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Manager
Corporations and Scheme Unit
Financial System and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via Email Only: insolvency@treasury.gov.au

Dear Sir/Madam,

Re: Insolvency Law Reform Bill (ILRB – 2014)

We are pleased to make a submission on the Insolvency Law Reform Bill 2014 (ILRB).

We applaud the Government's attempts to reform insolvency law and in particular the Government's attempts to remove unnecessary costs and increase efficiency in insolvency administrations, to promote market competition on price and quality and to remove unnecessary costs from the insolvency industry resulting in about $55.4 million per annum in compliance cost savings.

We are of the opinion that certain provisions of the Exposure Draft are likely to *increase* unnecessary costs and *reduce* efficiency in insolvency administrations.

We are also of the opinion that the proposed legislation misses some key opportunities to achieve the stated goals. These are referred to in more detail later in this submission and are summarised below.

The proposed legislation:

* Ignores reviewing the remuneration and disbursements of Receiverships.

* Has missed the opportunity to create significant trading trust and trust law reform. The current trust laws have added unnecessary complications and costs in recent times to insolvency practitioners and to the detriment of creditors.

* Has not addressed the need for a significant review of the asset realisation charges which are currently only imposed in bankruptcies.

* Has failed to address other practical concerns by insolvency practitioners which are addressed in detail later in this report including.

- Tax Clearance or Assessments

- Bankruptcy (Estate Charges) Act 1997

- Fair Entitlement Guarantee (FEG)

- Bank Statements and Closure of Bank Accounts

- Director Compliance
- Emails – Corporations
- Method of calculating Trustee and External Administrators Remuneration

SUBMISSION REGARDING BANKRUPTCY AMENDMENTS

THE REQUIREMENT FOR THE TRUSTEE TO CONVENE MEETINGS IN CERTAIN CIRCUMSTANCES

The proposed legislation provides that a trustee must convene a creditors meeting in certain circumstances.

We believe that the right to request a meeting and to vote at such a meeting should be restricted to exclude related party entities as such creditors are often in conflict with external or non-related creditors. This is especially true if the Trustee is investigating the regulated debtor or a related entity in relation to certain dealings.

Although the draft Act and rules does provide a reasonableness test and provide guidelines and examples we believe that it would be simpler to exclude related parties all together in this regard.

This would better achieve the stated objectives of the draft legislation in terms of reducing the costs of administering bankrupt estates.

REVIEW OF THE TRUSTEES REMUNERATION

The proposed legislation allows for a regulated debtor to request that the Inspector General carries out a review of the Trustee's remuneration.

In only the rarest of circumstances does the regulated debtor have a financial interest in the outcome of the administration of a bankrupt estate. The majority of bankrupt estates pay no dividend whatsoever to creditors because there are simply insufficient assets. Even if the bankruptcy trustee where to charge no fees whatsoever the fact that the estate is insolvent means that there is rarely a circumstance where there is a surplus to be refunded back to the regulated debtor after a distribution has been made to creditors.

The regulated debtor's interest of the estate is by contrast frequently hostile to the bankruptcy trustee and the regulated debtor's interest in requesting a review of the bankruptcy trustee's remuneration is usually motivated by agendas more reflective of the bankrupt's interest being in direct conflict with the interests of creditors.

Allowing the regulated debtor to automatically request remuneration reviews will add an unnecessary level of complication to many administrations. Involving the Inspector General in a multitude of vexatious claims and in the circumstances will have a result quite contrary to the stated aims of the draft legislation which is to simplify the administrations and reduce costs.

The current legislation by contrast adequately provides for a fair and transparent supervision and review of Trustees and their professional conduct.

CORPORATIONS

AMENDMENT TO THE PROVISION AND LODGEMENT OF FINANCIAL INFORMATION WITH THE ASIC.

The draft legislation proposes the deletion of the current requirements for a liquidator to lodge a Form 524 and replaces it with a requirement to lodge an Annual Administration Return within three (3) months after the end of the financial year.

We believe that this requirement will add considerably to the costs in administering insolvent companies and further we believe this information provides no useful information whatsoever to any of the relevant stakeholders.

Creditors and shareholders should look directly to the external administrator for reports on the administration on insolvent companies and there is currently adequate reporting requirements in place. In any event the proposed legislation strengthens significantly the reporting requirements to creditors and other stakeholders and such information is far more beneficial relevant and timely than the information required by the proposed annual administration return.

An additional problem also occurs in mandating that all returns be lodged at the end of the financial year. This will put considerable administration stress on the professional practices of insolvency firms and also put stress on the ASIC which will be receiving a great volume of data within a very restricted window of time. There is also significant confidentiality issues involved in publishing the relevant data and making it available to the public who have no direct interest in the matter.

At the very least the draft legislation should exempt External Administrations from having to lodge returns where there are no funds in the administration or there have been no movement since the last return.

We appreciate that the Federal Government has an interest in harvesting statistical information so far as insolvent estates are concerned. However we believe that the current regime with respect to section 533 reports adequately meets this objective and we note that there is no proposal to make any amendments with regard to this report.

We also note that the statistics gathered by AFSA are currently very extensive and informative however most of this information comes from the initial statement of affairs lodged by the debtor. This could easily be replicated with respect to companies.

AMENDMENTS ALLOWING THE INSPECTION OF THE ADMINISTRATORS RECORDS.

This amendment permits a creditor or a contributory to inspect the external administrator's books and records at all reasonable times.

We are opposed to this provision because it would considerably disrupt the smooth administration of an insolvent company. We also believe that the role of supervising external administrators should fairly be carried out by ASIC. This is because ASIC is the primary regulator when it comes to the supervision of liquidators and company administrators. It has the powers and the professional skills to properly carry out this work and to allow creditors and contributories direct access to the records will potentially unnecessarily and unfairly complicate these administrations.

This is particularly true since the interest of an individual creditor or contributory is not necessarily the same as the interests of all the creditors generally. We acknowledge that there is an exception in relation to "reasonable excuse" however we believe this is vague and has the potential to simply create more costly disputes

AMENDMENTS ALLOWING THE APPOINTMENT OF REVIEWING LIQUIDATOR.

The proposed legislation allows the appointment of a reviewing liquidator regarding remuneration and expenses by resolution of creditors.

We believe that this will add unnecessarily to the costs of administration in that it potentially allows parties with a vested interest to appoint a reviewing liquidator.

We believe as stated earlier that it is the role of ASIC to regulate the professional conduct of insolvency practitioners and this should include the review of remuneration and expenses. This is the role of the Inspector General in bankruptcy. In circumstances where there has been a justifiable complaint made about remuneration we believe that officers of ASIC are capable of making a review and should be appropriately resourced to carry out such a review.

2. MATTERS NOT ADDRESSED BY THE EXPOSURE DRAFT

A. Corporate Trading Trust

(i). General

It is common for a company to be appointed Trustee of a discretionary or other Trust.

The Trustee company is a legal entity and usually trades in its capacity as Trustee. Liabilities are incurred in its capacity as Trustee.

The Trust Deed usually provides that:

*The Trustee company is entitled to be indemnified from the assets of the Trust for debts incurred by it in the course of acting as Trustee. This right of indemnity out of the assets of the Trust are secured by an equitable charge over those assets.

*The Trustee company is disqualified from holding office as such if it goes into Liquidation or an Administrator or Deed Administrator (External Administrator) is appointed.

*A new Trustee in lieu of the company (the former Trustee) can be appointed by the Appointor.

A problem or question arises as to whether an External Administrator has the power to sell the trust assets in order to enforce the Trustee's indemnity and equitable charge if the Trustee is no longer a Trustee and/or a new Trustee is appointed.

Unfortunately, there are currently two (2) schools of thought each supported by conflicting case law which are summarised as follows:

a. Certain cases, and in particular those in the Federal Court of Australia, state that an External Administrator has the power to sell pursuant to Section 477(2)(c) of the Corporations Act (The Act). It is argued that this right of indemnity and resulting equitable charge is "property of the company" pursuant to Section 477(2)(c).

   One of the main advantages to creditors is that an External Administrator need not make an application to Court for him/her or another registered Liquidator to be appointed Receiver and Manager of the trust assets. Such an application will result in significant additional Liquidator remuneration and legal fees.

b. Another school of thought, mainly proposed by the Supreme Court of NSW, states that Section 477(2)(c) of the Act does not give the External Administrator power to sell in these circumstances as this right of indemnity and resulting equitable charge is not "property of the company" pursuant to this Section.

(ii) Recommendations

*There must be law reform to empower an External Administrator of a former Trustee company to sell trust assets in order to enforce the indemnity.

*The External Administrator should also be entitled to be paid all of his/her remuneration and disbursements reasonably and properly incurred in the administration of the former Trustee company.

(iii) Reasons

*It is in the interest of creditors as a whole to avoid the incurring of the additional remuneration and legal expenses associated with making an application to the Court for the appointment of a Receiver and Manager.

*It is also in the public interest and in the interests of the External Administrator that the law be clarified by way of reform to avoid the current uncertainty and inefficiencies arising as a result of the different schools of thought or case law.

(iv) Solution

a. Broaden the definition of "property of the company" in Section 477(2)(c) of the Act to include the Trustee's right of indemnity and resulting equitable charge. This should extend to Administrators and Deed Administrators.

b. Amend Section 556 of the Act "definition of deferred expenses" to state that Liquidators, Administrators and Deed Administrators are entitled to be indemnified from trust assets for all remuneration and disbursements incurred in the administration of the original Trustee company.

B. CLAIMED TRUSTS IN FREEHOLD

(i) General

Liquidators, Administrators and Bankruptcy Trustees (external administrators) are having nightmares regarding claimed trusts in freehold which usually only are made known after appointment.

Trust interests (express, implied/resulting and constructive) in freehold are claimed to be created as a result of moneys said to have been paid in relation to freehold. For example deposits, part payment of purchase price and mortgage instalments.

We believe it would be an understatement to say that the law regarding these trusts is confusing and invariably leads to complex and costly disputes with the associated risks of any litigation. The direct impact is suffered by creditors for whom external administrators are trying to recover as much as possible.

The costs and risks associated with challenging such claims are significant. This is of great concern to creditors and not in the public interest.

It appears that such trusts are now being used as schemes to the detriment of creditors and other stakeholders with the knowledge that they are unlikely to be challenged due to the high costs and risks. There is also a good chance of settlement where in reality there is a contrived trust claim. "Advisors" appear to be encouraging their clients to claim a trust when in reality the payment was a gift or loan

(ii) Suggested Solution

Legislation requirement that any trust interest in freehold must be registered at the appropriate state L.T.O. It is now essential that the public or potential creditors have **Notice** of such trust claims. Registration requirements could be along the same lines as the "old" floating charge requirements in the Corporations Act or PPSA.

If the trust is not registered within a requisite time frame after its creation, then the trust will be void/voidable against a Liquidator, Administrator, Deed Administrator and Bankruptcy Trustee. However, this requirement will be subject to the Family Law Act.

If there is no insolvency administration, the trust is valid even if there is no registration.

The arguments **for Notice** are compelling and certainly were front and centre of the PPSR legislation for personal property where the purpose of the register was to put everyone on notice. Creditors and other stakeholders are trading/ dealing with corporations or individuals and incurring costs to enforce their claims without the knowledge of such trust claims. Invariably there are little or no realisable assets to pay a dividend.

C. PRIVATE APPOINTMENT OF A RECEIVER OR RECEIVER AND MANAGER ("RECEIVER")

The Exposure Draft does not include Receivers. The definition of external administrator specifically excludes Receivers.

Accordingly, the objects of the Exposure Draft and in particular those relating to transparency and the removal of unnecessary costs have not been achieved due to this significant omission.

We wish to make a submission that certain sections of the Exposure Draft referred to below should also apply to Receivers.

C(1) Transparency

General

There is no statutory duty for Receivers to report directly to unsecured creditors.

Section 421A of the Corporations Act requires Receivers and Managers and Agents for the mortgagee in possession to prepare a report of the company's financial affairs. This report must be lodged with ASIC within two (2) months of the date of the appointment.

The aim of this report is to provide such information to the company's unsecured creditors and shareholders. Prejudicial information is excluded although this must be summarised.

However, this is the only Report which the Receiver is obliged to file. Accordingly, unsecured creditors and shareholders are kept in the dark regarding the company's financial affairs after this report.

Solution

a. The Section 421A Report should also be filed at regular intervals with ASIC, say every four (4) months, and at the end of the Receivership **OR**

b. Section 70-45 (Bankruptcy) and Section 70-45 (Corporations) regarding the right of individual creditors to request information etc. from the External Administrator should be amended whereby a Trustee and external administrator can also request this report from a Receiver:

The Receiver need not comply for reason given in those sections. For example, reasonable excuse. The Insolvency Practice Rules to also be amended in this regard.

C(2) Review of Remuneration and Disbursements of Receivers

General

A common complaint by bankrupts, directors and unsecured creditors in relation to the remuneration and disbursements of Receivers, whether actual or perceived, is that they are unreasonable and improper.

Their main concern is that any "excessive" remuneration and disbursements will significantly reduce the equity in property available to a Trustee and External Administrator for distribution to unsecured creditors and also erode any potential surplus to the bankrupt or company shareholders. Any excessive fees could also result in a shortfall to the Appointor.

(ii) Solution

a. 90-23 (Corporations) – Appointment of reviewing Liquidator by ASIC or the Court

*This is to also apply to Receivers.
*A person with a financial interest to make such an application is to include an External Administrator **OR**
*If our recommendation/solution is adopted whereby there is no Reviewing Liquidator, the power of review will be given to ASIC or AFSA/Inspector General. In this scenario a Trustee and External Administrator can make such an application to ASIC or AFSA/Inspector General.

b. 90-21 (Bankruptcy) – Review by Inspector General

This section is to also apply to Receivers over the property of a bankrupt which vests in the Trustee

D. TAX CLEARANCE OR ASSESSMENTS

In Liquidations, a tax clearance from the Australian Taxation Office ("ATO") is required prior to the payment of a dividend. This is not required in bankruptcy.

However, there is usually a long delay in obtaining such clearance or assessment which results in significant unnecessary delays and costs. This delay occurs even after all returns are lodged.

Creditors are not only dissatisfied in relation to the additional costs incurred but also the delay in their receipt of a dividend.

Solution

Amending the Income Tax Assessment Act whereby a tax clearance is no longer required if all returns are lodged.

The ATO like all creditors is forwarded a Notice of intention to declare a dividend and to lodge a Proof of Debt. It must comply with this Notice. The only exception is if the ATO has a reasonable excuse which it must disclose within the period of the Notice.

If returns have not been lodged and the external administrator does not have adequate books and records to file returns, this should not be a reasonable excuse for the ATO not to give a tax clearance.

E. BANKRUPTCY (ESTATE CHARGES) ACT 1997

There is a 6% realisation charge in bankruptcy on net realisations of assets. There is a formula for the calculation.

The main purpose of the realisation charge is to fund AFSA. However, there is no justifiable reason why bankruptcy should bear the burden of such a high 6% charge. A realisation charge should also be extended to corporations and apply to secured creditors.

The above should significantly reduce the 6% realisation charge and also provide additional revenue to finance ASIC and AFSA operations.

Another concern is that certain major expenses are not allowable deductions for assessment purposes. The main ones are legal fees and strata levies.

a. Legal fees.
If there is a recovery of funds after legal dispute, 6% realisation charge is on the gross and not net amount recovered. This is unjust especially if it could result in the Estate being liable for the charge. For example, there could be a complex matter whereby, say, only $20,000 is recovered and legal fees are greater than $18,800.

b. Strata levies.
Payment of these levies is compulsory on any sale. There is no justifiable reason why these levies cannot be deducted from the gross proceeds of sale in calculating the assessment. This would result in more funds being available to the Estate.

Solution

a. The realisation charge should be broadened across all administrations, personal and corporate including Receiverships, and should be borne by secured creditors equally with unsecured creditors.

b. Legal fees should be an allowable deduction from gross proceeds.

c. Strata levies should be an allowable deduction from gross proceeds.

F. FAIR ENTITLEMENT GUARANTEE (FEG)

External Administrators are currently experiencing a significant delay by FEGS/Department of Employment ("the Department") in the processing of employee claim entitlements.

This delay is causing increase in costs and also employee discontent in obtaining their entitlements.

Solution

To expedite the process, more reliance should be placed by FEGS on the employee entitlement assessment prepared by the External Administrator. If this is not acceptable, processing should be outsourced.

G. BANK STATEMENTS AND CLOSURE OF BANK ACCOUNTS

External Administrators are experiencing lengthy delays in obtaining bank statements which would assist in their investigations. This is causing not only increased costs in following up but also delays in completing investigations and commencing any recovery actions.

Another concern is the delay in closing pre-appointment bank accounts. External Administrators are also experiencing significant delays in these accounts not only being closed but the transfer of credit balances to the External Administrator's account.

Not only is this delay causing an increase in costs by continuous follow-ups but also a delay in the realisation of assets and the funds being available in the administration. There are a number of occasions whereby this amount is quite significant.

Solution

A legal obligation should be imposed on the bank to provide such statements and close the accounts within say two (2) weeks after the receipt of a Notice from the external administrator unless there are reasonable grounds for delay.

H. DIRECTOR COMPLIANCE

Official Liquidators are experiencing delays in directors delivering Report as to Affairs and books and records. Although these breaches can be reported to ASIC, there is considerable delay in enforcement and directors do not appear to be deterred by the current penalties.

Suffice to say that considerable additional costs and delays are incurred in identifying assets and liabilities in investigations and the finalisation of the administration.

Solution

The offence for such breaches should be significantly increased.

I. EMAILS - CORPORATIONS

A notice or document cannot be sent to creditors unless the recipient nominates the emailed address Regulation 5.6.11A of the Act.

This usually results in most notices and documents, especially immediately after the commencement of a liquidation or administration being sent by post. Furthermore, there is a delay in giving approval and many creditors don't bother to reply.

The result is that there are significant time, costs and postage charges incurred in the compilation and posting of reports and other documents.

This requirement does not apply in bankruptcy. There is no reason why this requirement to obtain consent should apply in liquidations and administrations where creditors are assumed to be more computer literate because of their business backgrounds. This is the 21st century.

Solution

A Liquidator or Administrator can forward the notice or document to an email address of which he/she is aware.

J. METHOD OF CALCULATING TRUSTEE AND EXTERNAL ADMINISTRATORS REMUNERATION

The main methods of calculating remuneration are time cost/hourly rate, fixed fee, proportionate and percentage.

Most practitioners have adopted the universal practice of using the time cost/hourly rate method.

However, recently there have been certain decisions in the Supreme Court of New South Wales stating that the proportional method was more appropriate on the facts given.

It is important to Trustees, External Administrators and creditors that the correct method be used. This will create efficiencies and cost savings for all parties.

However, the main problem is that there are no clear guidelines as to which method is appropriate for the job at hand.

The time cost/hourly rate method has been universally adopted as it is very difficult to assess or estimate whether other methods are more appropriate. This is especially at the commencement of the administration or prior to the realisation of assets or a disputed recovery action.

Further, there are tasks which do not relate to realisation of assets. For example, statutory obligations and creditors enquiries.

Solution

AFSA, ASIC and ARITA provide clearer and more detailed guidelines regarding the correct method to be used in particular circumstances and that these guidelines be adopted by the Courts.

We wish to thank you for your consideration of the abovementioned submission.

Should you have any enquiries please do not hesitate to contact Michael Jones, Bruce Gleeson or John Tanna of this office on telephone number (02) 9251 5222.

Yours faithfully,
Jones Partners Chartered Accountants
Insolvency and Business Recovery

John Tanna on behalf of
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