COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Australia's insolvency laws

MONDAY, 5 MARCH 2007

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JOINT STATUTORY COMMITTEE ON

CORPORATIONS AND FINANCIAL SERVICES

Monday, 5 March 2007

Members: Senator Chapman *(Chair)*, Ms Burke *(Deputy Chair)*, Senators Brandis, Murray, Sherry and Wong and Mr Baker, Mr Bartlett, Mr Bowen and Mr McArthur

Members in attendance: Ms Burke, Senator Chapman, Senator Murray, Senator Wong

Terms of reference for the inquiry:

To inquire into and report on:

Exposure Drafts of the Corporations Amendment (Insolvency) Bill 2007 and related regulations.

The bill includes measures to modernise Australia's insolvency laws to implement the integrated package of reforms announced by the Government in October 2005. The measures take into account recommendations of reviews by the Corporations and Markets Advisory Committee and the report of the Corporations and Financial Services Joint Committee, Corporate Insolvency Laws: a Stocktake (June 2004).

The bill provides an opportunity for the committee to revisit various aspects of its 2004 report and recommendations which are not incorporated in the bill. In particular, the committee will examine the bill with regard to the following issues:

the regulation of the insolvency process (7, 8, 13, 33, 35, 37, 47, 52, 54);

the role of administrators (3, 12, 18, 24, 25, 55);

the role of directors (10, 14, 31, 54);

the rights of creditors, including the treatment of employee entitlements (43, 44, 47); and

the need for empirical research and review processes (29, 30, 32, 34, 40, 41, 43, 58).

The numbers listed against each term of reference denote recommendations from the committee's June 2004 report which the Government either rejected, supported in principle, or argued were matters for ASIC.

WITNESSES

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BRINE, Mr Matthew, Manager, Government and Insolvency Unit, Corporations and Financial Services Division, Markets Group, The Treasury 6

DONNAN, Mr Frank, Policy Officer, Government and Insolvency Unit, Corporations and Financial Services Division, Markets Group, The Treasury 6

MAMMONE, Mr Daniel, Workplace Relations Adviser, Australian Chamber of Commerce and Industry 2

MELLUISH, Mr John, National President, Insolvency Practitioners Association of Australia 36

MILLER, Mr Geoffrey, General Manager, Corporations and Financial Services Division, Markets Group, The Treasury 6

POTTER, Mr Michael, Director, Economics and Taxation, Australian Chamber of Commerce and Industry 2

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Subcommittee met at 9.13 am

CHAIRMAN (Senator Chapman)—I declare open this public hearing of the Joint Committee on Corporations and Financial Services inquiry into the Exposure Draft of the Corporations Amendment (Insolvency) Bill 2007 and related draft regulations. This inquiry is an important opportunity for the committee to revisit recommendations from its June 2004 report on insolvency, which the government rejected. Supported in principle or argued were matters for ASIC across the range of recommendations that we made. These recommendations relate to a number of issues including the regulation of the insolvency process, the role of administrators and directors, the rights of creditors and the need for empirical research and new review processes.

The committee has agreed to table its report on 29 March 2007. I remind all witnesses that, in giving evidence to the committee, they are protected by parliamentary privilege. This gives special rights and immunities to people who appear before committees. People must be able to give evidence without prejudice to themselves. Any act which disadvantages a witness as a result of evidence given to a committee may be treated by the parliament as a contempt. It is also a contempt to give false or misleading evidence to a committee. If a witness objects to answering a question, the witness should state the grounds upon which the objection is taken and the committee will determine whether it will insist upon an answer having regard to the grounds which are claimed. If the committee determines to insist upon an answer, a witness may request that the answer be given in camera. Such a request—that is, a request to give evidence in camera—may of course be made any other time.

Any claim that it would be contrary to the public interest to answer a question must be made by a minister and should be accompanied by a statement setting out the basis for the claim. The parliament has resolved that an officer of a department of the Commonwealth should not be asked to give opinions on matters of policy and should be given a reasonable opportunity to refer questions asked of an officer to superior officers or to a minister. This resolution prohibits only questions asking for opinions on matters of policy. It does not preclude questions asking for explanations of policy or factual questions about when and how policies were developed.

[9.15 am]

MAMMONE, Mr Daniel, Workplace Relations Adviser, Australian Chamber of Commerce and Industry

POTTER, Mr Michael, Director, Economics and Taxation, Australian Chamber of Commerce and Industry

CHAIRMAN—The committee has before it your submission, which has been numbered 6. Are there any alterations or additions you wish to make to the written submission?

Mr Potter—No.

CHAIRMAN—I invite you to make a brief opening statement, at the conclusion of which I am sure we will have some questions.

Mr Potter—It is good to be here before the committee to talk to our submission. I do not propose to go through our submission in detail; it is there for your own perusal. I state at the outset that a fair portion of this submission was written by Peter Anderson, who is out of the country at the moment. Hence a bit of forbearance may be required in that either of us may not be experts on specific issues.

We generally support the bill. We certainly support the main area on which we comment in our submission, which is equating the superannuation contributions the same priority as is given to other employee entitlements. We are not proposing that GEERS be extended to cover superannuation. We think there are issues in respect of information about the extent of problems. We would like to see these further explored before there is any examination of issues such as using GEERS for superannuation.

I will mention one other thing. You may have noticed that our submission does not go into the Corporations Law issues relating to insolvency. These are issues which are quite important to business but, due to the limited time available, we have not had the opportunity to go to our members to examine the proposals in the bill relating to this issue.

CHAIRMAN—In your submission you mentioned that ACCI or its members may make separate submissions regarding matters of empirical research, the review process, the role of administrators and the regulation of insolvency processes. Is that likely to be forthcoming before we report?

Mr Potter—I cannot speak for our members, but we are not planning on doing anything further. We have 36 or 38 members, and they could be making submissions on this issue. We have drawn this to their attention. There are a lot of things going on, so they may decide there are other priorities that they wish to be involved in.

CHAIRMAN—You particularly draw attention to recommendations 43, 44 and 47, which you say you do not support. These, as I recall, were recommendations for the government to

examine or consider various issues in relation to employee entitlements. Can you enlarge on why you are so opposed to even a consideration of those matters?

Mr Potter—Recommendation 43 needs to be looked at in the context of the current operation of GEERS. It is not clear that we need to be doing something extra now that GEERS is in place or that there is a substantial problem that needs to be addressed. We would like to see GEERS continue and data from GEERS being made available to us and to the public generally and used as a means of determining whether there are problems relating to these recommendations.

CHAIRMAN—In regard to recommendation 43, you do not support a review of the Employee Entitlements Act because of a lack of available data or factual developments. That recommendation relates to conducting a review to consider possible reforms. Would that review have the opportunity to gather data as to how corporations may be—they may not be—deliberately structuring their businesses to avoid paying full entitlements?

Mr Potter—Yes, indeed. I guess the angle here is that we would want to see the data being made available. The appropriate place for that data to come from would be from the parts of the government that administer GEERS, which are different from the parts of the government that administer CMAC.

Senator MURRAY—CAMAC.

Mr Potter—I am not particularly familiar with this area, so excuse my use of the wrong terminology. The data has to come from a separate area of the government. I assume that GEERS is administered by DEWR, so they would have to be providing the information. We would like to see that information coming forward first, and then in that context it should be examined to see whether a review needs to be conducted.

CHAIRMAN—Your submission is limited to the employee issues. Do you have a view about recommendation 10 from our original inquiry, which relates to amending the law to permit an administrator or liquidator to recover from directors the cost of reconstructing records where directors have failed to keep adequate records?

Mr Potter—Our submission did not go into these types of issues. I would be very happy to take that back to the relevant people in our organisation to see if we have a view on that one. I cannot speak off the top of my head on that one. More generally, these are important issues and they affect businesses. Hopefully, we will be able to come back to you with some view on that.

CHAIRMAN—That would be useful.

Senator MURRAY—For clarity, you indicated that you have not been able to check with your members about the other matters in the exposure draft. Does that mean that with respect to employee entitlements you have been able to, or have you just relied on Mr Anderson's astonishing history and background? I mean that as a compliment and not in any other way.

Mr Potter—It was a bit of both. We wrote the submission and then circulated it in a draft form to the appropriate people. Having received comments, we put in the submission. The answer is yes to both parts of that question.

Senator MURRAY—One of the difficulties that both we as legislators and people in the Treasury face—and we have commented on it already in the discussion—is the issue of data. I have been interested by the number of instances thrown up by the much more active and vigorous regulator, the Office of Workplace Services, in discovering underpayments and wrong payments in part of the business community.

You would be familiar with what is referred to in science as a controlled population experiment. One that really brings this home is where they have taken a population of children and tracked, for 30 years, their health and so on and established links with genetics. In other words, they have got a good dataset on which they can draw general conclusions. My question to you is: if we do not know the extent of employee entitlement, misadventure or misdemeanours—by 'misadventure' I mean mistakes and by 'misdemeanours' I mean deliberate error—in the business community, do you think we should be encouraging government to institute processes for a representative sample to be checked from top to toe just to see what the real instance of, let us call it, misadventure or misdemeanour is?

Mr Potter—In theory, yes. I do know that the ABS does have a number of datasets—we have mentioned them at various stages—so there might be some existing data available from the ABS which can be used to address that question.

Senator MURRAY—As you know the ABS is not based on audit data; it is based on advised data.

Mr Potter—They use a wide range of data sources, so I guess if they are not using one particular data source then there might be an argument that they should be using that particular data source. For a long time Australia has not had longitudinal data on companies, which has been a major gap. But the ABS is now developing two longitudinal datasets on companies. One is a very detailed survey of a small number of companies and the other one is a very narrow set of questions applying to every company in the country. It is entirely possible that those datasets will be useful for this particular purpose.

Senator MURRAY—Unless you are able to employ the techniques of discovery in audit to verify the incidence of underpayment or inadvertent activity or advertent activity, a legislator's response is always going to be subject to guessing or hoping that the particular response will broadly fix a problem that is perceived to be in the community. If I understand your submission correctly, your concern is that that may not be an appropriate way to address these issues.

Mr Potter—Yes. There is another aspect to that, which is that GEERS may be able to provide administrative data which enables policymakers in general to determine the extent of any problem.

Senator MURRAY—I do not believe so. GEERS reacts to actual instances; it is not able to research or provide the data for the general incidents of these problems in the community. I will confess to you: I have absolutely no idea whether this is a widespread problem or an occasional problem.

Mr Potter—I guess having more information revealed from GEERS would make it easier for us to determine the extent to which GEERS can address these issues.

Senator MURRAY—My question to you is not designed for an academic exchange of probabilities. My question comes down to this: do you think the ACCI would accept an intrusive exercise that would pick on a representative sample, whatever that may be, to try to establish what the real incidence of these matters is?

Mr Potter—Possibly. I would not want to say definitively yes or no at this stage.

Senator MURRAY—But you do not automatically rule it out.

Mr Potter—Indeed.

CHAIRMAN—As there are no further questions, I thank you very much for your appearance before the committee this morning. It is much appreciated.

[9.29 am]

BRINE, Mr Matthew, Manager, Government and Insolvency Unit, Corporations and Financial Services Division, Markets Group, The Treasury

DONNAN, Mr Frank, Policy Officer, Government and Insolvency Unit, Corporations and Financial Services Division, Markets Group, The Treasury

MILLER, Mr Geoffrey, General Manager, Corporations and Financial Services Division, Markets Group, The Treasury

CHAIRMAN—The committee has before it your submission, which we have numbered 10. Are there any alterations or additions that you wish to make to the written submission? If not, I invite you to make an opening statement at the conclusion of which I am sure we will have some questions.

Mr Miller—Thank you for the invitation to appear before the committee this morning. It might assist the committee if I explain some of the background to the development of the insolvency package which was released by the government on 13 November 2006. The package is part of the government's program to improve business law. It improves the system of laws and practices that underpin economic activity in a modern credit-based economy. The package responds to the recommendations of a number of public reviews of corporate insolvency regimes by various committees over the years, in particular, reviews conducted by this committee and by CAMAC. The recommendations of these reviews have a common theme: they basically aim to improve to the extent possible the efficiency of insolvency processes and minimise uncertainty in the law that can give rise to protracted and costly litigation.

In your 2004 report, it is stated that the foremost objective was to promote and maximise trust and confidence in the operation of insolvency law on the part of the community in general and the business and the corporate sector in particular. This is the objective of this insolvency reform package.

It is important to ensure that the law is modernised and improved when the need arises. This is another reason for this package. If our laws impede commercial activity or impose unnecessary costs on stakeholders, they need to be reviewed. This is the first time that this area of the law has been updated since 1992, and those reforms in 1992 were based on the 1988 Harmer report.

The government is not proposing radical changes to the law here. It believes Australia's corporate insolvency laws are well-regarded and essentially sound. They do not require fundamental revision. The government first announced this package of reforms on 12 October 2005. It indicated then that the exposure draft legislation would be prepared in consultation with industry groups. To give effect to this commitment on consultation, the government decided to appoint a small advisory group—the Insolvency Law Advisory Group—to provide technical advice about the initial draft legislation. It was also important, given the specialised nature of this area of law, to have access to industry expertise to assist in the development of the reform package.

The Insolvency Law Advisory Group includes practitioners, insolvency experts and representatives from the Institute of Chartered Accountants in Australia, CPA Australia, the National Institute of Accountants, the Law Council of Australia, the Australian Banking Association and the Insolvency Practitioners Association of Australia. Tranches of the draft legislation were progressively prepared and discussed with the advisory group on a confidential basis throughout 2006, culminating in the public release of the complete package on 13 November. A subsequent meeting was also held to discuss the development of legislation to implement the UNCITRAL model law on cross-border insolvency.

The government then released an exposure draft of the Corporations Amendment (Insolvency) Bill 2007 and their regulations for public comment. Comments on the proposals closed on 23 February 2007. This allowed over three months for public exposure of the package. Twenty submissions were received. We are currently analysing the comments in the submissions, but as a preliminary response I would note that the comprehensive nature of the reforms and the extensive consultation process that preceded them was warmly welcomed. I thank you again for the opportunity to address you. We will take any questions. My colleagues here will probably do most of the answering of specific questions.

CHAIRMAN—Thank you.

Senator MURRAY—In relation to your remarks, Mr Miller, I appreciate that you could not indicate to the committee whether and when the government would introduce a bill to pass through the parliament. But with respect to your task, once you have reviewed submissions, once you have had our report—I think there are real problems with insolvency law, I am keen to see reform and I am concerned that it has taken pretty well three years to get the process to this stage—how long would it take you to get you to a final bill which you can give to government and say, 'When you're ready, this is ready to go'?

Mr Brine—We are aiming for a bill for introduction in the winter sittings, the budget session. We are required to seek MINCO, Ministerial Council for Corporations, approval before we introduce it into the parliament.

Senator MURRAY—In theory—without committing the government, obviously—could that mean possible passage of the bill before the end of the financial year?

Mr Brine—It would be possible, but we have not canvassed it with the government.

Senator MURRAY—Yes. In my head there is obviously the fear of an early election; once that happens, any bills could be delayed until 2008.

Mr Miller—The problem is we cannot shorten it any further because of the MINCO processes that we have to go through.

Senator MURRAY—But you would be able to get it ready, all things being equal, with all the proper cautions, by May?

Mr Brine—Yes, Senator.

Senator MURRAY—Thank you.

CHAIRMAN—My first question relates to the submission from the Insolvency Practitioners Association and is about the ATO's position that liability for a superannuation guarantee charge will arise:

> … where an external administrator makes a dividend in relation to preappointment employee entitlements and … does not make a superannuation contribution in respect of that dividend …

The Insolvency Practitioners Association argue that this position is 'untenable'. What is your response to their argument? Should the Corporations Act be amended to clarify this issue?

Mr Donnan—That issue has come up in submissions that we have just received, and certainly merits some examination and possibly an amendment to the legislation. For us to get approval for that, we would have to go back to the government—but it is an issue that certainly warrants consideration.

CHAIRMAN—Okay. I note the government's response, and also your elaboration on that, in relation to our recommendation 54 regarding CVL and directors. The recommendation is that directors should be able to immediately put a company into liquidation, and the government's concern is that this gives directors too much power. But again I note the Insolvency Practitioners Association persist with their argument that directors ought to 'be able to appoint a liquidator by resolution at a meeting of directors'. Do you have any further response to the Insolvency Practitioners view?

Mr Brine—Yes. We are concerned that that change to CVL would give directors a lot of power and, if there were to be a dispute between directors and members, that would fundamentally change the dynamics of that dispute. Liquidation is a very difficult process to stop once it has started, unlike voluntary administration.

We have sought to address the issue of making it easier to put a company into creditors' voluntary liquidation through a slightly different mechanism, which has been to uncouple the members meeting and the creditors meeting. Currently the creditors meeting and the members meeting must be held on the same day, and there must be a certain notice period before the creditors meeting. Uncoupling the process for the members and the creditors meetings allows directors to hold a members meeting on the same day, for smaller companies perhaps just by using the facility for members to consent to short notice under section 249H, which will allow them to put the company into CVL that day and to then have a creditors meeting several days later. This should avoid the legitimate problem that the IPAA have picked up, which is that a lot of companies are being put into voluntary administration where there is no prospect of that company continuing to trade without addressing the problem that others in the community have identified—that it would give directors a lot more power over members.

Senator MURRAY—And you can do that within the defined number of business days?

Mr Brine—That is correct.

CHAIRMAN—What do you see as the downside of giving the directors this additional power? You say it potentially gives them too much power. What is the potential downside of that?

Mr Brine—I think if there were a dispute with members—if members went to a certain course of action the directors opposed—the directors could threaten to put the company into liquidation, and there is very little the members could do to reverse that process once it had commenced.

CHAIRMAN—Can I direct your attention to our recommendation 10, regarding recovering from directors the cost of reconstructing company records. Your elaboration of the government response notes that that recommendation poses considerable difficulties. It does not appear to address, though, the issues raised in the submissions of the Insolvency Practitioners Association and the Certified Practising Accountants. Their view is that the implementation of that recommendation would assist liquidators with their investigations of failed companies and the identification of phoenix activity, and it would give added weight to the gravity of any breach of section 286. What is your response to those points? I think they are fairly strong points.

Mr Brine—I am looking at the framework of obligations for directors. We certainly acknowledge that keeping accurate and up-to-date financial records is an important obligation—it is a key obligation of companies—however, we need to understand that any change to introduce new directors' duties would affect all of Australia's 1.5 million companies and it would affect executive directors and non-executive directors, for-profit companies and not-for-profit companies. So the change has a potential substantial impact on corporate governance norms.

Secondly, we are concerned that the framework of powers and duties strike an appropriate balance between promoting market integrity and not discouraging entrepreneurship through the corporate forum. In this context, we think this recommendation has the potential to give rise to some practical difficulties. First, it is not clear exactly how you would go about reconstructing financial records that do not exist or that are missing. The cost of this could be significant, and this may vary considerably across companies. Uncertainty as to the cost of reconstructing these financial records may give rise to costly litigation itself.

In many companies, company directors are not involved in maintaining or updating financial records. They delegate that to other officials in the company. As such, the proposed sanctions would expose directors to new liabilities and query whether we would want all directors to be involved in maintaining financial records.

The Corporations Act already provides for directors' liability where they have failed to take reasonable steps to secure compliance by the company with the obligation to keep financial records. I think that framework strikes the right balance where we require directors to take reasonable steps. I guess the strict liability offence with an uncertain financial penalty would be quite a departure from that. That summarises the concerns we have with that recommendation.

Senator MURRAY—On that point, rather than having a catch-all principle, isn't it easier to identify classes of directors so that the more onerous provisions apply to a class of directors who are likely to be directly involved in the maintenance or non-maintenance of company records? Typically, the phoenix company is not a large corporation; it is a small, hands-on operation.

Typically, people who wish to pervert the law involve themselves directly with the books. What you have enunciated is a very good general principle, but if you are trying to go after wrongdoing, which you are, then isn't it possible to devise a mechanism that targets those who are likely to engage in this kind of behaviour rather than the average or general director, particularly of a larger company?

Mr Brine—It would be possible. You could break down the obligation to apply to certain classes of company—for example, it could apply to proprietary companies rather than public companies.

Senator MURRAY—Have you thought of that? Have you rejected that?

Mr Brine—The problem there is that the class of proprietary companies is very broad.

Senator MURRAY—Can't you attack a class of behaviour rather than a class of company?

Mr Brine—At the moment the law tries to attack a class of behaviour in that it says directors must take reasonable action to comply or secure appliance. In that sense, we have tried to characterise the behaviour that we want to see directors undertake.

Senator MURRAY—But can't you classify it in terms of conduct? In other words, where a director typically conducts himself in a hands-on matter—I am not expressing myself legally, but you would understand what I mean—then the consequence of that is that they can be subject to this provision.

Mr Brine—That would be a departure from the general approach we take to directors' duties. In sections 180 to 184 there is a system of duties that apply to all companies and all directors. I guess that, legally speaking, it would be technically possible to craft a provision that talked about directors where they are the only company officer or the only shareholder, but that would be novel.

Senator MURRAY—What about applying it to executive directors? Typically, an executive director is hands on; it is entirely different to a non-executive director. Can you do it that way?

Mr Brine—You could. I do not think the term is defined in the legislation at the moment. Again, you would potentially capture a number of executive directors who, while being involved hands-on in the management of the company, are not involved in the maintenance of financial records.

Senator MURRAY—The problem with your approach—which, by the way, I broadly agree with; I think you should have general principles and should avoid specific classes where you can—is in being fair and just and proper to the majority; it gives wriggle room and escape room for this minority that we want to target. I am not sure from your answers to the chair's questions and my questions that we have got that balance right. The trends in corporate law worldwide are essentially that small proprietary companies shall not be subject to the broader requirements which apply to the mass of medium and larger companies. Some years ago there was the concept of the close company, for instance, which was a limited operation. If we are going to go in that direction—and I see that developing in accounting standards by the way; we are developing

accounting standards to apply internationally which will be specific for small for-profit and not-for-profit organisations—I would have thought that we could target this sort of activity in that way.

Mr Miller—It is a balancing act. I think it is balanced, as far as the principles are concerned. If you start drilling down for every possible and less likely event, all you are going to do is move to a more black-letter law, to something that is a lot more complex, which is fine if—

Senator MURRAY—I am not suggesting that as a general principle. What we are discussing here is the requirement that books are reconstructed. I think that is the specific building block on which much hangs in insolvency decisions. I am satisfied with your responses for the general corporate situation, but I am concerned for the miscreants that it still does not allow for that balance that you are discussing.

Mr Brine—It is a difficult question. If we step back a level, perhaps our general position is that we do not see the solution in this sort of law reform; we see the solution in initiatives like: the Assetless Administration Fund; changes to the rules for disqualification to restore the previous understanding that disqualification is not a penalty, it is protective for the community; bringing in stricter regulation of insolvency practitioners; giving ASIC more powers in key areas. While each of those reforms are incremental when looked at individually, we are hoping that the cumulative effect will be to discourage the conduct that you have identified. So, while we see some problems with this approach, it is not that we are not cognisant of this issue and not trying to take some steps to address it.

Senator MURRAY—Do you think the alternative is to leave the principles as enunciated by you but to allow application to be made in particular circumstances to either ASIC or a court for the process of reconstructing books to occur in a particular case?

Mr Brine—That could be a workable approach. It is not something we have thought about in detail, but that perhaps has the potential to be a little more targeted if there were criteria to be met before this sort of regime were to kick in.

Senator MURRAY—Without having thought about it at length, you are not instinctively repulsed by the idea?

Mr Brine—No. We would need to think about it in a little bit more detail, but a regime which had appropriate safeguards would have some merit.

CHAIRMAN—Can the department provide any details of measures that have been taken by the government, in association with the Council of Australian Governments, to enhance the detection of phoenix activity and prosecution of offenders? Has the minister raised the adequacy of arrangements for checking business names of companies on state business name registries against the ASCOT database with an appropriate ministerial forum, as recommended by the committee in its June 2004 report? If not, is that likely to occur and, if so, when?

Mr Brine—Perhaps I can answer the later question first. We have not yet referred the issue of reviewing the adequacy of arrangements for checking the business names of companies on business name registries against the ASCOT database to COAG or one of its committees. We

have looked at this issue, though. First, we would note that the Australian Business Register now provides a facility to allow a person to check the trading name of a business against the associated entity name and the Australian business number. So there is a mechanism there to address, I think, the key concern that was raised with the PJC, that there was no mechanism to check ABNs against business names. We noted that.

The second thing we noted was that COAG has agreed to the Small Business Ministerial Council developing a model for a more coherent registration system for both ABNs and business names, including trademark searching. It has been a longstanding issue that people quite often register a company name without realising there is no trademark associated with that. The Small Business Ministerial Council is progressing consideration of this matter with a view to presenting a model to the next COAG meeting, which is in April this year. Subject to COAG's agreement, a discussion paper outlining a new model for registration of ABNs and business names will be issued in the near future.

Again, there is currently a mechanism for checking business names against ABNs. We are monitoring developments that are occurring in COAG through the Small Business Ministerial Council and when they release their report we will review that with a view to identifying whether any enhancements can be made to make it easier to check ABNs against business names.

The other question asked was about initiatives to do with phoenix companies. I note there that the assetless administration mechanism has been introduced and is working well. I think ASIC in their submission detail the progress that has been made with the Assetless Administration Fund. The other mechanism to note is that the government has announced that the tax law will be amended to make it easier for the ATO to share information with ASIC about a number of matters, including phoenix companies. We are hopeful that that will assist ASIC in its endeavours to prevent this sort of conduct.

CHAIRMAN—I note that in relation to the Assetless Administration Fund you say, 'The administration of this program will provide improved information about assetless companies.' But you seem to continue to reject our proposal for a specific empirical study of assetless companies. Given that you are moving forward on the fund and you say that there will be improved information, why not have a specific empirical study?

Mr Brine—I guess any budget related decision like this is considered by the government in the context of the annual budget process. Bids for funding for empirical studies like the one that is proposed here are considered against other priorities in the portfolio and other priorities across government. At this stage the government has not made any decision to allocate new funding for an empirical study. Perhaps the point is not that we are opposed to a study but rather that, in making its decisions about which funding matters to prioritise, the government has not made a decision to fund this initiative at this point in time. However in that context I would note that ASIC is getting more information about assetless administration through the administration of this fund and its liaison with liquidators there. It has also conducted a new information-gathering process, which is providing it with more information about liquidations generally. Again, that is addressed in some detail in its submission.

Mr Donnan—Also ASIC can undertake currently an empirical study of that kind. It did so in 1998. That was quite a substantial study involving the sample technique that Senator Murray mentioned earlier. You might remember that report. It was quite a good report into the entire operation of the voluntary administration scheme.

Senator MURRAY—I have asked ASIC before about the difficulty people have—when moving into the area of insolvency, disciplinary action or reacting to individuals before them—of knowing the history of the individuals concerned. If you search ASIC information for the history of corporate involvement, you can quite easily find the official history of an individual—whether they have been an agent, a licensee, a director or have had some kind of official function. If you search the ASIC database to find out what disciplinary or administrative actions have ever been taken against individuals—or even criminal or civil actions—then you cannot find that. And yet that is very relevant to circumstances in insolvency, because for somebody involved, for instance, in phoenix companies quite often there is a pattern of administrative action having been taken against them—there might even be a case of bankruptcy in the background. I very much doubt that the average liquidator would be able to easily establish if someone has been banned from managing a corporation for three years and that ban has expired, that the ATO had punished them for not putting in their tax returns, or that they were once bankrupt and had then been cleared. These indicate a pattern of behaviour.

In criminal investigations by the police, if you have crossed the law, generally speaking, they can draw it together, and the purpose of cross-state databases has in fact enabled authorities to do that. What do you think about that issue and that problem? Do you think we should devise an obligation by ASIC that if an insolvency—even if it is a voluntary situation—is to occur, they automatically supply background data information, or do you think that would be profoundly unfair to the individuals concerned?

Mr Brine—So the proposal is that ASIC would provide information to their liquidator about the officers involved?

Senator MURRAY—Yes, because if someone simply has fallen onto hard times in business or made an error of judgment—perfectly legitimate behaviour—insolvency is no crime and it is just a very unfortunate circumstance. But if it is contrived, if it is the consequence of wrongful behaviour, then the liquidator needs to be more cautious, more alert to those issues that might surround it. They will not be alert to it unless they have some mechanism for knowing that the people they deal with have a history which should make them a little more wary of them than they otherwise might be.

Mr Miller—I suspect ASIC might have a few comments on the mechanism side of it, because they would have to try to collect this information, plus there will be a cost involved. I think I am right by saying that most of this information is probably publicly available but in, as you say, diverse sources.

Senator MURRAY—Not necessarily. There is not to my knowledge—and ASIC can confirm this—a register of past offences which is easily able to be accessed. If you were to plug in a name—let us invent one, say, Matthew Miller; and if there is a Matthew Miller out there, this does not refer to you—and you wanted to see what their corporate history was, both negative and positive, you would not be able to do so.

Mr Miller—The court records would have most of this. Somehow ASIC would have to try to pull all this together. It is something you might want to talk to ASIC about. But I could see it would be a huge job and there would be a huge cost to do so. Would the cost be enough—

Senator MURRAY—It might not be a huge cost; going back you might struggle. But throughout the interaction of legislators and policy makers such as you is the constant understanding that modern databases enable an interlinking which facilitates a better understanding of particular circumstances. We have already discussed that with respect to this bill. So the question is: how can you ensure that those people who are least attractive in the corporate world are actually monitored and reacted to more forcefully than those poor devils who have simply fallen onto hard times or made an unfortunate error of judgment in the normal risk environment which business attracts?

Mr Brine—This issue has been raised with us before in the context of the disqualification provisions. As you would know, a person becomes automatically disqualified in a number of situations—for example, where they are convicted of a criminal offence for a certain period or even if they are convicted overseas of an offence for a certain period, they are automatically disqualified. ASIC maintains a register of disqualified persons, but that register applies only to persons who are disqualified as a result of ASIC action. There have been suggestions from time to time that we extend that to include all persons who are, under the law, disqualified. Again, this raises some practical issues about how ASIC would identify persons who are convicted of these relevant criminal offences within Australia, let alone overseas.

We have previously corresponded with the states, through the ministerial council, asking them whether they would be prepared to meet the costs in some way of an automatic reporting mechanism whereby their courts notify ASIC of criminal convictions that meet the criteria that are specified in the Corporations Act. I cannot remember what the exact terms used in section 206 are, but if a criminal conviction involves fraud and it is for longer than two years, or whatever the period is, ASIC would automatically be notified and ASIC would note on their website that that person had been disqualified for whatever the relevant period was. So far, we have not heard back from the states that they would support that, and that correspondence was sent some time—a number of months, if not over a year—ago.

We do not see it as feasible to put the obligation on ASIC to keep track of everyone who is convicted of a serious criminal offence or an offence involving fraud or dishonesty in a corporation. However, as an initial step, if the state courts were prepared to examine this issue of notifying ASIC automatically of an eligible offence, and ASIC could then reasonably easily put that on their database, and if we were to secure the agreement of the Federal Court to do the same thing, that would be a positive step.

Senator MURRAY—To return to my earlier themes, I think there are circumstances when liability needs to be raised against the individuals concerned. But that will only arise where a liquidator, even under voluntary circumstances, is prompted to dig and inquire further than they otherwise might—within the ordinary bounds of discretion and cost. So I think the liquidator needs to have a warning signals system available to him or her which they can access so that they can then make decisions as to whether, for instance, books need to be visited in a particularly thorough manner or reconstructed or whatever it is. That is what is in my mind. When we had a look at this area, there was a whole area of insolvency administration which was

by rote—tough luck, and you just have to clean up the mess. But there is a whole area which is being contrived and is therefore deserving of different attention. That is why I am putting these questions to you.

Mr Brine—I guess there is a broader criminal justice framework, and the decisions about the information that is made available about criminals' convictions is not necessarily one for us; it might be something that the Attorney-General's Department would have a firmer view on. There is the issue about disqualification that picks up a number of those concerns which we are aware of, but we do not see ASIC as being able to collate that information without some assistance.

Senator MURRAY—That would be the systems approach. It might have to be prospective; they might have no chance of going back.

You would have noted, I assume, in your general awareness of government policy, that the Attorney-General's Department has been very active on bankruptcy law; I think we have had three bills before us. To my knowledge this is the first insolvency bill in 11 years. Are you actively ensuring appropriate linkages between bankruptcy provisions and advances in insolvency law, given—particularly at the small proprietary end and the phoenix company end—the obvious intersections? Do you talk to each other?

Mr Brine—Yes; we talk to our colleagues in ITSA reasonably regularly. And of course the IPAA is an industry association that covers both personal bankruptcy and corporate insolvency, so they are quick to alert us to any inconsistencies that are giving them difficulties. One observation I would make, though, is that the policy environment for corporations and individuals will vary from time to time, so it is appropriate that there are some differences.

Senator MURRAY—I just want to be sure that the obvious linkages are being picked up on and that the right hand does indeed know what the left hand is doing.

Mr Brine—We are consulting with them on the UNCITRAL model law at the current time, for example, because that is something that will affect both corporate and personal bankruptcy.

Senator MURRAY—I am not asking you to tell me anything about policy, but is it in your mind that there may be other insolvency bills coming before the parliament in due course—that this is not an isolated reform?

Mr Brine—I think there is the Model Law on Cross-Border Insolvency, which is being progressed alongside this package. That was initially circulated for comment as part of CLERP 8. That has been in the public forum for a long time now and progress with that has not been as quick as we would like, but that certainly is on the same time track as this bill, if not slightly faster.

I think also that this process has fleshed out a number of issues, such as advertising in insolvency, that we would be keen to progress at a later date. While we do not want to hold the bill up to address those issues at this time, because I think we would need to conduct another consultation round on any legislation to address those issues, we certainly envisage that they will be picked up in a new bill, probably next year.

Senator MURRAY—So recommendations from this inquiry which have not been dealt with in this exposure bill, those from our previous report or those that we might raise in this inquiry's report, would have a legislative vehicle that they could be attached to later on?

Mr Brine—That is correct. Regarding other things on our forward work agenda, I have just noted the CAMAC inquiries into long-tail liabilities and Sons of Gwalia, both of which we would expect to report on if not late this year then early next year. Both of those could require a legislative response.

CHAIRMAN—You are probably aware of a submission that I made to Chris Pearce. I think the same person made a submission to you, Mr Brine, but wishes to remain anonymous. We raised particular concerns about voluntary administration and preference recoveries in the distribution of funds where he believes that liquidators, for want of a better word, are ripping off creditors. I note Chris Pearce's responses to those representations, which this gentleman does not believe are adequate. Have you given any further consideration to the issues he raised, and if so what is your response to those?

Mr Brine—We have and we will be giving further consideration to those. I think the main issue that he raises is that the clawback provisions are being misused and should be wound back. I think that is a legitimate concern. It goes to some of the fundamental insolvency rules, and we will be working through those issues.

Obviously they are not addressed in the current draft. That may be something for a future bill. There do not seem to be any easy answers to the issues that he is raising, although the practical experiences that he cites are of concern. Again, this may be something that is addressed through the incremental reforms in other areas, such as giving ASIC new powers to look at how liquidators comply with their fiduciary duties—a slightly more stringent registration regime. They may all go towards addressing these types of problems.

Certainly, we have not had a lot of evidence that this is an issue. From time to time we get ministerial representations raising similar problems, but it is not something that any of the business lobby groups have raised with us. The ABA, for example, has not raised with us a concern that this is being misused.

CHAIRMAN—It is interesting that this gentleman as an experienced practitioner raises this.

Mr Brine—That is correct.

Mr Donnan—The preference provisions have been part of insolvency law since the time of Queen Elizabeth. It would be very odd if we took them out of the act, and creditors would certainly find plenty of opportunities to criticise the law. Another point to make is that it is not clear that preferences are used just to pay liquidators' remuneration. We see many instances where preference recoveries go back to creditors. That might be an area where trying to collect some empirical information might be warranted. But we are aware of many instances where preferences go back to creditors.

CHAIRMAN—Do you have that information?

Mr Donnan—It is only anecdotal and ad hoc. Of course, there is a lot of case law on preferences, and large sums are involved in large insolvencies. Again, it would seem very odd for an insolvency law not to have those provisions in it.

CHAIRMAN—Thank you for that. As we have no further questions, thank you very much to each of you for your attendance at our hearing and for your assistance with our inquiry.

[10.17 am]

RODGERS, Mr Malcolm, Executive Director, Regulation, Australian Securities and Investments Commission

CHAIRMAN—I welcome the representative from the Australian Securities and Investments Commission. Mr Rodgers, the committee has before it ASIC's submission, which we have numbered 7. Are there any alterations or additions you wish to make to the written submission?

Mr Rodgers—No.

CHAIRMAN—I invite you to make a brief opening statement, at the conclusion of which I am sure we will have some questions.

Mr Rodgers—I do not propose to make an opening statement, Chairman, other than to say that we have taken the opportunity in responding to the terms of reference that are specifically directed to ASIC to describe in outline in the covering letter the initiatives that we have been taken in the insolvency area since the committee last considered this. Apart from that I am happy to go straight to questions.

CHAIRMAN—In your submission, you say that since 2002 insolvency has become 'a significant national regulatory priority' for ASIC. Can you give us some details of particular programs and outcomes that justify that conclusion as well as details on any research and information you have published that support that claim.

Mr Rodgers—The reference to a national priority is a reference to our own internal business planning processes in the 2005-06 year. But generally we have pursued a number of lines which I might describe to you in brief outline. Firstly, we have been working with the insolvency profession on the quality of the information available to external administrators. We have taken a large number of what might appear to be minor administrative prosecutions against directors who are not, in our view, adequately cooperating with external administrators to improve the quality of the information flow between directors and officers of companies under external administration and an incoming external administrator. Our submission notes that, while we have a large number of relatively minor prosecutions, we are now detecting a distinct trend in phone calls or communications from ASIC to directors to suggest that they cooperate more effectively with an external administrator, resulting in pretty much immediate cooperation. So that is the first strand—to improve the flow of information from the company under external administration to the external administrator.

The second strand, what has been mentioned already, is the assetless administration. I guess that starts from the proposition that a company that is likely to be of most interest to ASIC as a regulator is a company whose failure has been so severe that it has not enough assets to fund the inquiries that an external administrator would make. So, with the government's assistance, we have established an assetless administration fund, which is directed to putting a liquidator—usually—in a position where they can make the inquiries that otherwise a complete lack of assets in a failed company would not enable them to make.

So that information can be gathered by the liquidator and given to ASIC in those cases which are most likely to be of interest to ASIC. We are already starting to see results, some of which are reflected in our submission, in that ASIC is in a position much earlier and with better quality information to make inquiries and to take regulatory action in a much more timely manner against failed companies. So those are the two major strands. We have also worked much more extensively with the profession in the period between 2002 and the present time to get the system working effectively as a whole.

CHAIRMAN—In relation to assetless companies, we recommended that as a first step ASIC begin to collate statistics on insolvent assetless companies and to publish such figures on a triennial basis, together with an analysis. In your response you note:

ASIC ... is compiling statistics from electronically lodged statutory reports in the format of Schedule B to ASIC's Practice Note *50 External administrators: reporting and lodging* for the 2004/5 and 2005/2006 financial years.

Can you explain to me how that relates to assetless companies and the information that it provides in practical terms on assetless companies?

Mr Rodgers—What we did some years ago was to invite external administrators to supply us not only with the information the act requires but with a fair bit more information at the beginning of the administration process than the law strictly requires. That is something the profession has embraced and accepted. That data coming to us electronically goes to our ability to create a snapshot not only of what is occurring in a particular administration and the circumstances of a particular administration. It enables us to collate that information and reflect more generally on the pattern that is emerging with external administrations more generally. One of the questions we ask is about the size of the losses and the assets that are or may be available. So it will cover assetless administration.

In our submission we have said that we are in the process of compiling those submissions. That information has taken us a little longer to gather than we had hoped. But I am hopeful that in the remaining months of this financial year we will be able to put that information together and reflect to the committee and publicly on what information we are able to glean through that process.

CHAIRMAN—Do you have a view on our recommendation 7 regarding the establishment of a new advisory council with representatives from across the insolvency industry to assist ASIC in the maintenance of professional standards of insolvency practitioners? The Treasury argues in its submission that this would duplicate existing mechanisms for consultation.

Mr Rodgers—My recollection was that that was a recommendation for the government. To the extent that it involves a government policy issue, I would not want to be drawn to comment on it. The only thing that I would say is that we have worked very hard—and our submission indicates this—in our connection with the profession and those involved in the insolvency industry. We think that that is working well and providing both us and the industry with the information and the opportunity for exchanges of views that are essential for the good administration of this part of the legislation.

Senator MURRAY—You heard my questioning of Treasury earlier. Essentially, I want to know whether it is feasible, advisable or desirable for ASIC to head up a better database of miscreant activity, if I can put it that way. Administrators and liquidators are like anyone else. If it is a straightforward situation, they do not want to incur cost and effort which is unnecessary. But there are circumstances in which the characters involved may not be known to the liquidator or the administrator in the normal course of events but may have a history of bankruptcy, phoenix company activity or failing to lodge tax statements or may have been penalised administratively by you et cetera. You heard the discourse earlier. Do you have commentary on all that?

Mr Rodgers—As my Treasury colleague responded, we maintain a register of directors who we have taken administrative banning action over. To the extent that we are talking about the conduct of directors or officers in respect of a corporation, if there were to be a some kind of public reflection of that more broadly, I can see a logic in having it attached in some way to the public register of corporations. It would be feasible. Having said those two things, there are some buts. ASIC could not do this of it own initiative. It ultimately becomes a policy question of some significance, I would suggest, as to whether you ought to bring together all of the potential misconduct of a person who happens also to be a director of a corporation, whether or not the misconduct relates to their actions as a director, and put it in one place for the benefit of the community. It seems to me that there is a very interesting set of public policy issues buried in that question, and I would not want to express a view on ASIC's behalf about the desirability or otherwise of doing that.

Senator MURRAY—One of the difficulties we all have in coming to a view on these matters is, of course, that the datasets are inadequate. My legislative difficulty is this: if you take the view that you do not want to go in that direction and therefore you are not going to target classes of persons for much more intense and reactive activity by an administrator or liquidator but rely on the general law, you are therefore required to make the general law such that it is not excessively onerous because most people do not need that highly targeted activity. The reconstruction of books is, I think, a prime example of that; it is a costly, difficult and time-consuming exercise which should only be engaged in if there is a genuine need—and you do that through a targeted approach. Is your reaction such that you would wish to wait and see the effects of these exposure draft changes and other changes—such as those outlined by Treasury, which parallel it—before considering the sort of issue I have raised further?

Mr Rodgers—The short answer to that is yes. As a said, it is connected to a set of public policy issues which I suspect should not be a lead point rather than a point of comment and contribution if that set of proposals gets a public airing.

Senator MURRAY—Do you, in your own records, have an easy ability to pick up the negative corporate history of any individual?

Mr Rodgers—We have access to considerably more information than is on the public record. If you take the simple proposition that the corporate register in its present form begins with an inquiry about the corporation rather than an inquiry about a person—

Senator MURRAY—Except in phoenix company situations, generally it is the person that counts.

Mr Rodgers—Our own internal systems allow us to connect on a personal basis so that we can track the official position in any records that we have maintained about any individual within the system, but that is not publicly available because the public is invited to make inquiries about a corporation rather than an individual. Similarly, a degree of cooperation with other law enforcement authorities—and potentially, as we have heard from Treasury, with the tax office—will put us in a position where we have more information than is on the public register.

Senator MURRAY—As you know, most administrations or liquidations are not at the initiative of ASIC—ASIC has nothing to do with them—but, for those that are at your initiative, is there anything in the law to prevent you from formally advising the appointed administrator or liquidator that they should be more diligent because the personalities involved in that corporation have a history with yourselves? Is there a privacy constraint?

Mr Rodgers—The starting point proposition is section 127 of the ASIC Act, which requires us to keep confidential the information that we acquire in our capacity as a regulator. It does have a number of exceptions enabling us to share information so acquired with other government agencies, with equivalent foreign regulatory bodies and with the Australian Stock Exchange. I do not think there is a provision allowing us to share information with an individual insolvency practitioner.

Senator MURRAY—Because I think this is a sensitive area I do not want on the record anyone getting a misunderstanding of what I am on about. I am really less interested in your detailed knowledge than in the administration of a penalty or the knowledge that a person has had action taken against them. In other words, it is a recorded misdemeanour or event of some kind which, if you searched, you might find on the public record, such as a bankruptcy, an administrative penalty and so on. So with respect to those kinds of things, do you automatically advise the liquidator or the administrator?

Mr Rodgers—I suspect that we owe no duty of confidentiality in respect of information which is publicly available on another record. We do not acquire that information in our capacity as a regulator.

Senator MURRAY—Let us get to what I am after. The liquidator or the administrator may be ignorant of matters which are otherwise on the public record and may not have the time, the resources or the opportunity to search for them. Do you think that the law should be changed so as to allow you to provide those at your own discretion in instances where you think it would be helpful to the administration or liquidation?

Mr Rodgers—In some cases, I do not think that requires legislative change because merely drawing the attention of a person to publicly available information will be precluded.

Senator MURRAY—But the fact is, you do not do it, do you?

Mr Rodgers—I cannot say that it never occurs. I am not sure that it occurs as a matter of course. Where it does occur, it will occur only if we take the view that we do not broach our own obligations in doing so.

Senator MURRAY—Mr Rodgers, could you come back to the committee and indicate to us whether, firstly, it ever occurs—and bear in mind that I am talking about recorded matters that are on the public record not stuff you may have found out in your own investigations, which I think would be difficult—secondly, whether you feel it should be automatic or at your discretion and, thirdly, whether you believe that ASIC could institute that as a more regular procedure because it would be helpful or whether you have an alternative view. Do you understand what I am after?

Mr Rodgers—We can do that.

Senator MURRAY—Lastly, could you confirm your view that no legislative change would be required and that it would just need a different policy approach.

Mr Rodgers—I am happy to take that on notice.

Senator MURRAY—I have this belief that liquidators and administrators do not always have all the information which would assist them in their task; and we have discussed the data issue elsewhere. Do you follow that?

Mr Rodgers—Yes, I do.

Ms BURKE—Does ASIC play a role in the administration of GEERS or provide information or assist in that process?

Mr Rodgers—Not specifically. We do so some things with GEERS only in relation to our overall responsibilities for insolvency. But the actual administration of GEERS does not sit with us.

Ms BURKE—One of the issues with GEERS that relates back to the administration of insolvency is the ability for the liquidators to actually get the information about what is owed to the employees. One of the dramas of winding up a lot of these companies is that they were not very good at keeping records, period, so there is no way of ascertaining the timesheets or the wages earned so that the individual can then put in a claim. Oft times, individuals are then left rifling through their own personal records to find their tax returns and so on, and then they are advised, 'No, that's not sufficient'.

Is there any requirement for these companies to have up-to-date records that you administer, so that when someone comes to wrap them up they can say, 'These are your creditors and these are your liabilities'? It seems that that is often amiss when someone is winding up these firms.

Mr Rodgers—Yes, there is a specific provision—I think section 286 of the current Corporations Act—that requires a company to keep proper books and records. I will not say it is routine, but it is common, when we are taking action against officers of a failed company, for failure to keep proper books and records to be one of the bases on which we take action. It is a difficult question. By the time you get to liquidation, the failure to keep proper books and records has already occurred, and then that goes to the issues that Senator Murray has been raising about what the regime ought to enable somebody to do in order to reconstruct, to the

extent that that is practically possible, that piece of history which has not been recorded as it happened.

Ms BURKE—The other thing would be to ensure that companies are keeping them as they go along. I know that that would be a massive audit process. Companies are meant to put in their statements to you annually about what they have done, but is there any way of having a process to ensure that when they end up in this mess there are records and that they have kept appropriate logs of when employees worked and who they did or did not pay money to along the way?

Mr Rodgers—For part of the corporate population. My recollection is that about 25,000 of the 1.5 million companies are required to put accounts on the public record which are audited. Directors have to make statements on the public record that they have been doing the right thing, as do auditors. But it is hard to imagine how you could in real time police the obligations of the balance. The numbers escape me at the moment, but it is somewhere between 1.4 and 1.5 million companies. It is difficult to imagine how that could occur in real time.

Senator MURRAY—That is why you need a targeted approach.

Ms BURKE—Yes. I do not actually envisage ASIC having the ability to go out there and do it all, but it seems that with more and more small to medium sized entities registering—and employing staff and paying people; not just employing themselves as the company—we are looking for a situation where there is something to assist those companies along the way, so that they do not end up in the mess that a lot of them do.

Mr Rodgers—The one area which perhaps I should have mentioned in response to the chairman's question about initiative is the work that we have done through the National Insolvency Coordination Unit, which is an attempt to get to a problem before it results in a collapse. I think our submission says that we visited in excess of 1,600 companies that we had some reason to imagine might need our advice because there might be a looming insolvency or a failure to meet their obligations. But even targeting those is fairly difficult.

Again, we are talking about such a large population that it is impossible for me to imagine how you would monitor that on a real-time basis. Where we have been able to get information—and it includes some listed companies but also some small to medium companies where we think there may be an insolvency crisis looming—we have initiated contact, had a look at things like books and records, and had a friendly and constructive chat to directors and officers about the need for them to be conscious of their obligations. I think, as our submission shows, that has on many occasions resulted in a decision to call in an administrator, but it has also focused people's minds on their obligations as a whole. It is a relatively small number in a very large population.

Ms BURKE—There are two complaints that often walk through the electorate office door. One is the lack of professionalism of some administrators, in terms of insolvency ability, and the ability of creditors and individuals to get information out of them about—as they perceive it—their money, and also the lack of administrators available. I just want to check that issue. The other big one is not just loss of pay but underpayment of super. Without fail, the underpayment of super is the one that sticks, and also—although I know it is not your area—the ability of the

ATO to get it back and to find out anything. There are also issues around privacy on that one. I am just wondering whether those two issues have come across ASIC's—

Mr Rodgers—Certainly the issue of the overall quality of the professionalism of the insolvency profession has been part of our thinking. While we have been working with the profession, it has also been our strategy to work on the profession, because we do think in some areas there is room for improvement. Not only through the parliament's processes but also through our processes there have been complaints about the competence of an administrator in a particular administration and about remuneration and so on. We have been, both in speaking to the profession and in the material that we have put out as guidance or helpful indications of our thinking—and that was always part of our strategy over the last three or four years—working not only on the insolvent company but also on the quality of the professionalism brought to bear by the insolvency practitioners.

On the superannuation front, it is really much the same issue as GEERS. It is often back to proper books and records. There is a large risk that companies in distress will fund themselves through that period of distress before insolvency by, effectively, using other people's money. And that is present in that environment.

Senator WONG—I was late, so I am sorry if I am covering an area that has been dealt with. I will go to statutory reports; I do not know how many questions have been asked in relation to that. I noticed in the table ASIC prepared that in your comments against the committee's recommendation No. 40 in the 1994 report, regarding more comprehensible data in relation to statutory reports, you refer back to your comments in relation to recommendation 30. This is an issue which obviously also has been raised in the Auditor-General's context, regarding the number of statutory reports actually investigated. Are there any comments you would like to make about that? It does not seem to me, from that table you have provided attached to your submission, that ASIC is actually undertaking recommendation 40.

Mr Rodgers—We are compiling the statistics. As I have said previously, that has taken longer than we would have hoped. But we are well advanced now on compiling an information set out of the material that our electronic interface with the profession enables us to do, and I am reasonably confident—that is, I am advised—that we can complete that work and reflect it publicly in the period between now and 30 June.

Senator WONG—That is welcome. I did raise this question in the estimates process, but have there been any changes to the way in which ASIC approaches the statutory report, subsequent to the Auditor-General's report on that issue?

Mr Rodgers—On? Sorry, I am—

Senator WONG—My recollection is that the Auditor-General looked at the proportion of administrators' and liquidators' reports that were investigated by ASIC and indicated—notwithstanding the fact that there was a very substantial increase in the number of statutory reports—that the proportion of those actually looked at by the commission had dropped from about six or seven per cent to one per cent. I did raise this was Mr Cooper and Mr D'Aloisio and the indication was that you had a different approach to risk analysis. I cannot remember the term that was used, but there was some explanation for it. There were some criticisms—although that

might be too strong a word—made by the Auditor-General of the proportion investigated and I am wondering if any action has been taken subsequent to that report.

Mr Rodgers—If I can just reiterate what I understand to be Mr Cooper's response. I say this merely to put it in context. The ANAO report looked at what is in effect only one aspect of our dealings with insolvency, which is what we do with 533 reports. It did correctly note that we had produced some kind of regulatory response to something like 7½ per cent in the late 1990s and that that figure has been pretty much consistently around one per cent for the last two years. All of that is correct. We have tried to do a number of other things that enable regulatory interventions. That is only one potential source. Some of the initiatives that we have taken through ASIC were administration and I think that the numbers reflected in our submission show that when we get timely information, as we have been through that process, that is effectively like a speeded up 533 reporting obligation. We are able to act more quickly and more decisively on those and the numbers are starting to show.

As to the overall proportion more broadly, again, I have a couple of comments. An investigation is an interesting word in this context because, as you know, it has a very formal meaning within ASIC. It means you commence a very formal process under section 13 of the ASIC Act. One per cent does not mean that we do not do anything about the other 99 per cent. There are a variety of actions, with some of them leading to a regulatory outcome. But, going forward, I think that we will look at how we do that. We are now moving well and truly into our 2007-08 planning year and in view of the comments made in the ANAO report and the issues that have been raised, including in Senate estimates, we will certainly look at how we are doing that job and whether it is feasible, given other priorities, to up the number of responses that we make.

Senator WONG—I assume ASIC does not disagree with the recommendations.

Mr Rodgers—No.

Senator WONG—So it may be a process whereby you look at a different systemic approach and different levels of investigations. I appreciate that you cannot investigate all of them and nor would it be sensible to do so, but it is an issue that is certainly raised with me in my portfolio responsibilities on occasion. There is a perception from some that these matters in the statutory reports are not followed up. That is anecdotal and people obviously put their own views about this, but it is an issue that obviously the Auditor-General has looked out and I suppose I am flagging with you that, in terms of statutory responsibilities in relation to insolvency, it is certainly an issue that has come to our attention.

Mr Rodgers—I would say, Senator, that what we have been working hard to put in place over the last three or four years generally makes it appropriate now; I think we are now at the point where we can actually revisit that and our overall engagement with it can be more effective and efficient than it would have been had it not been for the other environmental work we have been doing over the last three or four years.

Senator WONG—I appreciate that, but there is a statutory reporting process which is not written into the law except for those sectoral issues. One final issue is that in your submission you choose not to respond to a range of the 1994 recommendations on the basis that they are

matters of policy for government. I understand your position, but obviously from the committee's perspective, given that we have made various recommendations which have not been picked up by the government, we may wish for the opportunity to test your views as to the viability of some of the recommendations that you have chosen not to comment on, in the event that the committee sought to re-emphasise those again in relation to this bill. So I am wondering what sort of process you might want us to undertake to enable that to occur.

Mr Rodgers—We are always happy to assist with information about our practical experience in dealing with these issues—how things work or whether something would work. We are keen, I think, not to be drawn into the public policy process. But if the committee, through its deliberations, did want to invite us to comment on a particular issue, can I suggest that unless you want to do that in a hearing we would be happy to take that on in an exchange of correspondence.

Senator WONG—Thanks very much.

CHAIRMAN—I note that in your submission, where you have the table of responses to our recommendations, there is no comment on recommendations 11, 22, 50 or 53. Can you provide some comment on those recommendations?

Mr Rodgers—I think we had characterised those as not being directed at ASIC; that is the reason they are not there.

CHAIRMAN—Even though the government has? The first one relates to a practice note:

The Committee recommends that ASIC issue a practice note as to what constitutes insolvency …

That is definitely for ASIC.

Mr Rodgers—I am not sure I can answer that. So the question about that is what has happened?

CHAIRMAN—Yes, what is your response to that recommendation, also to recommendations 22, 50 and 53, which are related, I guess.

Mr Rodgers—Let me deal with the first one. Our submission, and the covering letter to our submission—

CHAIRMAN—Which is this?

Mr Rodgers—This is dealing with recommendation 22. I will come back to 11. We have put on our website a number of information sheets I think which were designed to communicate the basics of insolvency to creditors, employees, directors and shareholders. I apologise if it is not in the submission.

If I can go back to recommendation 11: we have issued one of these information sheets directed to directors which provides some help in identifying the sorts of indicators of insolvency. This is an area where we need to be cautious, of course. While we are happy to

provide people with help and guidance, we also need to be careful not to be seen to be substituting our view for a definitive legal opinion. We have in fact done that, Senator, in the sense that we have provided it. So that is 11. I think we have done recommendation 22; we did produce a fairly comprehensive set of information sheets that were for the guidance of the ordinary layperson—whether they be director, employee or creditor—about how the insolvency regime works. The other ones, Senator?

CHAIRMAN—Fifty and 53, which are probably related to each other. It is working with the IPAA to educate unsophisticated creditors about their rights in relation to deed of company arrangements.

Mr Rodgers—I think my learned colleague is about to pass me another helpful note. Again, there are two bits to that. We have worked substantially with the IPAA over the period. Also, that set of information sheets was designed to really cover off from our perspective on those recommendations. If you look at page 4 of our submission, you will see a list of the publications and you will also see that, effectively, that work by ASIC was endorsed and adopted by the IPAA and it has been cobadged as a list of helpful materials available to those who need to know about insolvency.

CHAIRMAN—The others were 26 and 27, but I assume your response to that might be incorporated into your response to 24.

Mr Rodgers—It is fair to make that assumption, Senator.

CHAIRMAN—Are there any further questions?

Senator MURRAY—There is one last question I wanted to ask. Mr Rodgers, I think you will recall—because I think you were in the room at the time—a discussion with Treasury about the committee's recommendation 10 and the issue of recovering from directors who fail to ensure that company records are complete and up to date the cost and expense of reconstructing a company's financial records. Not to do anything other than paraphrase my understanding of their remarks, essentially they were concerned that, as a general obligation to directors, that would be too onerous an approach, to which my response at the end of the series of questions was: did they think that it was perhaps possible in certain targeted circumstances, where a particular class of director had been identified as problematic, for an application to be made to someone like ASIC or some other body to approve those circumstances? Their reaction was that they were not immediately negative about that, but they would need to think about it. Rather than you answering on the run, would you have a look at that interaction with Treasury and come back to the committee with a view as to whether, if the government will not accept recommendation 10 in the broad for the reasons it has given, there should be an exceptional circumstance whereby applications could be made for that to occur?

Mr Rodgers—I am happy to take that on notice, Senator.

CHAIRMAN—As there are no further questions, Mr Rodgers, thank you very much for your appearance before our committee and for your assistance with our inquiry.

Proceedings suspended from 11.04 am to 11.19 am

PURCELL, Mr John Anthony, Policy Advisor, CPA Australia

CHAIRMAN—I welcome Mr Purcell, representing CPA Australia. Do you have anything to add about the capacity in which you appear?

Mr Purcell—It is a joint submission, but I am here representing CPA Australia, rather than both that and the Institute of Chartered Accountants.

CHAIRMAN—The committee has before it your submission, which we have numbered 12. Are there any alterations or additions that you wish to make to the written submission?

Mr Purcell—No.

CHAIRMAN—I invite you to make a brief opening statement, at the conclusion of which I am sure we will have some questions.

Mr Purcell—Both the Institute of Chartered Accountants in Australia and CPA Australia had been approached to make written submissions to the committee's inquiry into the exposure draft of the Corporations Amendment (Insolvency) Bill 2007. The two accounting bodies have taken the opportunity to present a joint submission. We addressed the 27 2004 stock-take recommendations and have presented a consensus view. While we express support for a number of these recommendations, we firmly believe that they do not present any basis for delaying the progress of the 2007 bill. Additionally, it is worth remarking that a number of the recommendations present difficult choices, with alternative approaches having merit.

I would like to take this opportunity to thank the committee for their invitation. Participation in this and similar forums, including CAMAC and more recently the insolvency advisory committee, are seen as important avenues for participation in the law reform process. The views expressed in this session of the committee's hearing are those in my capacity as an employee of CPA Australia.

CHAIRMAN—In your submission, you support measures included in committee recommendation 10 because you say that they would give added weight to the gravity of a breach of section 286 and assist in the conduct of administrations. How do you balance this against the comments by Treasury that the recommendation would pose considerable difficulties for directors and would be subject to considerable variation and subjective determination?

Mr Purcell—This is probably one of the recommendations that I alluded to as having some difficulty in balancing the right kind of outcome. From the accounting profession's perspective, one of the areas of vital interest to us is compliance with section 286. The stronger the message can be that directors take the key responsibility for ensuring that accounts are kept and maintained, the better the chances for quality outcomes in insolvency administration. So it is conceded that there are particular issues and complexities associated with recovering accounting records that may have either been disposed of, destroyed or hidden. Nonetheless, it is a significant message about accounting practice and to directors in particular that there is a key responsibility there.

CHAIRMAN—What do you say in relation to Treasury's comment that the proposal would expose directors who are innocent of any wrongdoing in relation to the maintenance of financial records to potentially significant costs?

Mr Purcell—Breaches of section 286, as I understand them, are strict liability offences, as opposed to absolute liability offences. I would suggest that there is possibly scope, if the law developed in this direction, for a degree of flexibility for those cases of innocent omission and failure.

Senator MURRAY—On the same topic—and you might like to look back on this later—I had a discourse with Treasury and later with ASIC on this issue and ASIC are going to come back with a view on notice concerning my questions. Essentially, with respect to recommendation 10, what I suggested to Treasury was that there was an opportunity to achieve the same outcome but from a more targeted direction. Essentially, my proposition for them to consider—and my judgement is that they indicated interest without taking a position—was that perhaps, if Treasury and government have the view that they do with respect to recommendation 10, there was an exceptional circumstance and thus a step they could take which would achieve the same outcome. Instead of the administrator or liquidator making the decision to recover from directors, the administrator or liquidator would have to apply to another party—such as ASIC. If they agreed, then it would occur. What should inform them should be a situation where perhaps the directors concerned had a history which indicated that this sort of approach might be warranted. How do you react to that approach being taken instead?

Mr Purcell—It seems quite a commendable and flexible approach which would address the particular circumstances of innocent error and omission.

Senator MURRAY—Could your organisation have a look at the *Hansard* record of those discourses between me and Treasury and between me and ASIC and see if you can suggest a way forward on the basis of the liquidator or the administrator not taking the decision—somebody else would on application and on looking at the specific circumstances.

Mr Purcell—I am certainly happy to take that on notice and provide further comment.

Senator MURRAY—I might say that my instinct is that that process should avoid the courts because of the cost and time. It needs to be an administrative action.

Mr Purcell—My immediate thoughts were that if you take it into a more formalised process like recoveries in relation to insolvent trading then there is some risk of further delay in a process of administration.

CHAIRMAN—In relation to recommendation 13, which you support in principle, Treasury has responded that this would arguably make the corporate insolvency clawback provisions too broad and potentially allow liquidators to call into question many of the transactions the company may have entered into in the two years prior to the commencement of liquidation. Can you perhaps enlarge on the reasons why you support our recommendation and why you do not give much credence to what Treasury is saying there?

Mr Purcell—At a broad level, there is merit—and I know Treasury have taken a contrary view on this—in the idea that the nature of personal bankruptcy and corporate insolvency are quite distinct. The types of transactions involved are different in volume and in nature. From a policy perspective, however, there is a need for caution in allowing the clawback arrangements between both schemes to be materially different.

Senator WONG—Could you expand on your last comment? What are the policy implications that you are referring to?

Mr Purcell—There are potential issues of certainty in the law if an individual operating under bankruptcy provisions is going to be subject to different arrangements in relation to clawback of antecedent transactions than those they would be subject to if they conducted business in an incorporated form. There is a need to be conscious of making sure that there are not too many significant and material differences between the two arrangements. If there are to be differences, they need to be well understood, rationalised and put in a form that businesses clearly understand.

Senator WONG—Which is a sound response, I think. What are the policy problems that you see in having significant differences particularly in this area of clawback between the personal bankruptcy and corporate insolvency regimes?

Mr Purcell—Potentially—and this is merely speculative—it may influence parties unduly as to the choice of form through which they conduct business. If they are under less risk of being subject to a fairly rigorous antecedent transaction recovery regime, that may tend some people to prefer a particular type of structure through which to operate. With our response to this recommendation there are clear issues of trying to find the right balance between the effective insolvency recovery processes of antecedent transactions and issues in relation to—as I have pointed out there—whether management decisions in the period leading up to insolvency should be unduly fettered, and this relates to our comments around business judgement.

CHAIRMAN—In relation to recommendation 54 you indicate some support for that. You say in your submission that, again, Treasury believes that that recommendation would give too much power to directors in relation to members of the company. What is your response in that regard?

Mr Purcell—Here is another area where there is obviously a diversity of views as to what the appropriate legislative response is. My understanding is though that in a significant number of instances, which were sought to be covered by this recommendation, we may in fact be dealing with companies which have a single shareholder and the directors are the one and the same. In those particular circumstances there are probably not interests of members to be separately considered and the rights of members in relation to their shares. Obviously, the law takes particular regard to protecting proprietary rights related to shares so maybe we are suggesting in this particular circumstance some sort of differential approach which allows single-director, single-member companies to be subject to a more convenient arrangement to move into liquidation.

CHAIRMAN—I also note in relation to recommendation 31 that tentatively you seem to agree with the government's response to that. But you also appear uncertain as to how to balance a requirement for prompt and significant regulatory responses to corporate misconduct, or the

argument where you say that some lapse in time is required to assist the effectiveness of the asset list administration fund. At what time do you think it might be appropriate to support the recommendation that we have made or decide that it is unnecessary?

Mr Purcell—I will defer to ASIC to make that type of judgement. One of the points that we were trying to stress in our response to that particular recommendation was that we would not want to see circumstances arise where we have in place 'one strike and you're out' type arrangements. We believe the law should necessarily encourage legitimate risk taking. Business failure and business downturn are unfortunately a necessary consequence of risk taking.

Senator WONG—In respect of the committee's recommendation that you were just discussing, it is not 'one strike and you're out', there is a concurrent—

Mr Purcell—It was two-tiered.

Senator WONG—Yes, it was a two-tiered process. I get very concerned when people say that because it forgets the second part of the test that was recommended. Do you have a concern with the two-tier test that was outlined in recommendation 31? Do you think that is insufficient? I will remind you of those two conditions. They are:

... the person is or has been a director of a company which has failed (as defined in s 206D(2)) and the person, as a director of the company (either taken alone or taken together with his/her conduct as a director of any other company) makes him or her unfit to be concerned in the management of a company.

That is a fairly focused definition.

Mr Purcell—I think the emphasis should be on that second test.

Senator WONG—But if that second test is in place, do you say that the legitimate commercial risk issue—that is, not wanting to deter people from taking on legitimate commercial risk—is not dealt with by the second test?

Mr Purcell—I would certainly concede that that test alone should be an adequate basis. So if someone makes themselves unfit—say, for example, by engaging in insolvent trading—then that alone probably is a basis for the disqualification.

Senator WONG—I would like to go back to the uncommercial transaction issue. I think Senator Chapman put the Treasury's view to you. Have you had an opportunity to have a look at the Law Council's submission?

Mr Purcell—No, it only came in I believe—

Senator WONG—Yes, it was fairly late from memory.

Mr Purcell—It was after the weekend.

Senator WONG—I suppose it is consistent with Treasury's view. They do not support the removal of insolvency as a prerequisite for the avoidance of uncommercial transactions. They

make some comments about that. Do you have that in front of you? I am talking about the submission from the Law Council.

Mr Purcell—No.

Senator WONG—I want to take you to the Law Council's comments on recommendation 13. I have only one copy. Why don't you have a look at this, to save time? I am talking about the section down the bottom—and just ignore any of my scribble. Do you have a response to that, Mr Purcell? I am interested in testing what the Law Council is saying with the professional bodies and vice versa.

Mr Purcell—I will make a couple of comments about it. I think that, at least since the High Court decision in Spies v The Queen, there is a clear understanding that directors' duties are owed to the company and its members in the absence of a clear situation of insolvency. I would suggest that the Law Council's response reflects that understanding—that, up until the time that there is a clear indication of evident insolvency, there is not a direct duty owed to creditors; and until such time as that is apparent the duty is to the members. That is perhaps consistent with our comments about legitimate taking of business risk. Obviously we are entering into some grey areas where the taking of business risk may have become extreme and accentuated the company's risk of becoming insolvent.

Senator WONG—As I understood your submission, the accounting bodies support in principle the removal of insolvency as a prerequisite. Is that correct? The Law Council's position is the opposite.

Mr Purcell—Ours is an in-principle support of the recommendation. It is, to a significant degree, qualified around those issues of it being a problematic issue of drafting something which is appropriate which takes into account both, as the Law Council has indicated, the interests of members and, as we would indicate, the taking of legitimate business risk.

Senator WONG—Is one of the issues that whether or not a company is insolvent is a post facto definition, in a sense, so it is very hard to determine at the time if the company is actually insolvent?

Mr Purcell—If you look at some of the insolvent trading litigation, the actual identification of the point in time from which the company had been trade insolvent is a difficult matter for determination. So, we can give in-principle support for this type of change, but I clearly recognise that it presents some significant practical difficulties.

Senator WONG—Without demanding that you are really detailed in your response to this, I am interested in knowing whether you have any other views about how you might deal with those concerns in terms of the way you would approach redrafting that section. There is a view that using the requirement that a company be insolvent as a threshold for the uncommercial transaction regime, I suppose, is unduly restrictive. Are there any other ways in which you could deal with the issues to which you have alluded and to which the Law Council has alluded and that Treasury has responded to?

Mr Purcell—An immediate response perhaps—and this creates more divergence between what happens in bankruptcy and what happens in insolvency—is to make that threshold in fact shorter: 12 months.

Senator WONG—Thank you, Mr Purcell.

Ms BURKE—On a very practical level, have you any comments from members of your organisation about whether they have had assistance in dealing with and getting money out of GEERS and how they have found that?

Mr Purcell—My understanding on the feedback I have had from our membership is that it has generally proved to be a satisfactory scheme. But on this particular matter, I will defer to my counterparts in the IPAA, as they have more direct dealings with membership and their dealings with the GEERS scheme.

Ms BURKE—One of the issues that walks through an electorate office door is the fact that somebody is entitled to receive money under GEERS but cannot prove it because the company never actually kept paperwork: there are no time sheets, there is no actual payment. The same thing happens for people who are creditors, saying, 'They owe us this money; here is my invoice,' but the company never kept the records. One of the fundamentals of this is how we can ensure that when businesses of all sizes go under they actually have the appropriate paperwork so that people can at least put in the claim—whether they are ever going to see the money is another thing. We need to ensure that they have got the actual paper trail to demonstrate that. I would follow the same line with ASIC about how we assist companies to ensure that they are up to speed with their paperwork and how you recreate that paper trail after the event. Is there any work that both your associations have been doing to assist people in those areas?

Mr Purcell—Not directly that I am aware of. Again, the IPAA may have some comment. I would also remark that perhaps this ties back into the problems around recommendation 10. It is problematic, and I would suggest insolvency administrators have their various procedures and means to deal with proving in relation to these types of problems.

Ms BURKE—Do you think there are also enough people within the insolvency practice, that there are actually enough people of high calibre? One of the other complaints is often that people are dealing with people who are not as professional as they would hope they would be—they actually do not know what they are doing a lot of the time; the administrators come in or there is a bit of criticism about people doing the actual winding up and the assisting. Whether it is founded or not, I do not know, but that is one of the criticisms that comes through the electorate office door about trying to get information, about how it is going, creditors meetings—all those sorts of things at a very pointy end. Is it something that the association has ever dealt with or come across?

Mr Purcell—Firstly, issues of insolvency and the treatment of one's entitlements are obviously extremely emotional and difficult. My experience in the vast majority of cases in my discussions with our members who are insolvency practitioners is that they are of a very high calibre; they deal with an immense number of demands over a very short period of time. Both the professional bodies will have disciplinary arrangements in place for substantial complaints of

substandard practice and malpractice. Though, again, I would emphasise that the vast majority of practitioners in this area are of a high calibre, both technically and—

Ms BURKE—The complaint would not be at the malpractice end; it is more at the professional end. It is about how they go about it and how they inform everybody.

Mr Purcell—There are certain elements in the bill in well-advanced form which seek to improve the flow of information to creditors in order to understand the rationale around the decisions that they are making. Hopefully, that will contribute to allaying concerns in individual cases.

Senator MURRAY—In recommendation 3, the committee recommends that administrators should be prohibited from using a casting vote in the resolution concerning his or her replacement. The CPA and the ICAA said that the accounting bodies support this recommendation. It gives an underpinning to independence as one of the cornerstones of external administration. The government response was negative and so was the response of CAMAC. At the heart of business and political life are issues of conflict of interest and how you avoid them. This is a classic area where conflict of interest is apparent. I think the government and CAMAC have got it wrong. The question is: what can we do about it? One of the things said in the Treasury response on page 2 is:

In addition, it may be noted that:

A prohibition may be ineffective on the basis that the administrator can effectively confirm their own appointment by simply refraining from using their casting vote to effect their removal.

That led me to want to ask you when administrators vote and do not vote. In other words, do they not exercise their vote on many occasions? I am not just talking about a casting vote; I am talking about the vote in normal circumstances where votes apply.

Mr Purcell—I am not aware of that type of situation occurring.

Senator MURRAY—One of the alternatives is to mandate a vote—in other words, say they must vote. Where it is a casting vote, they must give reasons. I want the government to say that they agree they should give reasons. The alternative to our recommendation would simply be to qualify our recommendation by saying, instead of what we do at present, that the committee recommends the administrator should be prohibited from using a casting vote in the resolution concerning his or her replacement unless the casting vote effects their removal. Do you follow?

Mr Purcell—What is of paramount significance is whose interests are being attended to by an appropriate level of transparency—that is, the creditors.

Senator MURRAY—Can I ask you to take this on notice because I think this is a fundamental area of conflict of interest? Would you mind going back to the Treasury response and CAMAC view of things and suggest to the committee an alternative way in which the committee's intent of avoiding conflict of interest could be satisfied? I am trying to simplify the position of ourselves versus the government. That might include mandating votes in certain

circumstances and not others but, if you could do a bit of lateral thinking, that would be helpful. Thank you.

Mr Purcell—Yes.

CHAIRMAN—As there are no further questions, Mr Purcell, thank you very much for your attendance at our hearing and your assistance with our inquiry.

[11.51 am]

ARNOLD, Mrs Kim, Technical Director, Insolvency Practitioners Association of Australia

MELLUISH, Mr John, National President, Insolvency Practitioners Association of Australia

CHAIRMAN—Welcome. The committee has before it your submission, which we have labelled No. 3. Are there any alterations or additions that you wish to make to the written submission?

Mr Melluish—No, there are not.

CHAIRMAN—I invite you to make an opening statement, at the conclusion of which I am sure we will have some questions for you.

Mr Melluish—The Insolvency Practitioners Association of Australia welcomes the opportunity to appear this morning to discuss the exposure draft of the Corporations Amendment (Insolvency) Bill 2007. The IPAA is an independent, self-governing organisation that represents professionals who specialise in the field of insolvency. We have over 1,200 full and associate members, including accountants, lawyers, bankers, credit managers, university professors and other professions with an interest in insolvency. We provide continuing education forums for members by way of discussion groups, conferences and our quarterly magazine, the *Australian Insolvency Journal*. We also consult with regulatory bodies such as ASIC and ITSA in the development of standards which our members must follow. We liaise and work with government bodies such as the Australian Taxation Office and the Department of Employment and Workplace Relations. We are active contributors to discussions on reform to Australia's insolvency laws and other related insolvency issues.

The IPAA is a supporter of the bill and the much-needed reforms that it will make to Australia's corporate insolvency laws. The IPAA appreciates the opportunity it was given by the government to participate in the Insolvency Law Advisory Group. This consultation process has resulted in a quality reform package, the introduction of which is being highly anticipated by the insolvency industry.

Whilst we recognise that there are some matters that the IPAA would have liked to have seen included in the bill that were not, there are no matters of such significance that the commencement of the bill should be delayed. The IPAA will, however, continue to pursue reform on a number of matters, including providing for alternates to chair the second meeting of creditors in involuntary administration, in limited circumstances; allowing for creditors to approve provisional liquidators' remuneration if the company is placed into liquidation; online advertising by external administrators; a review of how the insolvent trading provisions apply to restructuring professionals; more flexibility in the use of electronic communication; a moratorium on contracts in a voluntary administration; and clarification of the status of shareholder claims. At this hearing, we are attempting to articulate the views of our members,

who represent a wide cross-section of the professional insolvency community. We look forward to your questions.

CHAIRMAN—Thanks very much.

Senator WONG—Mr Melluish, is the list of things you will continue to advocate in your submission? I notice that you included shareholder claims, which I assume is a reference to Gwalia.

Mr Melluish—Yes.

Mrs Arnold—No, they are not in our submission, but we are happy—

Senator WONG—Well, it is on the *Hansard* now. If you have a copy, I would not mind having a quick look at them when I am asking you questions. Sorry, Chairman, back to you.

CHAIRMAN—In your submission, in relation to a number of our recommendations you say have no objection to them; others you say you support. Can you just draw a distinction there as to what you mean by there being no objection, as against support?

Mrs Arnold—Essentially, we do have a keener interest in matters which we support. For matters on which we have no objection, it is more that we think it is something that would be worth while; however, it is not something that we are pushing to see in or wish to see out. It would be a matter which we do not disagree with but which we do not strongly support; whereas some of the other matters we do support.

CHAIRMAN—Okay. Treasury have responded negatively to recommendation 13, where you see merit in the two-year period preceding formal insolvency. Have you seen Treasury's response to that in their submission?

Mr Melluish—Their submission to this inquiry? No.

CHAIRMAN—I was going to ask you for your reaction to their response, which really extends the response that they gave in the government's original response.

Mrs Arnold—Unfortunately, I had some difficulty accessing the documents on the web this morning, so I apologise for that.

CHAIRMAN—In essence, they say:

Removal of the 'insolvency' prerequisite in the case of uncommercial transactions would arguably make the corporate insolvency clawback provisions too broad and potentially allow liquidators to call into question many of the transactions that a company may have entered into in the two years prior to the commencement of the liquidation. It would depart from the general principle that companies should be able to deal with their property in accordance with general corporate governance norms until the point where the interests of creditors are likely to be adversely affected.

Mr Melluish—I think the definition of 'uncommercial transaction' is a fairly narrow one, and we are talking about the types of transactions that potentially have not been in the best interests

of the company, to which the directors owe their primary fiduciary duty. I cannot imagine too many transactions of the type that would be potentially voidable that have not been entered into with some related party for some ulterior purpose.

CHAIRMAN—In relation to recommendation 54, you say:

The IPAA notes that there is a need for further amendments to section 497 to properly provide for the liquidator to conduct the first meeting of creditors and these matters have been raised with Treasury in our submission ...

Have you had a response from Treasury to that?

Mrs Arnold—No, we have not as yet.

CHAIRMAN—Again, the view of Treasury that they expressed in their submission to us was that that gave directors too much power as against the power of members. I am just wondering what your view is on that.

Mrs Arnold—The bill as it is currently drafted is providing some amendments which will enable, I suppose, what we would class as those companies with one or two directors who are the same as the shareholders, or family members who are shareholders, to hold a meeting of directors and a meeting of members immediately after the meeting of directors, enabling the company to proceed into liquidation a lot quicker than it can at the moment. Our suggestions in relation to amendments to section 497 reflect the fact that the time frame for the holding of meetings has been amended in the bill and, as such, there are some subsequent amendments that need to be made to 497 to enable those time frame adjustments to properly work.

There is a secondary issue about whether members should still be involved in the process about placing a company into a creditors voluntary liquidation. The IPAA's view has been that, if directors are able to place a company into voluntary administration, they should equally have the power to place a company into creditors voluntary liquidation. We understand that Treasury have concerns about the rights of members being protected and that a company being placed into liquidation is a much more serious step than placing a company into voluntary administration, because at least with a voluntary administration there is an opportunity for the company to be once again returned to the control of the directors; whereas that opportunity does not exist in the CVL process.

The position that was put in the bill was essentially a negotiated position between ourselves and Treasury to achieve what we saw as a vast improvement over the existing CVL process and at least make creditors voluntaries a more viable option for directors when they are looking at an insolvency scenario. At the moment, particularly when they are served with a 222AOE notice by the tax office, the only viable option available to directors is voluntary administration, which means you have a lot of companies going into voluntary administration where there is no intention of trying to restructure or do a deed. By the amendment which we essentially, as I said, negotiated with Treasury, there is another option that is opening up for directors, and we think that it will see a shift in numbers between CVLs and VAs.

Senator MURRAY—Could I ask you to have a look at the *Hansard* record, because I do not think you were in here when Treasury gave their evidence. They said one way of being helpful in

this area was to uncouple the directors' meetings from the members' meetings, so that within a defined number of business days you would first have the directors' meeting and then the creditors' meeting. They felt that that might assist in this area. Without trying to paraphrase their views, I think perhaps you could have a look at that and advise the committee how you react.

Mr Melluish—We supported this recommendation, we took that to Treasury and they raised the shareholder concerns that you have talked about. We have negotiated a position which we think gives the necessary streamlining to a creditors voluntary procedure, whilst also taking into account their view of shareholder rights.

Senator MURRAY—But their compromise position, on the face of it, seems to me to have merit. Essentially what they were saying is that the present set-up does not allow shareholders time to consider the matter, because you have the directors' meeting and the shareholders' meeting on the same day, and that if you uncouple them and separate them out by a few business days you are able to get the advice to the creditors' meeting, and so on.

Mrs Arnold—I am certainly happy to have a look at the *Hansard* transcript.

Senator MURRAY—Have a look at it and let us know how you feel about that. That is all I am asking you to do.

CHAIRMAN—In relation to recommendation 24, you comment that the IPAA is preparing a statement of best practice in relation to remuneration guidelines for practitioners. Can you tell me what stage the drafting of that statement has reached and when it is likely to be published?

Mr Melluish—The drafting of that remuneration statement has not reached any level at this stage. We have been awaiting the release of the ASIC document and we have had various meetings with ASIC as to the timing of the release of that document. It is still within ASIC for their review, pending where the law reform goes I believe.

CHAIRMAN—I note you support the recommendation concerning an administrator being prohibited from using a casting vote in a resolution concerning their replacement. Again, the government's response rejected that recommendation and Treasury expanded on that in their submission to this inquiry on the basis that:

> A prohibition may be ineffective on the basis that the administrator can effectively confirm their own appointment by simply refraining from using their casting vote to effect their removal.

We have noted that the default position will be that the administrator retains their position. Treasury further says:

> It is important that the voluntary administration proceed expeditiously and not be obstructed by the inability of creditors to reach a decision. The policy intent for the use of the casting vote in the voluntary administration procedure … arguably remains persuasive.

They then go into what the explanatory statement to the corporations regulations said. How strongly are you of the view that that recommendation should be implemented? Do you accept Treasury's response to that?

Mr Melluish—I think Treasury is partially correct in that we need to ensure that there is a system in place that could allow for the administration to move on with a new administrator or the existing administrator rather than be caught in a deadlock situation. So I think that should be the most important aspect of whether they exercise their casting vote or not. We would also support that, in exercising that casting vote, the incumbent administrator seek to exercise it in a way that does not support his remaining in that position if creditors have indicated that they would like him removed.

CHAIRMAN—Have you expressed a view on recommendation 10, relating to recovering from directors?

Senator MURRAY—Yes, they have; it is at page 6.

CHAIRMAN—Page 6? Yes; again, you support the recommendation? The Treasury opposition to that recommendation is based on their view that it could expose directors who may be innocent of any wrongdoing in relation to the maintenance of the financial records to potentially significant costs.

Mr Melluish—As a practitioner, the majority of circumstances where there is a lack of books and records do not relate to those books and records being written up properly. It is the provision of the source documentation to begin with—so if someone says there are no books and records, there are no chequebooks, there are no bank statements. A large number of the matters that we now deal with are what the ATO describes as 'microbusinesses'. So, in terms of the lack of books and records, the cost of assessing the cost of writing them up would not be a complete answer to the problem. But it is a recommendation that we would support in that we think that greater responsibility should be placed on those directors who fail to adhere to their obligations.

Mrs Arnold—It is very hard for insolvency practitioners to do their work when there are no books and records to do their work with. From our perspective, we want the law to provide incentives for people to provide us with the information we need to do our work.

Senator WONG—They are already required to do this, under the law—to keep the accounts; correct?

Mrs Arnold—Yes, they are.

Senator WONG—So is the best way to understand the proposal in recommendation 10 as an additional incentive to comply with what they are already supposed to be doing anyway?

Mrs Arnold—Yes, that is correct.

Senator MURRAY—This question has been discussed at some length throughout the day and, reading between the lines, there might be a view that it is in the financial and administrative interests of the liquidator or the administrator to have this provision in, and therefore you have got to avoid that self-interest. One of the solutions we have been groping towards, which I would like to ask you to take on notice and think about, is whether there is not a better arms-length administrative way of targeting this so that it is not a general provision but a specific provision, particularly aimed at people who are what I would call 'miscreants' rather than ordinary folk.

And that is that the liquidator or administrator would make application to ASIC or a body like that for this provision to be enacted. Could you think about that—have a look at the *Hansard* record and the various discussions that have taken place, and come back with a view on that? It is essentially targeting this to a smaller group of applications rather than making the general provision available for the liquidator or the administrator to exercise.

Mrs Arnold—Sure.

Mr Melluish—Given that this is a matter that obviously has a high incidence of interest here, can I give a small example of what happens in current practice when someone does not provide any books and records? A company goes into official liquidation and the directors may know that they owe that company some money, by way of a directors' loan account, or there have been transactions where that would ultimately cost them money. They go to the liquidator and say, 'No, I do not have any records; they have been tossed in the bin.' The liquidator would then report that to ASIC and the liquidator assistance unit would then take that matter off to a local court. The result of that process would be that they could be fined between $500 and $2,000. So, in terms of an out for them, it is much easier to take the fine of $500 than bother giving the records and exposing themselves to a larger claim.

Senator MURRAY—We understood that. That is why our recommendation was in there originally. But the government said no because the general application will have more negatives than positives. When I put the further proposition to Treasury that perhaps it should be targeted and made less general in application, their response, as I interpreted it, was one of being prepared to consider that. Therefore, if we are going to reinforce this recommendation, we need you to consider the discussions today and come back to us with a more targeted approach.

Mrs Arnold—Certainly, we can do that.

Mr Melluish—We have also been talking to ASIC and exploring other channels for increasing the penalty provisions through a breach of section 286.

Senator WONG—Because the current penalties are not a sufficient deterrent. If the example you gave is a reasonable example of the practice then it is really a theoretical deterrent only because the cost is minimal.

Mr Melluish—Yes.

Mrs Arnold—Yes.

Senator WONG—I will not take too much of your time because you have actually done a very detailed response to most of the recommendations we were addressing. Thank you for all of your work on that. I just wanted to check if there were any of these reforms to which you referred which were covered by our previous report. Do you want it back to have a look at?

Mrs Arnold—Yes, sorry. We only have the one copy with us today. I think the one that is covered is in relation to the moratorium on contracts in voluntary administration. That is something that we do have a keen interest in and will be continuing to pursue.

Senator WONG—What did you say about how we approached that in the 1994 inquiry?

Mrs Arnold—Which recommendation was that?

Senator WONG—I do not remember.

Mrs Arnold—In our recommendation 55 we said that, although your recommendation was not exactly what we put forward to you four years ago when this process first started, we definitely see this as a reasonable option. We note that it has been rejected, but it is one matter which we will be continuing to pursue on our reform agenda—though we do not want to delay the commencement of the bill. Our biggest issue is that much of the bill is quite important for us, particularly in some areas, so we are very conscious that we need this reform package in a timely manner.

Senator MURRAY—Treasury obviously cannot speak for the government, but they did give us an assurance today that from their perspective they do not regard this bill that we are considering as the end of the process; they will be raising other issues. So that may be of some comfort to you; it is of some comfort to me.

Mr Melluish—It became apparent to us that a fix for Sons of Gwalia would not be included in this round of reform. That made it fairly timely that a second round of reform would be required.

Mrs Arnold—One of the other matters that was covered by your recommendations was the use of electronic communication. From our perspective we do not feel that the solution put forward in the bill necessarily gives us the flexibility to use electronic communication with creditors. This is something that we will be continuing to pursue as well. The bill proposes that creditors have to elect to receive electronic communication, which is quite difficult and, I would think, quite an unworkable process. There is very little incentive for creditors to go through that election process because they know that, even if they choose not to elect to receive it electronically, they will still receive it by post. So we would like to see more flexibility there. I think that will only be a matter of time as electronic communication—

Senator WONG—You want it to be more the other way, do you?

Mrs Arnold—We put forward a suggestion which I call the 'Ansett scenario'. What was put forward in the Ansett case was that the information was made available on a website and creditors were provided with a one-page written notice saying, 'The information is available to download here. If you cannot access it online, here is a contact phone number: ring us and we will post it to you.' It is a matter of trying to balance that access versus cost saving.

Senator WONG—Although you could perhaps argue that the number of people involved in the Ansett case would indicate that you should support that kind of approach. That is not necessarily the approach you might want to take in relation to smaller administrations, but I presume that is not where the issue arises for your members.

Mrs Arnold—No, I do not think the issues arise with the small administrations. It would be a cost-benefit approach, because administrators are going to have to manage the call line and send

out the information in writing. So smaller administrations are going to be better off just doing it in writing straight up. The issues will arise for those larger administrations where there is a lot more cost benefit to providing creditors with the Ansett type scenario—so the one-page notice. And, certainly, you would not be doing it for a one-page notice. If you were sending out a one- or two-page document, you would just send it; whereas we are talking about section 439A reports, which are quite substantial documents.

CHAIRMAN—With regard to recommendation 55, have you looked at the government's response and Treasury's further response to that?

Mrs Arnold—In their submission to you?

CHAIRMAN—Yes.

Mrs Arnold—No, I was not able to access that document; I am sorry.

CHAIRMAN—The government's response was:

A prohibition on the enforceability of 'ipso facto' clauses would erode the freedom of contract, restricting the capacity of creditors to manage risk.

The proposed amendment may introduce a high level of complexity to the law and increase the costs of voluntary administrations where an application is made to a court.

In addition, in their submission, Treasury say:

Companies have incentives to continue to trade with enterprises in external administration. Such commercial decisions should be left to individual companies to determine in light of their, and their counterparty's, circumstances.

Then they go on to refer to the fact that CAMAC examined this issue and recommended 'there be no change to the current position'.

Mr Melluish—Their statement that a company would be financially advantaged by continuing—that can be true and it can be untrue. There may be commercial advantages in terminating that contract which destroys value for the debtor company, and they are the instances in which we think the ipso facto clause would preserve value for those other interested stakeholders.

Mrs Arnold—Particularly, I think, for technology based companies—for example, where the contract with a telecommunications company might be the only actual valuable asset and the termination of that contract could result in a total erosion of the asset base of the insolvent company. I think that your suggestion, or the recommendation that was put forward, about the involvement of the court was a good balance between the straight-out moratorium that we were requesting initially and ensuring that freedom of contract between the parties. There are a lot of instances in voluntary administrations where people's rights or parties' rights are overridden by the moratorium process—and, quite frankly, the IPAA does not see a substantial difference between overriding a retention of title creditors' rights or any other parties' rights and putting a hold on the rights of other types of contract creditors or contract positions. So we are very much

a supporter of this, and the involvement of the court is probably a good balance between the two positions.

CHAIRMAN—Further questions?

Ms BURKE—I want to go back to some of the practicalities. Sometimes with these companies that are wound up it is not that they have thrown out the books; it is that they never actually had books—some of the smaller ones where people have gone into business and have literally done it by the seat of their pants. It is not that they are trying to avoid something; they never had it. So in a lot of those cases you go in and you recreate the books for them. They are actually trying to do the right thing. So should there be a step prior to some of these people ending up in this situation to try to ensure that they are given assistance with doing books and things? I asked the same thing of ASIC, and I know it is virtually impossible by virtue of the number of companies, but what support should be out there so that it is not a matter of recreating a scenario after the event, so that they have actually kept some records before they end up in this situation?

Mr Melluish—With the types of microbusinesses you are talking about, we do not actually go in and redo any books. If there are no assets involved then it gets shut down; creditors get told that there is no money and it gets struck off. We have been—

Ms BURKE—There are some who are sort of in between, though. There are some where the people who miss out are not just micro; they actually employ people—that is where I am going to next—and it is the employees who are the last ones to know. There is no hope of going to GEERS because they have no way to demonstrate what they earned over the time they worked. So we end up in this vicious cycle of having no ability to demonstrate that. The administrator says, 'Well, we're not going to spend any of the asset base recreating your records,' and these people have no way of demonstrating to GEERS that they did actually earn anything; nine times out of 10, they were lucky to even get a group certificate.

Mr Melluish—There are processes that we have been through with the Department of Employment and Workplace Relations to say, 'Yes, we know this person started at this time; here's a statutory declaration from them that they were earning $600 a week,' or whatever the figure is, and they do end up getting a payout.

But, for the people running businesses who are not keeping the proper records and doing the right things, we have been arguing for some time that there might be some minimum level of training given to someone who nominates themselves to be a director. I think there is a need for increased identification provisions for someone who nominates to be a director. That has been raised with ASIC, and we have been told, 'Well, does not happen anywhere else in the world, so I cannot see it happening here.'

Senator MURRAY—My memory is that it does happen elsewhere in the world. My memory is that in Germany, because they were bothered about the number of small business failures, they introduced a basic provision that anyone entering into business had to do a day's course on the basics that you had to comply with, had to know and had to do, and it dropped the number of business failures. I do know that in some states—in my own state of Western Australia—there is a voluntary scheme through the small business organisation, where they provide that sort of

training. But, when this has been tested with the government before, the government's view has been that introducing those sorts of regulations is not attractive to them. But there have been attempts elsewhere in the world to do this.

Mrs Arnold—From our perspective, anything which can improve the record keeping or the information that is provided to us in the event of insolvency is of benefit to everyone. It is not just of benefit to us; it is of benefit to all the stakeholders involved in the process.

Ms BURKE—In relation to the notion of information given out to various creditors along the way in the actual administration process and winding up, there is quite a bit of criticism about getting information and knowing when the meetings are going to be, what is happening and where it is at, both from the employees who are impacted but also from minor creditors. Often we will have someone walk through the door in the office and say, 'Nobody's telling me anything. I ring and I'm fobbed off'—they probably are the 100th in the queue. So there is that sort of instance where individuals just are not being provided any information. There is the run around of, 'Oh, it's privacy,' and the notion of, 'Well, it's my money, Ralph,' the sort of thing that you keep going round and round in circles with—those sorts of issues that you have had to address or have looked at. Do you have any comments?

Mr Melluish—I am sure there are instances where practitioners have been appointed to matters, there is no money, and they want to wrap it up as quickly as possible. To that extent, people who want to know everything about a company are not getting the information that they require. That is really the nature of our system in having practitioners doing unpaid work. In a general sense, the IPAA supports a minimum level of investigation into a company's affairs and certainly would support its members acting in a professional manner, responding to any correspondence, answering any telephone calls and the like. As a general principle, people are being heard and their questions are being answered. Sometimes they do not like the answers, but they should always be able to talk to someone about their issue.

Ms BURKE—I am interested in the GEERS accepting stat decs. That has not been my experience, so I am quite fascinated to follow that one through—and I will not do it with you; I will do it with someone else. But DEWR has said that it is acceptable for practitioners to provide stat decs?

Mr Melluish—They do operate in a very regulated environment. They say, 'These are the rules, and don't talk to us about the rules.' But we have had instances where, if it can be shown that someone has a valid claim, notwithstanding that the bits of paper do not all add up, and it is for something like wages—one of the higher priorities rather than redundancy or sick leave—then claims have been met.

Ms BURKE—The other biggest problem is super and the inability to actually get payment of SGC that just has not been made. Again, it is not your issue; it is the ATO's issue, but just experience with—

Mr Melluish—We have been running a liaison meeting with the ATO. At the moment, we are progressing the issue of, when we pay SGC money into the ATO, where does it go, how long does it take to get out and how can how employees ring you and get an update on where it is up to?

Mrs Arnold—Superannuation is something we have been working on for quite a few years now. There is significant reform in this bill, which will hopefully enable superannuation to move more effectively from our side. As I said, we are working with the tax office. We are going to be getting some information sheets which can go out to employees about how they can find out information on their super and that sort of thing. That should assist employees to get a better understanding of what happens with their money, where it goes and how they can find out about it.

Mr Melluish—It has been difficult for us to find out where it is up to—and we pay the cheque to the government—so the employees have no chance.

Ms BURKE—All they get told is that, because of privacy regulations, they are not allowed to be told. The ATO says, 'There are privacy regulations,' and they say, 'It's not the company's money; it's my money.' We used to have a circular conversation in which no-one would tell you anything.

Mrs Arnold—We are attempting to resolve that. The information sheets will come out once we have a new piece of legislation, and things are going to work better. The biggest issue at the moment is that there are a lot of questions around entitlements to superannuation or the priority of SGC in a lot of forms of external administration, which this bill will correct. Then the information sheets will be developed and made available to employees, and I think there will be a big improvement in that flow of information.

Ms BURKE—I hope so.

Mrs Arnold—As John mentioned, we have been having liaison meetings with the tax office. One of our objectives with those meetings is to try and improve the flow of communication, not only between the tax office and practitioners—which had a lot of issues as well, and that is certainly improving—but also between the tax office and other parties that are involved in the process as well.

CHAIRMAN—We have had a submission from an insolvency practitioner, who wishes to remain anonymous—and that is fair enough. He raises a general concern that, when they are doing liquidations and voluntary administrations, insolvency practitioners tend to act in their own interest rather than in the interest of creditors. He gives examples of where he has seen this happen. What is your response to that?

Mr Melluish—I think that ASIC and the industry are aware that there are a small number of practitioners who need to be either disciplined or exited from the industry. We do not feel that that is pervasive across our membership; it is a very limited number of people. The majority of registered liquidators and our members are qualified professionals who do their best to carry out their obligations as the law requires and in the interests of those stakeholders that make up the various administrations.

Senator MURRAY—From memory, there have been three bills over the last 10 years that have changed bankruptcy law, two of which have recently gone through. As you know, at the proprietary end of the world there is a lot of intersect between the affairs of individuals and the

affairs of companies. Has there been any carryover, any effects, of that bankruptcy legislation with respect to insolvency practice?

Mr Melluish—One of the outcomes of making it so easy to register a company and carry on business as a corporation has been that very few people trade a business in their own name any more, so we have not seen bankruptcy administrations that involve trading businesses. That has meant there is not a great deal of crossover between insolvency on the bankruptcy/consumer side and corporate insolvency.

Senator MURRAY—As you know, one of the key elements of the changes to bankruptcy law was to try and ensure that assets cannot be distributed in a manner which would, for instance, pervert a proper superannuation division or proper access to the assets and so on. That has not had any effect at the smaller corporate end in the way people are structuring their affairs and operating?

Mr Melluish—No. There have been a number of articles very recently about using superannuation to defeat your creditors. It is now a big hole that you can put all of your money in and still go bankrupt. But we have not seen the practical aspect of that arise, because it is going to take time for people to top up their super to that level. Maybe, for bankruptcy in four or five years, we are going to find people who have vast amounts of funds available to them whilst also being bankrupt.

Senator MURRAY—Thank you very much.

CHAIRMAN—As there are no further questions, I thank both of you for your appearance before the committee and your contribution to our inquiry.

[12.31 pm]

PROUDMAN, Mr David Hudson, National Chair, Insolvency and Reconstruction Committee, Business Law Section, Law Council of Australia

CHAIRMAN—Welcome. The committee has before it your submission, which we have labelled No. 13. Are there any alterations or additions that you wish to make to the written submission?

Mr Proudman—No, I have none.

CHAIRMAN—I invite you to make a brief opening statement, at the conclusion of which I am sure we will have some questions.

Mr Proudman—Very briefly, thank you for the opportunity of being involved in this inquiry. Thank you also to others for our having had the opportunity to be involved in the Insolvency Law Advisory Group. We are generally very supportive of this legislation. We have had the opportunity of liaising pretty closely over the last 12 or 18 months with the Insolvency Practitioners Association, and, as you will probably see from our submissions, we share many of the views that they share. We have worked quite closely on some of these issues, and it has been very good that we have reached the same view on many of these issues. Other than that, I invite your questions.

Senator WONG—Mr Proudman, I think you were here for my discussion with the previous witnesses regarding the uncommercial transactions insolvency threshold requirement.

Mr Proudman—I was.

Senator WONG—In the light of that, do you want to perhaps give us a bit more detail about the committee's opposition to the recommendation—or if there is a different way through?

Mr Proudman—The difficulty that we face with removing the prerequisite for insolvency is that you risk opening up a review of all transactions that have occurred, even though they have occurred in circumstances where they may have been in the best interests of the shareholders because of the circumstances that applied at that time. They may have occurred in circumstances where one party clearly had a better bargaining position than the other party—and that is normal trading business relationships. The concern ultimately, which I have tried to summarise in the brief response, is to try to focus on looking back at events with hindsight—and at least the benefit of hindsight is an advantage that the liquidator does have—but to try and assess the transaction by reference to what the circumstances at the time were and where the duties at that time should have been considered. The view we take is that, when a company is not insolvent, the primary duty is to the shareholders, and that is not necessarily going to result in the same outcome as if you were to look at that transaction having the creditors' interests as your primary responsibility.

Senator WONG—All of which I understand. Obviously this is going back to the 2004 inquiry. I know the Law Council made a submission to that. I cannot recall, Mr Proudman, whether you were involved in that.

Mr Proudman—I was not, but I think that the submission was not dissimilar to the one I have just put to you.

Senator WONG—No, it was not dissimilar. I think what we were grappling with—and this is a few years down the track—was the concern that the insolvency prerequisite was a particularly problematic one. I think all that you say is understood, and there was not an intention to seek to unduly or inappropriately widen the net, but my recollection is that the evidence suggested that having the very strict threshold requirement of insolvency perhaps was unduly restrictive. Has the Law Council's committee considered an alternative way of looking at that issue, or have you simply responded directly to this particular recommendation?

Mr Proudman—We have not considered alternatives, although it may interest you to know that there are varying views amongst the committee members—

Senator WONG—I am aware of that, Mr Proudman!

Mr Proudman—ranging from removing uncommercial transactions entirely, at the one extreme. So the answer is, no, we have not looked at that and looked at any alternatives. The view we take is that the reason that this concept of insolvency is difficult is that it creates an enormous evidentiary problem. You mentioned earlier that it is a sort of post factum viewing, which it is. But to open it up to anything more than that, we think, is going to be very dangerous.

Senator WONG—What about the argument about whether there should be better clarification of insolvency in the legislation? It becomes a bit of a circular argument, doesn't it—

Mr Proudman—It does.

Senator WONG—that this is a difficult threshold because it is post factum et cetera? You say, 'We don't want to go back too far; it casts the net too widely.' Other people then say, 'Well, it's very hard to know when the state of insolvency is entered, which then has a whole range of legal consequences and practical consequences'—and, in this context, whether or not a transaction is potentially uncommercial.

Mr Proudman—I agree. You are absolutely right.

Senator WONG—So, agreed, there are the problems—but none!

Mr Proudman—Absolutely there are the problems. But, if one were to take a somewhat facile view, you would say, would you not, that the directors should be doing their job properly? The directors should be aware of the state of affairs of their company. There are provisions in there providing the concept of defences for people who engage third parties to conduct reviews and the like. I think you have to draw the line, and I would take a somewhat black or white approach to it, because in the middle ground it is very hard to find something that is going to suit all circumstances.

Senator WONG—So who are you suggesting has the facile view, Mr Proudman?

Mr Proudman—Me!

Senator MURRAY—You had better add for your safety that you said that ironically!

Mr Proudman—Thank you. The law is very difficult to address or deal with in this area in any set of circumstances, and that is part of this disinclination to expand its application.

Senator WONG—Just to clarify, I assume you understood that a range of the recommendations that you said should not be included in legislative reform were not intended to be recommendations about legislative reform; they were recommendations about activities of statutory authorities et cetera.

Mr Proudman—I did, and in hindsight I probably should have made some comment about that, but when I was preparing the document I had very much at the forefront of my mind the draft legislation.

Senator WONG—Sure. So is there anything you would change in the current bill?

Mr Proudman—That is a very loaded question. There are a number of—

Senator WONG—I should have asked the IPAA that, but they gave us a much more detailed submission so we could be more clear about what they wanted!

Mr Proudman—We share many of the comments that they make about changes. I have also had the benefit of seeing the report they provided to Treasury, and there are a number of changes in there—in fact, I think, almost all of them—which we would strongly support.

Senator WONG—Do we have all the Treasury submissions or have we not asked for them? Did we ask for them?

Senator MURRAY—But Treasury, in their defence, did indicate that they are looking at a second tranche.

Senator WONG—Yes, I know. So has the Law Council made an alternative submission to Treasury as well that would be beneficial for us to see? First questions first: have you made an alternative submission to the Treasury?

Mr Proudman—Not yet, no. We intend to do so, but the submission that we make will be very supportive of the IPAA approach, having regard to the resources and the detail to which they have gone.

Senator WONG—Mr Melluish is not at the table, but did the IPAA provide us with the same report as the report to Treasury? The February 2007 one is the same one? Mrs Arnold informs me that it is. Thank you.

Ms BURKE—You have an Insolvency and Reconstruction Law Committee; what does the 'reconstruction' actually mean? I am curious. A lot of what we have been talking about is reconstructing the books, so I want to know what the 'reconstruction' bit is.

Mr Proudman—A large part of the practice of insolvency practitioners, and by that I mean accountants and lawyers who advise in the area, is informal work rather than a formal appointment as a receiver or liquidator or voluntary administrator. A lot of the work that we do and a lot of the work that the insolvency practitioners do is in helping creditors, or debtors for that matter, reconstruct or 'work out'—another term that is commonly used. So it is not just dealing with insolvencies; it is dealing with insolvencies and work outs or reconstructions.

Ms BURKE—Look at the step before the events and hopefully you can—

Mr Proudman—Not necessarily, because that may be the last step. It may be the only step. If you get a few things running your way then sometimes you can avoid the insolvency.

Ms BURKE—So turn it around, refinance, sell off, do something beforehand?

Mr Proudman—Correct.

Ms BURKE—In those instances, does this notion of the books or lack of the books—this is a bit of a hobbyhorse for me—where they just do not have the level of information they should have, become an issue as well?

Mr Proudman—There is no question that you cannot do your job properly, either as an insolvency accountant or as an insolvency lawyer, without having the core information. That is an issue and, as Mr Melluish pointed out, it is perhaps a little more common than we might want it to be.

Ms BURKE—It is my experience that it is not just the little firms and microbusinesses but also some medium-sized firms that employ people. There are some sizeable entities that just do not have these things for whatever reason. Is that your experience or the experiences of other people coming through?

Mr Proudman—I do not know that I have seen it in sizeable entities but I have certainly seen it in medium-sized entities, without wanting to particularly draw a special line in the sand somewhere with those words. And certainly at the lower end in terms of businesses it is a common problem. Invariably it is half the cause of the insolvency in the first place, because they are not aware of their position.

Ms BURKE—So the notion of giving these businesses support at the outset, and then as they progress, in running a business better could result in fewer insolvencies and bankruptcies?

Mr Proudman—It may not necessarily involve fewer insolvencies but it may involve getting to them earlier, because you know what the position is, and perhaps doing something about it, which may then reduce the number of insolvency appointments.

CHAIRMAN—Have you examined Treasury's response to our recommendation 54?

Mr Proudman—No, I have not, I am sorry.

CHAIRMAN—This is in relation to the directors being able to put a company immediately into liquidation. In essence they say that that proposal would give directors too much power as against the rights of members.

Mr Proudman—During the process of the discussions with Treasury, we very much shared the IPAA view about this. There are a large number of cases where a company goes into voluntary administration because it is easy and convenient for that to occur. When that occurs, because there is little or no prospect of anything other than ultimately a liquidation, an investigation is conducted, a section 439(a) report is prepared and two creditors meetings are held. Our view is that in a lot of cases they are wasted resources—wasted creditors' funds, if you like. We support the view that it should simply be in the capacity of the directors to say, 'The company is insolvent; there is no help or prospect of anything other than liquidation; we will be able to resolve, as we do, to appoint a voluntary administrator to appoint a liquidator.' To elaborate on the concern about the members, in the vast majority of cases where this is a problem, in my view, it is actually the directors who are also the members.

CHAIRMAN—Would you limit that provision to companies of a certain size?

Mr Proudman—We could do that. We assess size presumably by reference to shareholder numbers rather than by reference, say, to revenue. Yes, one could do that.

Senator MURRAY—Would you automatically exclude public companies? For instance, there are small companies in West Perth where they have 50 members but are public limited companies.

Mr Proudman—It would make sense to exclude public companies because of all the other obligations and bits and pieces that hang off being a public company. Yes, it is quite a good suggestion.

Senator MURRAY—I am of the mind, just listening to Treasury and getting a feel for how things are moving worldwide, that general principles that apply in law are always desirable. But in many of these cases you need to target matters for efficiency, practicality and cost reasons. I thought the committee was on the button with its recommendation 54. I think that a generally negative response does not address the issue you outlined very clearly where directors are the members, plus a few. In that case this process does not make sense.

Mr Proudman—I think the other thing that underlies this is that I would have thought that any director properly discharging their duty as part of their deliberations about whether or not to resolve that the company would go into liquidation, might say, 'Hang on a minute. Can I turn to the creditors of this company or the members of this company and see if there is any capacity for them to help us fix this insolvent state before I make the resolution to go into liquidation?' It is not legislated but it seems to me that it is a reasonably obvious step that a director might take. In that sense, there is almost a referral to members as an opportunity for a solution before the liquidation resolution is passed.

Senator MURRAY—I do not know whether you have had the opportunity to have a look at the Treasury response, but they talk about an uncoupling of the directors meetings and of shareholders meetings in time terms. Do you think—I hesitate to suggest it because it is another administrative mechanism—that directors should be given this power in targeted situations, say, for small companies being a target, but that they would have to advise all shareholders in writing and if any of the shareholders disagreed then they would have to revert to the process? In other words, the directors would take a decision but within a certain period, if there were a rejection of that decision, they would have to go through the present process. As a safeguard, say you have a circumstance where you have 50 members—50 of those members and eight directors, and the eight directors take a view that ten of the 50 do not like—

Mr Proudman—I have a concern about that approach. There is a period of time between the decision of the directors that the company is insolvent and should have a liquidator appointed to it and when that appointment is made—whether it is a voluntary administration appointment or a liquidator is appointed with the members supporting it. There is a period of a few days, perhaps, in which the company will trade while it is insolvent. Other consequences may arise from that outcome.

On this topic, one of the points that I have raised previously with Treasury about this—and I have seen it happen a number of times—is that when a company goes into liquidation it is possible for a liquidator to appoint a voluntary administrator. So when the directors appoint a liquidator—let's take the scenario where the directors appoint a liquidator without reference to the members, because there is no need to refer to them—the liquidator, who is a qualified insolvency accountant, steps into the driver's seat and says: 'Hang on a minute; there might be an opportunity here for us to actually put a deed of company arrangement proposal together or do something else. I will then, with my expertise, make that decision and then go down that voluntary administration path.' So it is not as though the moment a company is in liquidation that is necessarily where it must stay.

CHAIRMAN—Your submission says you support recommendation 3, which is:

… that an administrator should be prohibited from using a casting vote in a resolution concerning his or her replacement.

Again, Treasury have expanded on the government's response to that recommendation and said:

A prohibition may be ineffective on the basis that the administrator can effectively confirm their own appointment by simply refraining from using their casting vote to effect their removal.

They go on to refer to the explanatory statement to the corporations regulations, which notes:

The term 'casting vote' … has a broader meaning in this context than is usual and will allow the chairperson to effectively decide between the interests of the creditors with the preponderance in numbers and the interests of the creditors with the preponderance of value.

They also refer to CAMAC having reviewed this matter and recommended that the current position of the casting vote be retained.

Mr Proudman—Perhaps I could make some observations. The environment in which a casting vote—and you touched on it a moment ago, Senator—is even considered is where you have a majority in number voting in favour of one thing and a majority in value voting the other way. This is quite a difficult and vexed question for administrators who sit in a creditors meeting and are faced with this dilemma. There are a number of things that they have to think about. Some of it might be self-interest, but there are a number of things they have to think about in terms of what they genuinely believe is the best outcome for the creditors.

When there is a majority in number in favour of a resolution for a deed of company arrangement and that person is going to be the deed administrator, and then there is a majority in value against the resolution for that deed of company arrangement, there is inherently the conflict of their own position but overlaying that—in my view, much more significantly—is: what is actually the right answer, the best outcome, for these people that I have before me right now? Do I support the number or do I support the value? So dealing with casting votes is always on a bed of difficult circumstances and very difficult judgement calls for insolvency practitioners. And I might add that, from all I have ever seen, for the most part they all exercise that quite judiciously and quite carefully.

The issue of dealing just with a casting vote in relation to a resolution is vexed by the same problem: 'I've got a number of people in this room who want me to stay, but I've got a number of people of greater value who want me to go.' You can see how not exercising the casting vote, which means that the resolution fails, actually supports the group of creditors who want no change. So I think that as a general rule we should have a prohibition, but it just means that it maintains the status quo. And if the creditors who are in favour of a replacement can put up good and proper and cogent reasons why that person should be replaced then it is quite likely that the other creditors who had voted against the change would be convinced that they should in fact change their view.

Senator MURRAY—I asked some earlier witnesses in this inquiry to think more about this issue, bearing in mind the Treasury response and the discourse today, and one of the possibilities is in fact to mandate a style of voting in particular circumstances. In the principle that you have just outlined, if a casting vote is to be applied then it must be applied to the status quo. It is quite a common procedure in parliaments, for instance, when you have a vote which can change a circumstance or must be used to hold a circumstance.

I would prefer you did not give a definitive answer now. I think governments and CAMAC have got this issue wrong. I think we do need to sharpen up on the conflict of interest area. I would ask you if you would not mind having a look at the submissions with respect to this specific area and perhaps coming back to us with an informed view as to whether there is a narrower area in which this casting vote issue could be made more principled and less discretionary than it is at present.

Mr Proudman—I will do that, but may I just observe that to mandate one way or the other is going to remove the flexibility of the decision being made contrary to the way in which it might otherwise have been made, in the sense that it might be that the administrator simply says, 'In all of these circumstances I do not have the support of the creditors with the recommendations that I am making and it is actually in their best interests that I be replaced.'

Senator MURRAY—Yes, but can I say in response that committee recommendation 3 was actually a mandated prohibition: you may not vote. The government's response is: you should retain the discretion in all circumstances. I think maybe there is a halfway house: that you may not vote, or you must vote, in particular circumstances. That is really where I am trying to get to. Is that clear, Mr Proudman?

Mr Proudman—I think so, thank you.

CHAIRMAN—Can I direct your attention to our recommendation 10, which you again say you support, but Treasury again has expanded on the government's rejection of that in their submission, basically on the grounds that it could subject directors who were not guilty of neglect in relation to maintaining the books to penalties.

Mr Proudman—I share the same concerns that the IPAA have. However, I am perhaps a bit stronger on this than they are. I probably should have said that we strongly support recommendation 10. It certainly seems to me and I think to the Law Council generally that when you become a director of a company you are thereupon obligated to do certain things, and there are a large number of things that you are obligated to do. It seems inappropriate that you should be able to, if you like, get away with not doing something as fundamental as maintaining good books and records of a company in the current circumstances, as one does, particularly in light of the fact—and this is certainly my personal view—that a very large proportion of insolvencies arise as a consequence of not having proper books and records. So I am very supportive of that view and I think it would be a significant deterrent, after the first two or three insolvency appointments where liquidators seek to recover moneys from the directors for the costs of doing that work, that will send a very clear message to a lot of people.

Senator MURRAY—Since we are unlikely in the short term to be able to change the government's mind in rejecting our recommendation, again there is a potential halfway house, and that is to take away from the liquidator or the administrator the decision to determine the issue of costs and reconstructing books and to allow an objective third party to make that decision. You do not want to go to the courts because of the time and the costs; it would need to be an administrative action, and probably ASIC is the right body. But perhaps the halfway house here is for a liquidator or an administrator to be able to make an application to ASIC, who would then approve that that recommendation applied. So it is more targeted, more select, particularly to circumstances where you have individuals who have a history of bad corporate behaviour. Perhaps you would like to consider that one too and come back to us, if is not immediately obvious to you.

Mr Proudman—Is it intended that the decision of ASIC would be subject to review?

Senator MURRAY—That is the sort of thing on which I would like your response because in all these matters I am concerned that as soon as you allow administrative process and review and so on you extend the time and the cost—and often, particularly with small proprietary companies, you need expeditious treatment of the issue. That is why I suggest you might want to think about it and come back to us. It refers to recommendation 10 and you will find it in the Treasury submission to us.

Mr Proudman—The reason I asked that question is that the concept of going before a master of the Supreme Court, for example, certainly in my state of South Australia, to get an order would not be a hugely difficult or impractical exercise. So if it were that the ASIC decision was, 'Yes, you are entitled to recover these costs—or whatever it happens to be—from these directors,' and that decision was the subject of a review, you would end up in that court process quite quickly. And a court-driven decision might be an easier starting point in trying to provide some certainty and some clarity, because you might well end up there in any event.

Senator MURRAY—That is the sort of advice I would like to get. I think the committee was on the button, but I can understand the government's response. Maybe there is a more targeted way in which we can do this.

CHAIRMAN—The other issue I want to raise is recommendation 55, which again you support, and Treasury has again expanded on the government's rejection of that recommendation.

Mr Proudman—I had the benefit of hearing you a moment ago when you summarised Treasury's position. The way that I look at this issue is to break up the contract into three parts. The first part of the contract is a breach which arises prior to the appointment of the voluntary administrator. The second is to look at the breach being the appointment of the voluntary administrator. The third is to look at the breaches that arise after the voluntary administrator has been appointed.

The problem here—I think the example was of OneTel, where all of these customers and contracts basically fell away and there was little or nothing of the business left immediately on appointment—can be overcome if you just remove the breach for appointment. So if there is a pre-appointment breach, that is, someone has failed to pay some money under that contract, well, that is a pre-appointment breach. And if one of the consequences of that breach is that you are entitled to terminate, well, then you are entitled to terminate. Likewise, if there is a post-appointment breach, that is, the voluntary administrator is in running the business and wants to preserve the business assets and the goodwill associated with these contracts but the company breaches the contract whilst within the control of the administrator, then my view would be that that is a breach for which you should be entitled to terminate.

What is happening and what is of concern is that the mere appointment of the administrator gives rise to the right to terminate without actually giving the company the opportunity, consistent with part 5.3A objects, to continue to trade forward into the future, albeit under the auspices of the administrator. As long as that contract is continuing to perform, why should that contractor, where it is so fundamental, be entitled to simply say, 'Well, it's too bad; you've appointed a voluntary administrator, I'm terminating my contract,' because it is so contrary to the whole of the objects of part 5.3A?

So when I break it up in my mind to those three events I simply say: if there is a breach for anything other than appointment, and the consequence is termination, go for it—terminate. But if it is merely because there has been an appointment and nothing else, then I think the part 5.3A objects should prevail and that that contract should continue to exist, subject of course to a subsequent breach by the company even though it is under the auspices of the administrator.

Senator MURRAY—With your logic—which I follow and like—you are essentially suggesting that the appointment of an administrator is a remediating action, because it is designed to remediate a problem, not worsen it.

Mr Proudman—Absolutely, because that is consistent with the part 5.3A objects. That is quite right. Now, if you were to take that approach, it seems to me the difficulty will be: what view does one take about other appointments? Do you take the same view about the appointment of a receiver as you do about the appointment of a voluntary administrator or a liquidator? Of course, as matters currently stand, both of those events would normally be expressed as events of default under contracts.

Senator MURRAY—Except that an administrator is specifically charged with a business outcome, whereas a receiver is not.

Mr Proudman—And I think that is the answer; that is right. When the June 1993 amendments first came in, on 23 June, and voluntary administrators were being appointed, every single contract that existed did not have the appointment of a voluntary administrator as an event of default, because voluntary administration just did not exist. As contracts were renewed or redrafted or prepared over time, along with a liquidator being appointed or a receiver being appointed there was another event of default which was the appointment of an administrator, and there was a hiatus until—I think even as late as 1999, in some cases, I was advising administrators about the circumstances under contracts where administration still was not an event of default so you could continue that process and continue that contract. It was quite beneficial.

Senator MURRAY—But if you change the law you would make it prospective, wouldn't you? You wouldn't want to overturn standing contracts.

Mr Proudman—No. No, absolutely not. It would only be prospective. I am just giving an example of where, for that first few years, we would actually find an administration with a contract that was still on foot because administration was not an event of default, and you preserve that contract and that goodwill of that business.

Senator MURRAY—It is a very interesting argument.

CHAIRMAN—As there are no further questions, thanks very much, Mr Proudman, for appearing before the committee and for your assistance with our inquiry today.

Mr Proudman—Thank you.

CHAIRMAN—That concludes this public hearing.

Subcommittee adjourned at 1.07 pm