

2010 CORPORATE INSOLVENCY REFORMS

Reversal of the effect of *Sons of Gwalia v Margaretic* and related issues

Section 563A of the Corporations Act subordinates any claims made by a person in their capacity as a member of the company, whether by way of dividends, profits or otherwise, below the claims of other unsecured creditors against the company. However, the High Court decision in the 2007 case, *Sons of Gwalia Ltd v Margaretic*, determined that a compensation claim by a shareholder against a company was not subordinated by section 563A.

In February 2007, the previous government referred the decision to the Corporations and Markets Advisory Committee (CAMAC) for its analysis and advice. CAMAC issued its report *Shareholder claims against insolvent companies: Implications of the Sons of Gwalia decision* in December 2008. CAMAC recommended that the decision should not be reversed.

The Government intends to amend the law so that it substantially corresponds to how it was generally perceived to be prior to the High Court's decision – i.e. to 'reverse' *Sons of Gwalia*.

The Government will also amend the law so that:

- the right of subordinated shareholder claimants to vote as creditors in insolvency proceedings be removed, unless the Court permits otherwise;
- any requirement for an administrator or liquidator to provide reports to creditors to such claimants be removed, except where a claimant makes a specific request for a copy of a particular report; and
- the rule in the case of *Houldsworth v City of Glasgow Bank* be abrogated.

Issues in external administration

CAMAC issued its report, *Issues in external administration*, in November 2008, making recommendations for reform in respect of a number of issues that arose in the course of the previous government's consultations on the 2007 insolvency reforms, but which were not actioned as part of those reforms.

Further detail is provided at Attachment A.

Relation-back and commencement dates

The terms 'relation-back' and 'commencement date' are utilised in a number of 'clawback provisions' contained in the Corporations Act which enable the reversal of uncommercial transactions, unfair preferences, unfair loans and unreasonable director-related transactions made in the period leading up to the commencement of a company's liquidation. The existing anomalies in these provisions are subject to abuse and may potentially be used by directors to manipulate the relation-back and commencement dates for a liquidation, limiting how far back the clawback provisions will apply.

The Government will amend the law to address the anomalies that exist in the meanings of 'relation-back date' and 'commencement date' where: a voluntary administration is commenced after an application for winding up has been filed; and where a winding up occurs after the termination of a Deed of Company Arrangement pursuant to the Corporations Regulations rather than pursuant to the Corporations Act.

Miscellaneous reforms

The Government will also amend the law to address a series of minor technical and mechanical issues. These amendments will correct the use of archaic terminology; eliminate duplication and inconsistencies between provisions; fix implementation issues arising from the passage of the 2007 insolvency reforms; and improve the efficacy of certain provisions.

Further detail is provided at Attachment B.

ATTACHMENT A — ISSUES IN EXTERNAL ADMINISTRATION

Background

The *Corporations Amendment (Insolvency) Act 2007* introduced the first substantial reform of Australia's corporate insolvency system since the implementation of recommendations of the Harmer Review in 1992. In the course of consultation on the 2007 reforms, a number of issues were raised which were unable to be pursued as part of the reform package. The previous government referred these issues for consideration by the Corporations and Markets Advisory Committee (CAMAC). CAMAC issued its report, *Issues in external administration*, in November 2008, making recommendations for reform in respect of some of these matters.

The following reforms largely align with CAMAC's recommendations.

Access to creditor lists

In a voluntary liquidation where the company is insolvent, a liquidator is required to provide to creditors the names, addresses and estimated amounts owed in respect of all other creditors in the administration. Hard copies of these lists must be sent to all creditors with debts in excess of \$1,000, and upon request to creditors with debts less than this threshold.

The law will be amended to provide that insolvency practitioners should be permitted, but not compelled, to make creditor lists available electronically, rather than posting hard copies.

Notice to property owners

An administrator is required to consider whether the company to which they have been appointed will retain any equipment or other property in the company's possession that is owned by a third party. An administrator who decides not to retain such property must notify the owner of that decision within five business days after the commencement of the administration.

The law will be amended to provide that an external administrator will be required to advise the third parties of the location of their property, when they are advising those parties that they do not intend to use their property in an administration (provided that the information is reasonably available to the practitioner).

Chairing the major meeting

A voluntary administrator is obliged to chair the major meeting of creditors, at which the proposed Deed of Company Arrangement (DoCA) is considered and voted upon, unless excused by a Court order.

The law will be amended to provide that the major meeting of creditors should be able to be chaired by an administrator's nominee, when it cannot reasonably be chaired by the

administrator, without the need for a Court order. Creditors would have the right to reject the nominee and require the meeting to be adjourned and be chaired by the administrator or an acceptable nominee.

Notification of breach of Deed of Company Arrangement

Creditors have the right to resolve to terminate DoCAs that have been breached or to apply to the courts for remedial action. However, there is no statutory requirement for a DoCA administrator or for the directors of the company (where the DoCA returns control of the company to the directors rather than an administrator) to inform creditors that a breach of the DoCA has occurred. It is currently open for the terms of a DoCA to impose such an obligation.

The law will be amended to provide that a deed administrator or the directors, where the DoCA returns control to directors, should be required to notify creditors (in the case of directors, via the administrator) of any breach of a deed of company arrangement which could reasonably be expected to have a material effect on the purpose or outcome of the deed.

Provisional liquidator's remuneration

Where a person has petitioned the Court for the liquidation of a company, the Court may appoint a provisional liquidator to take control of the company to safeguard the assets of the company pending the outcome of the proceeding. Currently, a provisional liquidator's remuneration must be approved by the Court.

The law will be amended to provide that creditors be able to approve a provisional liquidator's remuneration in cases where they will ultimately bear these costs, subject to the power of the Court to confirm, increase or reduce that remuneration.

Postal voting by creditors

Liquidators of court-ordered or creditors' voluntary liquidations cannot enter into compromises of debts in excess of \$100,000 or agreements under which the company's obligations may not be discharged within three months, except with the approval of the Court, of the committee of inspection or of a resolution of the creditors. In the case of a members' voluntary liquidation, the relevant approval is by a special resolution of members.

The law will be amended to allow postal voting in all kinds of liquidations in respect of these matters.

Replacing a liquidator

The members in a members' voluntary liquidation or creditors in a creditors' voluntary liquidation may fill any vacancy in the office of liquidator, which may arise if the incumbent ceased to be a registered liquidator, resigns or dies.

The law will be amended to provide that ASIC would be able to administratively appoint a replacement liquidator when there is a vacancy in office. Public notice of appointments would be required and appointments would have to be in accordance with publicly available guidelines to be developed by ASIC, in consultation with relevant stakeholders.

Taking possession of and transferring books

ASIC does not have a generic power to require the production, and to take possession, of books of a company under external administration. Its powers in this regard can only be used in support of its enforcement and other functions and powers. There is also no power for ASIC to transfer books to another person.

The law will be amended to provide that ASIC, in the event of a vacancy of the position of external administrator, would be able to take possession of books relating to a company in external administration and transfer those books to another external administrator.

The publication of external administration notices

There are a range of notices that, in the course of external administrations, must be published in the print media. These public disclosure obligations are in addition to obligations for petitioning creditors and for external administrators to communicate directly with known creditors to inform them of certain events.

There are very significant costs to administration in complying with these obligations; likewise, there are costs to creditors in monitoring newspapers for relevant notifications (particularly as there is no set newspaper or day of the week on which notices must be published).

The law will be amended to facilitate the future provision of notices via a single website. The reforms will apply to both advertisement requirements and gazettal requirements.

Exemption from publication

A company in external administration that changes its name during, or six months prior to, the external administration must disclose its former name as well as its current name on public documents, for the period of the administration or any subsequent liquidation.

An administrator of a DoCA has the right to apply to the Court for an exemption from this disclosure requirement, but no other kind of external administration has this right. The Courts may grant such an exemption provided that there is no significant risk to the interests of creditors, including contingent and prospective creditors, as a whole.

The law will be amended to provide that administrators, receivers and other controllers and liquidators, as well as DoCA administrators, would have the right to apply to the court for an exemption from the requirement for a company to publish its former name on public documents.

Electronic communication with creditors

The purpose of sending notices to creditors is to ensure that they are informed of events that may affect their rights and as a result are given an opportunity to protect those rights.

The law will be amended to provide that external administrators would be permitted to advise, in their first notification to creditors, that all further notices to creditors and other documents relevant to the external administration will be published on a designated website. The first notification would also indicate that a creditor may choose: to register to be notified electronically when new material is placed on the website; or to receive by mail, free of charge, a printed version of these further notices and other documents. If they make no nomination, they would not receive any further notifications.

ATTACHMENT B – MINOR MISCELLANEOUS INSOLVENCY REFORMS

Appointment of liquidator upon transition from Deed of Company Arrangement

The NSW Supreme Court case of *Jick Holdings* identified an error in the insolvency provisions of the Corporations Act arising from the amendments in the Insolvency Act. The error has the effect that where the Court makes an order terminating a Deed of Company Arrangement (DoCA) and winding up a company, or where a provision in a DoCA providing for its termination and the winding up of a company is triggered, no liquidator is appointed by default to the subsequent liquidation.

The law will be amended to provide that, for section 446B transitions, the former administrator will be automatically appointed as the liquidator, subject to:

- the Court having the power to appoint an alternative liquidator, in the event that a DoCA or administration is brought to an end by a Court order; and
- except where the Court provides otherwise, creditors holding 10 per cent or more of the claims against the company by number or value being able, within 10 working days of the transition, to direct the default liquidator to call a meeting of creditors to be held within 20 working days of the transition to consider whether to appoint an alternative nominated liquidator.

Assetless Administration Fund

Sections 473 and 499 of the Corporations Act provide that a liquidator's entitlement to remuneration only arises if approved by a committee of inspection, a meeting of creditors or the Court.

ASIC administers the Assetless Administration Fund (AA Fund) which may, upon application by a liquidator, provide financial assistance to carry out investigations into alleged misconduct by company officers.

On one view, sections 473 and 499 may be interpreted as requiring liquidators to obtain approval before seeking payment from the AA Fund for investigation work.

The law will be amended to provide that external administrators should be explicitly authorised to claim properly incurred remuneration out of AA Fund monies even in the absence of any approval under sections 473 or 499 of the Corporations Act.

Pooling provisions

Pooling provisions for liquidations were introduced as part of the 2007 reforms. The amendments did not provide for notice of pooling-related Court orders under sections 579A, 579B and 579C of the Corporations Act to be lodged with ASIC.

The law will be amended to provide that persons obtaining such orders be required to lodge notice of them with ASIC.

Company under external administration — former name to be used on documents

Section 161A of the Corporations Act was inserted in the 2007 insolvency reforms. There are incorrect cross-references in the section.

The law will be amended to provide that the reference to '(iii)' in subsection 161A(3) be amended to '(iv)' and the reference to '(iv)' in subsection 161A(2) be amended to '(iii)'.

Persons not to act as receivers

Section 418 of the Corporations Act provides that persons with certain relationships with a company are disqualified from acting as a receiver over the company's property.

One such relationship is that of a 'senior manager', be it of the company, one of its mortgagees or a related body corporate.

Concerns have been raised by stakeholders that this term may be wide enough to include a 'receiver and manager'.

The law will be amended to provide that, in section 418, a 'senior manager' does not include a 'receiver and manager'.

First meeting of creditors in a voluntary liquidation

As a result of the 2007 amendments, subsection 497(1) of the Corporations Act requires a liquidator to 'cause' a meeting of the creditors to be 'convened' within 11 days.

The wording of this section does not achieve the intended result. The policy intention was that the section would require the liquidator to hold the meeting within 11 days as explained in the Explanatory Memorandum to the Insolvency Act. The word 'convene' means to arrange the holding of a meeting.

The law will be amended to provide to give effect to the original intention that the meeting would be held within 11 days.

Lodgement of a report as to affairs

Directors are required to provide a report as to the affairs of the company in the prescribed form to a liquidator. The law will be amended to provide for the lodgement of this form with ASIC.

Chairing of a first meeting of creditors

The general rule for the selection of a chairperson for a creditors' meeting is contained in regulation 5.6.17 of the Corporations Regulations. It states that if a meeting is convened by 'a liquidator ... that person, or a person nominated by that person, must chair the meeting'.

The 2007 reforms amended subsection 497(1) of the Corporations Act, in part, to provide that it would be convened by the liquidator, rather than the company. However the 2007 reforms did not remove subsection 497(8) which states that, in respect of a section 497 meeting, 'the creditors may appoint one of their number or the liquidator to preside at the meeting'.

The law will be amended to provide that there be no exception for section 497 meetings to the general rule contained in regulation 5.6.17 — subsection 497(8) will be repealed.

Bankrupt ineligible

The definition of 'insolvent under administration' in section 9 of the Corporations Act, while effective in specifying the correct meaning of an insolvent under administration, does so by first defining it as meaning a bankrupt (under local or foreign law). It then states that a bankrupt includes persons subject to controlling trusteeships, personal insolvency agreements or equivalent foreign proceedings. Although subject to personal insolvency administration, such persons are not technically 'bankrupts'.

Although section 9 implies a meaning for 'bankrupt' that differs from that in the Bankruptcy Act, there are a range of sections in the Corporations Act that on their face use the term in accordance with its *Bankruptcy Act 1966* meaning.

The definition of insolvent under administration will be amended so that it does not internally define 'bankrupt' in a manner inconsistent with its definition in the Bankruptcy Act and its use throughout the Corporations Act. The meaning of insolvent under administration will remain unaltered.

Court power in the event of reinstatement

Subsection 601AH(1) of the Corporations Act provides ASIC with the power to reinstate a company that has been deregistered. Subsection (2) provides a similar power to the Court.

Subsection (3) provides the Court with a power to validate any acts done during deregistration and to make any other orders it considers appropriate. However, as drafted, this power appears to only apply to subsection (2) reinstatements.

The law will be amended to provide the Court with the power to make orders consequential to ASIC-initiated reinstatements as well as Court-initiated reinstatements.

Automatic adjournment of a meeting for no quorum

Regulation 5.6.16 of the Corporations Regulations provides that if there is no quorum at a meeting of creditors, the meeting is automatically adjourned for a period between 7 and 21 days, as determined by the chair of the meeting.

This provision applies to the first meeting of creditors in a voluntary administration under section 436E. As a consequence, a section 436E meeting may be adjourned for 21 days, which could be inconsistent with the requirement to then hold the second creditors'

meeting in a voluntary administration between 15 business days and 30 business days from the commencement of the administration.

The law will be amended to provide that, if there is no quorum at the first meeting of creditors it should be automatically adjourned for a period of between 7 and 10 days, rather than 7 and 21 days

When administration begins and ends

Paragraph 435C(3)(h) of the Corporations Act provides that the voluntary administration of an insurer will end when 'management of the general insurer vests in a judicial manager of the company appointed by the Federal Court under Part VB of the *Insurance Act 1973* or Part 8 of the *Life Insurance Act 1995*.'

The Life Insurance Act deals with 'life companies' and not 'general insurers'.

The section will be amended to refer to when management of the general insurer vests in a judicial manager of the company appointed by the Federal Court under Part VB of the *Insurance Act 1973*, or management of the life company vests in a judicial manager of the company appointed by the Federal Court under Part 8 of the *Life Insurance Act 1995*.

When administrator may dispose of encumbered property

Section 442C of the Corporations Act sets out the rules for voluntary administrators and deed administrators regarding the disposal of third party property or company property which is subject to charges, liens or pledges.

Paragraph 442C(2)(a) provides authority to administrators to dispose of company or third party property in the ordinary course of business. This is subject to subsection 442C(4) which gives the Court a power to make orders to prevent certain property disposals in the ordinary course of business from taking place. There appears to be a drafting error in this subsection.

The subsection refers only to property 'of the company' and not to third party property. This is notwithstanding that the potential applicants for an order under subsection 442C(4) include the owner or lessor of the property in question (see paragraph 442C(5)(b)).

Section 442C will be amended to provide that the Court has the power to make orders preventing the disposal of both company and third party property.

Certain notices to be lodged

Both sections 465A and 470 of the Corporations Act impose obligations upon persons applying to wind up a company to lodge certain notices with ASIC. Although these sections do not appear to conflict (section 470 is merely more specific as to the requirements), they do unnecessarily overlap.

Amendments will be made to the Corporations Act to eliminate this overlap and any possibility of conflict.

Carrying on business

Section 477 of the Corporations Act provides that in a court-ordered liquidation the liquidator may carry on the business of the company 'so far as is necessary for the beneficial disposal or winding up of that business'.

In comparison, in a voluntary liquidation, section 493 provides that the company must 'cease to carry on its business except so far as is in the opinion of the liquidator required for the beneficial disposal or winding up of that business'.

There appears to be no basis for the different wording between the two sections as they are intended to have the same effect.

Additionally, it appears that section 477 is also applied to voluntary windings up by operation of section 506. That is, both sections 477 and 493 apply to voluntary liquidations.

The law will be amended to provide for a single consistent rule that applies to all kinds of winding up.

Resolution that company be wound up voluntarily

Section 491 of the Corporations Act provides that a company must, within seven days after the passing of a resolution for voluntary winding up, lodge a 'printed copy of the resolution'.

Other provisions, such as subsection 507(11), merely refer to the lodgement of certain resolutions, with no reference to 'printed'.

Concerns have been raised that the reference to 'printed' may be read as being unnecessarily restrictive, in particular given the practice of electronically lodging these resolutions.

The lodgement requirement in section 491 will be amended to refer to the lodgement of notice of the resolution in a prescribed form, without use of the term 'printed copy'.

Lodgement with ASIC of declarations of relationship

External administrators in either a voluntary administration or a creditors' voluntary winding up must make declarations to creditors about relevant relationships and/or indemnities.

The law will be amended to provide for the lodgement of these declarations with ASIC.