the group and its officers or employees were involved in the management or operations of any of the other companies in the group;

(2) The conduct of a company and its officers or employees within the group towards the creditors of any of the other companies in the group;

(3) The extent that the circumstances giving rise to the administration of any of the companies in the group are directly or indirectly attributable to the acts or omissions of any of the other companies in the group or their officers or employees;

(4) The extent that the activities and business of the companies in the group have been intermingled;

(5) The extent that creditors of any of the companies in the group may be advantaged or disadvantaged by the making of the order; and

(6) Any other relevant matters.

The above factors are similar to the New Zealand provision, (although the New Zealand provision does not include the fifth factor above) that empowers New Zealand courts to make pooling orders in respect of related companies once one of those companies is placed into liquidation[13] and echoes those factors originally identified by the Harmer Report as justification for court-ordered pooling.[14]

New Zealand case law suggests, (in relation to the corresponding provision in that jurisdiction), that costs savings are indirectly taken into account, as "*other relevant matters*", as if no pooling determinations are made and separate legal proceedings are

[13] See s271(1)(b) *Companies Act 1993 (New Zealand)* However the application for pooling in New Zealand can be lodged by not only the liquidator but a creditor or shareholder.
[14] Opcit *Harmer Report para 855.*

pursued the cost and length of the liquidation may considerably increase and thereby deplete funds which would otherwise be available for creditors.[15]

The court's power to approve a pooling determination regardless of a creditor/s objection rests on whether the exercise of this power would be "just and equitable".

Although Vaisey J in *Re Serene Shoes Ltd* [16] could not differentiate between the terms "just and equitable" and "just and beneficial" it is considered that the former phrase is distinct from the latter term. The expression "just and beneficial" which is used in s511[17] *Corporations Act* appears to take into consideration elements of cost and efficiency of function. Justice Young[18] considered that if *"the court can summarily solve the difficulty that has arisen in the liquidation by an order under the section in a cheap and efficient manner …. …It is "just and beneficial" to exercise the power"*.

In contrast, whether it is "just and equitable" to make a pooling determination takes into account the relative positions of the unsecured creditors within the group of companies vis a vis themselves, (as outlined above in the fifth factor which the court considers), and the respective shareholders of those companies given the management practices of those companies; the degree of intermingling of business and management between companies; and the creditors knowledge thereof. The term just and equitable is used in the corresponding New Zealand provisions and Farrar[19] has suggested that the term provides the court with the *"widest discretion to effect a result which accords with common notions of fairness in all the circumstances"*. In this regard its inclusion is to be applauded.

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[15] See *Re Dalhoff and King Holdings Ltd* (1991) 5 NZCLC 66,959 and *Re Pacific Syndicates (NA) Limited* (1989) 4 NZCLC 64,757 at 64,768.
[16] [1958] 3 All ER 316 at 317.
[17] Section 511 *Corporations Act2001 (Cth)* allows the Court to determine a particular question or exercise all or any of the Court's winding up powers if satisfied to do so would be just and beneficial.
[18] *Dean Willcocks v Soluble Solution Hydroponics Pty Ltd* (1997) 24 ACSR 79 at 81.
[19] Farrar J., *CORPORATE GOVERNANCE*; *Theories, Principles and Practice* (2nd ed) Oxford University Press 2005 at 264 referring to Casey J., in *Re Home Loans Funds (NZ) Ltd* (1983) 1 NZCLC 95073.

Pooling Process

Under Liquidation

Proposed Division 8 of the draft Corporations *Amendment (Insolvency) Bill 2007* deals with pooling within liquidation. The proposed provisions follow closely the model of pooling within a voluntary administration. However, in contrast to the position under voluntary administration where a court order can only be obtained after a proposal by the administrator has been objected to by a creditor, there are two separate methods of pooling available in a liquidation: voluntary pooling and court ordered pooling.

One issue that appears to be left open is at which date the liabilities will arise for the other companies in the pool. Under proposed section 579 it stated that if a debt or claim becomes a debt or claim that is "pooled" then it is stated that it is admissible to proof against the company. Presumably this is intended to mean that the liabilities will be liabilities of the other companies in the pool from the date on which they arose with respect to the original debtor. This would enable the debts to be dealt with as ordinary unsecured debts in the winding up in terms of priority. It could also be that ancillary orders are possible and it may be something that is dealt with in the order or determination itself. However no provision makes this clear in the proposal. If the time is meant to be prior to the commencement of winding up, it is possible to foresee issues that could arise as regards set off where for example a third party is a debtor of one company in the group and a creditor of another. When the liabilities are pooled it may result in set off becoming available and advantaging one creditor.

End of submission.