PART II

CURRENT POSITION

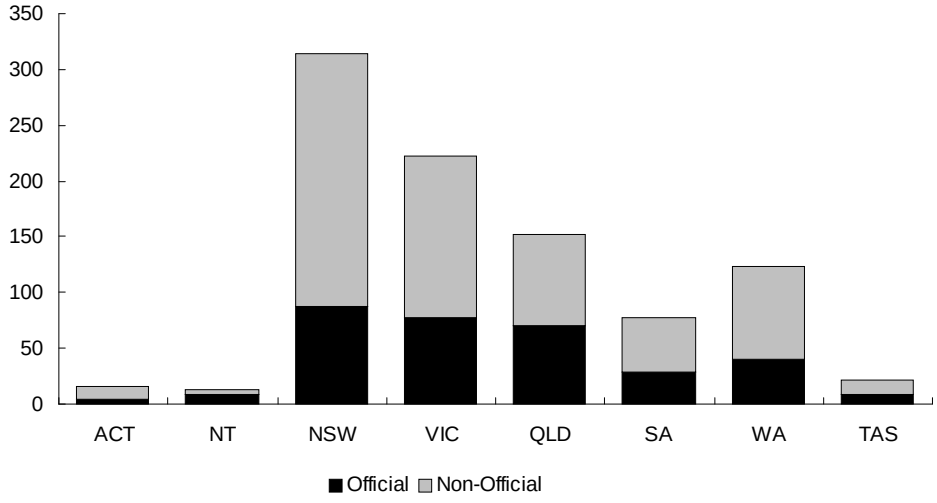
PROFILE AND ROLE OF INSOLVENCY PRACTITIONERS

2.1. In order to understand the issues that arise in relation to the regulatory system for insolvency practitioners, it is desirable to have some knowledge of the business environment in which they operate and the role that they play in the insolvency system. This chapter outlines those matters, focusing on the role of insolvency practitioners in the various procedures available under corporate and personal insolvency laws.

PROFILE

2.2. As at September 1996, there were 939 registered liquidators in Australia. Of those, 327 were also appointed by the ASC as official liquidators. Chart 2.1 below provides a breakdown of these figures by jurisdiction.

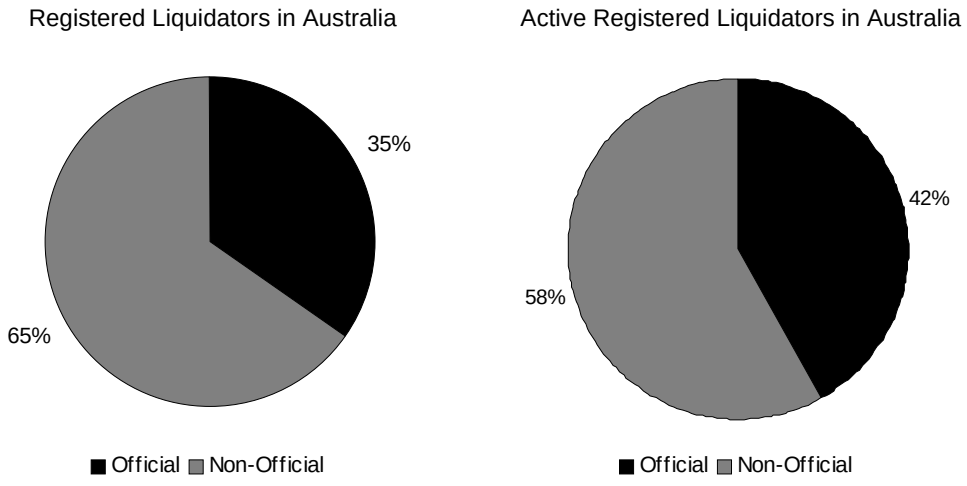
Chart 2.1: Registered Liquidators in Australia (Sept 1996)



2.3. The proportion of registered liquidators who are official liquidators is relevant to the issue of whether to retain the official liquidator class, which is discussed later in this report.

2.4. Although the figures above reflect the numbers of practitioners qualified as registered liquidators, they are somewhat misleading because many liquidators do not regularly accept corporate insolvency appointments. Statistics from the ASC indicate that a significant proportion of registered liquidators have not taken on any new appointments since 1 January 1991. The proportion of non-active practitioners is, in most jurisdictions, between 20 per cent and 30 per cent, giving an overall proportion of 26.6 per cent. A study by the ASC in two selected jurisdictions indicated that very few, if any, of the non-active practitioners are official liquidators. This was not confirmed in all jurisdictions but it could fairly be assumed that trend would apply uniformly. Chart 2.2 below illustrates how the overall breakdown of official/non-official registered liquidators varies if the number of non-official registered liquidators is discounted by 25 per cent on the grounds that a similar proportion would be inactive.

Chart 2.2



2.5. One point to note in relation to these statistics is that it is possible that the practitioners who have not accepted any appointments are, nevertheless, engaging in corporate insolvency work under the supervision of another person (such as an official liquidator in the same firm). However, the ASC has advised that it is more likely that such persons have ceased to engage in regular corporate insolvency work, since most of the persons concerned are partners of a firm.

ROLE

2.6. The role that the insolvency practitioner plays in any given administration will depend on whether it is an administration of corporate or personal property and the type of administration involved. This section outlines the various types of administrations available under corporate insolvency and personal bankruptcy laws and the role the insolvency practitioner plays in each.

Corporate Insolvency

2.7. Generally, corporate insolvency practitioners are appointed to corporations (usually companies) which are in financial difficulty or are insolvent. Their main task is to devise and implement a plan for the recovery of the company, or arrange for the winding up of the company in a manner which, as far as possible, maximises the returns to the company's creditors and members.[1]

If corporate reconstruction must be considered, insolvency practitioners:

- analyse the viability of the company within its market environment;
- choose a course of action for the company from among a range of possible options for the company's reconstruction;
- negotiate approval, and then implement, manage and monitor the plan; and
- simultaneously manage the day to day operations of the company.

2.9. Where a company is wound up, an insolvency practitioner must:

- arrange for the orderly realisation, collection and sale of assets of the company, as well as the subsequent disposition of assets to creditors according to their relative priorities; and
- investigate the company's affairs and report on the stewardship of directors and, where necessary, take legal proceedings to recover assets from other parties on behalf of the company.

2.10. The tasks outlined above may involve assessing and analysing:

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[1] These general remarks may not apply to practitioners appointed to act as receivers, receiver and managers or other controllers of corporate property. In such cases the practitioner is appointed over certain assets or classes of assets and their role is usually more limited.

- an industry and its performance;
- the placement and performance of particular products within a market;
- the structure and performance of a company's resource markets;
- organisational structures within a company;
- management performance and capabilities;
- labour relations and work practices;
- profitability both in terms of past performance and forecasts of future performance;
- asset structures and valuations, debt and capital structures, cash flows, risk exposure and the prospects of a company being able to obtain finance; and
- likely impacts of future Government policy or regulatory initiatives.[2]

Successful completion of the tasks require well-developed interpersonal skills. Commonly corporate insolvency practitioners are called upon to chair meetings and negotiate with employees, company officers and creditors regarding controversial and complex issues.

2.11. The legal responsibilities of the corporate insolvency practitioner are determined primarily by the provisions of the Corporations Law. Under the Corporations Law, an insolvency practitioner may be a:

- liquidator;
- provisional liquidator;
- receiver, receiver and manager or other controller;
- voluntary administrator or administrator of a deed of company arrangement; or
- scheme manager.

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[2] See generally Australian Society of Certified Practising Accountants, The Institute of Chartered Accountants in Australia and the New Zealand Society of Accountants, *Competency Based Standards for Professional Accountants in Australia and New Zealand: Discussion Paper prepared by Professor WP Birkett*, Link Publishing, Sydney, 1993 at pp. 125–164.

The legal responsibilities of the practitioner in any particular case will depend upon the type of administration concerned.

Liquidators

2.12. Liquidation, or winding up, is a procedure by which a corporation is ultimately dissolved. Generally, upon liquidation, the liquidator takes complete control of the corporation from the directors.[3] The objective of a winding up is to bring about an end to the corporation in an orderly and equitable manner which obtains the maximum return possible for creditors and members. The main tasks of a liquidator during the winding up are to:

- investigate the corporation's financial affairs and prepare a report on those affairs (including possible recovery actions available to the corporation);
- call in and realise the corporation's assets (including, where appropriate, bringing actions to recover assets which have been disposed of improperly); and
- distribute the proceeds to creditors who properly prove their claims in the priority set down in the Corporations Law.

2.13. A liquidator is required to report not only to the creditors and members of the corporation, but also to the ASC.[4] In specified circumstances, there is a particular responsibility to report suspected breaches of the Corporations Law by company officers.[5]

Types of Liquidation

2.14. There are essentially three different types of winding up under the Corporations Law:

- members' voluntary;
- creditors' voluntary; and
- compulsory.

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3 Subsections 471A(1), 495(2), Corporations Law.

4 Sections 476, 508, 509, 533, 539, Corporations Law.

5 Section 533, Corporations Law.

2.15. *Members' voluntary winding up* can only be used by solvent corporations. The directors are required to make a declaration to the effect that the corporation is capable of paying its debts in full within a period of 12 months.[6] A corporation enters a members' voluntary winding up following a special resolution by the members of the company in favour of winding up the corporation.[7] The members of the company decide who will be appointed as liquidator and what the remuneration will be.[8] Generally only **registered liquidators** may be appointed, except in the case of a winding up of a proprietary company.[9] There are restrictions on related parties being appointed, even if they are registered liquidators.[10]

2.16. *Creditors' voluntary winding up* may be used where a corporation is not solvent. A corporation may enter a creditors' voluntary winding up where the directors are unable to make a declaration of solvency or where a declaration is made but it later becomes apparent that the company is not solvent.[11] On the same day, or the day after, a meeting of members to consider a special resolution to wind up the corporation, a creditors' meeting is held.[12] The creditors may nominate a liquidator and if the nomination is different to the nomination by members, the creditors' choice will prevail.[13] Generally only **registered liquidators** may be appointed and there are restrictions on related parties being appointed, even if they are registered liquidators.[14] A corporation may also enter a creditors' voluntary winding up directly from voluntary administration through deeming provisions in the Corporations Law and, in those circumstances, the administrator or deed administrator is deemed to be nominated as the liquidator for the purposes of the winding up.[15] The creditors or their representatives (on a committee of inspection) determine the remuneration to be paid to the liquidator.[16]

2.17. *Compulsory winding up* is effected by an order of the court.[17] It most often arises where a creditor petitions the court to have a corporation wound up on grounds of insolvency, relying on failure of the corporation to comply with a demand for

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6 Section 494, Corporations Law.

7 Subsections 495(1), 495(2), Corporations Law.

8 Subsection 495(1), Corporations Law.

9 Section 532, Corporations Law. The exception formerly only applied to an exempt proprietary company, but the section was recently amended by the *First Corporate Law Simplification Act 1995*.

10 Section 532, Corporations Law.

11 Subsections 496(6), (8), Corporations Law.

12 Subsection 497(1), Corporations Law.

13 Subject to an order of the court to the contrary—see subsection 499(2), Corporations Law.

14 Section 532, Corporations Law.

15 See sections 446A, 446B, Corporations Law.

16 Subsection 499(3), Corporations Law.

17 Section 459A, 461, Corporations Law.

repayment of a debt.[18] The liquidator is appointed by the court and is an officer of the court. Only **official liquidators** are eligible to be appointed.[19] Depending on the jurisdiction, the court will either appoint the creditor's nominee or appoint a liquidator from a list using a rotation system.[20] Remuneration is determined at first instance by agreement between the liquidator and the creditors, but if no agreement is reached, by the court.[21] Very often there are not enough assets to satisfy even the liquidator's remuneration, but the lack of property is not a ground for refusing a winding up application.[22] Although liquidators cannot be compelled to incur expenditure where there is not enough property for reimbursement,[23] liquidators of assetless companies must still carry out obligations such as lodging reports with the ASC.[24]

Provisional Liquidators

2.18. The objective of provisional liquidation is not to wind up the corporation, but to preserve the status quo and make inquiries about the affairs of the corporation pending a liquidation, or the entering into of some other form of external administration or, in some cases, return the company to the control of the directors.

2.19. Provisional liquidation is effected by an order of the court after the filing of a winding up application but prior to the making of a winding up order.[25] Usually an application for placing a corporation in provisional liquidation is made with some urgency, as it is most commonly used where there is a concern that the assets could be dissipated. The appointment of a provisional liquidator allows control of the corporation to be quickly removed from the directors and enables investigations to be carried out.

2.20. Provisional liquidators have powers to carry on the business of the corporation as well as other powers conferred under the Corporations Law, the relevant rules of court, or granted by court order.[26] The powers are similar but more limited than those available to liquidators. A provisional liquidator is an officer of the court and is subject to the court's control. Creditors, members or the ASC may apply to the court in

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18 Pursuant to Part 5.4. Part 5.4A deals with winding up by the court on grounds other than insolvency.

19 Subsection 472(1), Corporations Law.

20 See further discussion of appointment in Chapter 9.

21 Subsection 473(3), Corporations Law.

22 Subsection 467(2), Corporations Law.

23 Subsection 545(1), Corporations Law.

24 Subsection 545(2), Corporations Law.

25 Subsection 472(2), Corporations Law.

26 Subsections 472(3), (4), Corporations Law.

relation to the exercise or proposed exercise by a provisional liquidator of certain powers, including the power to carry on the corporation's business.[27]

2.21. Only **official liquidators** are eligible for appointment as provisional liquidators,[28] and remuneration is as determined by the court.[29] A provisional liquidator's role includes making inquiries about the corporation's financial position, assessing future prospects and reporting back to the court about possible courses of action, such as liquidation or voluntary administration. The provisional liquidator will also take control of the corporation's business during the provisional liquidation.[30]

Receivers, Receiver and Managers and Other Controllers

2.22. Receivers, receiver and managers and other controllers are most commonly appointed by secured creditors where the debtor corporation defaults on covenants set out in security documents. Their role is usually to take possession of certain property in which the creditor has an interest, with a view to using or disposing of the property in order to obtain the maximum possible return for the secured creditor.

Receivers and Receiver and Managers

2.23. A receiver is also a manager (that is, a 'receiver and manager') if they have powers to manage the affairs of the corporation, as well as to take possession of particular items of property.[31] Securities known as 'floating charges' commonly provide for the security interest to encompass the whole of the corporation's assets and undertaking. In those instances, the secured creditor will usually be entitled to appoint a receiver and manager who has wide powers to deal with the property and the affairs of the corporation concerned. Receiver and managers are more commonly appointed than receivers. Part 5.2 of the Corporations Law deals with receivers and receiver and managers alike, and the word 'receiver' is used in that Part to describe both.[32] Similarly, the discussion below dealing with receivers is also intended to cover receiver and managers, unless the contrary intention appears.

2.24. Privately appointed receivers are officers of the debtor corporation. However, they act in the interests of the secured creditor who appoints them. They are not responsible for distribution of any surplus assets. Distributions of surplus assets to unsecured creditors will usually be made by a liquidator or sometimes by the company itself. It is possible for a receiver and a liquidator to be appointed at the same time, but

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27 Subsection 472(6), Corporations Law.
28 Subsection 472(2), Corporations Law.
29 Subsection 473(2), Corporations Law.
30 Subsection 472(4), 471A(2), Corporations Law.
31 Section 90, Corporations Law.
32 Section 416, Corporations Law.

the liquidator does not have control over the secured property. If the liquidator or the court approves, the receiver may carry on the corporation's business during the winding up instead of the liquidator.[33]

2.25. In some circumstances a receiver may be appointed by the court. The Supreme Courts have wide powers to appoint a receiver whenever it is 'just and equitable' to do so.[34] The 'just and convenient' jurisdiction can be invoked in a variety of situations but the main categories are where a security is enforceable or the secured property is in jeopardy, where other property in the company's possession is in jeopardy, or where a receiver is sought for the purposes of equitable execution.[35] The rules of court in a number of jurisdictions expressly allow the court to appoint a receiver for the purpose of taking control of corporate property to satisfy a judgement.[36] The courts also derive powers to appoint receivers pursuant to special legislation. For example, section 260 of the Corporations Law allows the court to appoint a receiver or a receiver and manager if the company's affairs are being conducted in an oppressive manner. A receiver or receiver manager appointed by the court is an officer of the court.

2.26. The activities of receivers of corporate property have been regulated under companies legislation since 1984. The Corporations Law now contains a number of statutory powers and obligations.[37] Some of the relevant provisions deal exclusively with receivers, while others apply to controllers generally.[38] Section 420, which deals exclusively with receivers, provides that they have powers to do 'all things necessary or convenient to be done for or in connection with, or as incidental to, the attainment of the objectives for which the receiver was appointed.' There are also a number of specific powers, which apply subject to any provision of the court order or instrument under which the receiver was appointed which operate to limit the statutory powers.

2.27. The ASC and the court have a general supervisory jurisdiction over the activities of receivers of corporate property.[39] Only **registered liquidators** are eligible for appointment as receivers of corporate property, and there are restrictions on related parties such as auditors or mortgagees acting as receivers of corporate property even if they are registered.[40]

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33 Section 420C, Corporations Law.

34 See, for example, section 67 of the *Supreme Court Act 1970* (NSW) and subsection 62(2) of the *Supreme Court Act 1958* (Vic).

35 See further O'Donovan, J. 1981, *Company Receivers and Managers*, Law Book Company, Sydney, pp. 223–233.

36 For example, see Supreme Court Rules of Victoria, Order 74.

37 For example, see sections 420 and 422, Corporations Law.

38 See below for discussion of provisions concerning controllers generally.

39 Sections 422–425, Corporations Law.

40 Section 418, Corporations Law.

2.28 Remuneration would usually be determined by the appointing party, but the court has power to fix or vary the amount, including retrospectively, on the application of a liquidator, voluntary administrator or deed administrator, or the ASC.[41]

Other Controllers

2.29. Under the Corporations Law, a controller is a receiver, or receiver and manager, or *any other person in possession or control of a corporation's property for the purpose of enforcing a charge*.[42] A managing controller is a receiver and manager, or *any other controller who has functions or powers of management of the corporation*.[43]

2.30. There are currently **no restrictions** on who may be a non-receiver controller and the court has no specific powers in relation to fixing remuneration of non-receiver controllers.

2.31. The Corporations Law does, however, provide for matters such as the liability of controllers for debts incurred, duties of care in relation to powers of sale, duties in relation to bank accounts and accounting records and a managing controller's obligation to prepare and lodge accounts relating to the corporation's affairs.[44] The court and the ASC have powers to inquire into controllers' actions and require controllers to make good any loss suffered.[45] The court is given powers to remove a controller for misconduct.[46]

2.32. The obligations of non-receiver controllers are discussed in detail in Chapter 11.

Voluntary Administrators and Administrators of Deeds of Company Arrangement

2.33. Prior to the introduction of the recommendations contained in the Harmer Report, the options available for insolvent companies under companies legislation were:

- receivership;
- liquidation;

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41 Section 425, Corporations Law.

42 Section 9, Corporations Law.

43 Section 9, Corporations Law.

44 There has criticism to the effect that some of the new obligations are too onerous and inappropriate in some circumstances. For further discussion of this issue, see Chapter 11.

45 Section 423, Corporations Law.

46 Section 434A, Corporations Law.

- schemes of arrangement; and
- official management.

2.34. In the Harmer Report, the Australian Law Reform Commission considered that the existing regimes for dealing with the affairs of a company in financial difficulty were too conservative. These regimes did not encourage a constructive approach to corporate insolvency by, for example, focusing on the possibility of saving the business (rather than saving the company) and preserving employment prospects. The Commission stated that:

> 'A constructive approach to corporate insolvency requires the preservation, if practical and possible, of the property and business of the company in the brief period before creditors are in a position to make an informed decision. This assists in an orderly and beneficial administration whether creditors decide to wind the company up or accept a compromise. An ordered form of administration of the affairs of an insolvent person is at the centre of insolvency law—whether, in the case of an insolvent company, that law offers the prospect of a winding-up or continuation of the corporate business. This approach is similar to that taken by insolvency law inquiry bodies in many overseas countries, such as the United States of America, Canada, the United Kingdom and some of the European nations...
>
> The Commission does not suggest that its approach will result in the salvation of failed companies or even companies which show signs of failing. Nonetheless, the aim is to encourage early positive action to deal with insolvency. It will be worthwhile and a considerable advantage over present procedures if it saves or provides better opportunities to salvage even a small percentage of the companies which, under the present procedures, have no alternative but to be wound up.'[47]

2.35. The voluntary administration reforms recommended by the Commission became part of a package of insolvency reforms contained in the *Corporate Law Reform Act 1992*. The Act abolished the official management regime, and replaced it with the voluntary administration scheme now contained in Part 5.3A of the Corporations Law. The scheme commenced on 23 June 1993.

2.36. The objective of Part 5.3A, as stated in section 435A of the Law, is to allow the

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47 Australian Law Reform Commission, *Report No 45, General Insolvency Inquiry*, (Mr R.W. Harmer, Commissioner-in-charge), AGPS, Canberra, 1988, paragraphs 53 and 54.

> 'business, property and affairs of an insolvent company to be administered in such a way that:
>
> – maximises the chances of the company, or as much as possible of its business, continuing in existence; or
>
> – if it is not possible for the company or its business to continue in existence—results in a better return for the company's creditors and members than would result from an immediate winding up of the company.'

2.37. The voluntary administration scheme has become an increasingly popular form of external administration which has resulted in these administrations forming a significant, if not the major, part of the practice of most insolvency practitioners.

2.38. The primary purpose of the legal framework set out in Part 5.3A is to provide a flexible and relatively inexpensive procedure which gives a company breathing space so that it can attempt a compromise or arrangement with its creditors aimed at saving the company or the business and maximising the return to creditors. If successful, the arrangement will be set out in a deed of company arrangement, which binds the company and the creditors. If these attempts fail, the legislation facilitates the transition to winding up.

Voluntary Administrators

2.39. An independent administrator, who must be a **registered liquidator**,[48] may be appointed to take over the affairs of a company by:

- a majority of the company's directors—where those directors believe the company to be insolvent, or that it is likely to become insolvent at some time in the future;[49] or
- a liquidator or provisional liquidator of the company;[50] or
- a chargee entitled to enforce a charge over the whole or substantially the whole of the company's property.[51]

Most voluntary administrators are appointed by directors.

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48 Section 448B, Corporations Law.
49 Section 436A, Corporations Law.
50 Section 436B, Corporations Law.
51 Section 436C, Corporations Law.

2.40. The remuneration of administrators is determined by the creditors or, if the creditors do not make a determination, by the court.[52]

2.41. The appointment of an administrator has some immediate and important consequences. On appointment, control of the company and its property, business and affairs are vested in the administrator.[53] The administrator acts as the company's agent, and the powers of all other officers of the company are not exercisable except with the administrator's written approval.[54] The administrator has power to remove directors from office and appoint new directors.[55] The administrator also has a duty to report possible offences or misconduct of company officers to the ASC and cooperate with any investigation the ASC may institute.[56]

2.42 The primary task for the administrator is to investigate the financial position of the company with a view to making a recommendation to a meeting of creditors about what should be done with the company. Having formed such an opinion, the administrator is required to call a meeting of creditors to determine the company's future. Generally the meeting will have to be held within 28 days (in the usual case) or 35 days (where Christmas or Easter intervenes) of the administrator's appointment.

2.43. A number of reports and statements must accompany the notice of the meeting, including the details of any proposed arrangement with the creditors recommended by the administrator.[57] The administrator must send the creditors a statement containing opinions as to whether it would be in the interests of the company's creditors:

- to execute a deed of company arrangement;
- for the administration to end; and
- for the company to be wound up.[58]

2.44. The administrator must also send to creditors an opinion regarding whether there are any transactions which might be voidable and which might enable a liquidator to recover money, property or other benefits.[59]

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52 Section 449E, Corporations Law.
53 Section 437A, Corporations Law.
54 Sections 437B, 437C, Corporations Law.
55 Section 442A, Corporations Law.
56 Section 438D, Corporations Law.
57 Subsection 439A(4), Corporations Law.
58 Section 438A, Corporations Law.
59 Regulation 5.3A.02, Corporations Regulations.

2.45. The administrator is required to chair the meeting.[60] The creditors may resolve at the meeting to:

- execute a deed of company arrangement;
- terminate the administration; or
- have the company wound up.[61]

Deed Administrators

2.46. The creditors may decide to enter into a deed of company arrangement. Most deeds will be in one of two forms, or a combination of both. In a moratorium type of deed, the creditors agree to accept payment at a later time, usually in instalments. In a compromise deed, the creditors agree to accept less than 100 cents in the dollar in full satisfaction of their claims. In many cases, compromise deeds will provide that some third party will make a contribution to the assets of the company. The Corporations Law sets out what a deed of company arrangement must contain, although the requirements are extremely flexible.[62]

2.47. The administrator of the company will become the administrator of the deed of company arrangement unless the creditors resolve otherwise.[63] Only a **registered liquidator** may be appointed a deed administrator.[64] Remuneration is fixed by creditors or, if no determination is made, by the court.[65]

2.48. The role of the deed administrator will be set out in the deed. A list of powers and functions is set out in prescribed provisions, but it is not necessary to include those in every deed. In the larger administrations it will usually be appropriate for the administrator to play a role in the management of the company's affairs. However, for smaller companies the deed administrator's role may be limited to, for example, making sure the deed is complied with. The day to day management of the company may be handed back to the directors while the deed administrator takes a much less active role.

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60 Subsection 439B(1), Corporations Law.
61 Section 439C, Corporations Law.
62 See section 444A, Corporations Law, Schedule 8A of the Corporations Regulations.
63 Subsection 444A(2), Corporations Law.
64 Section 448B, Corporations Law.
65 Section 449E, Corporations Law.

Transition to Winding Up

2.49. It may be that the creditors, at the meeting decide that the company should be wound up. In that case, the company will be deemed to have entered into a creditors' voluntary winding up and the administrator will be deemed to have been appointed as the liquidator of the company.[66]

2.50. A transition into a creditors' voluntary winding up will also be deemed to occur where:

- the company fails within 21 days to execute a deed of company arrangement agreed upon by the creditors;[67] or
- creditors terminate a deed of company arrangement and resolve that the company should be wound up.[68]

Scheme Managers

2.51. The Corporations Law provides for a mechanism by which a corporation may enter into a legally enforceable scheme of arrangement or compromise with its creditors.[69] This arrangement or compromise must be approved by creditors at meetings duly convened in accordance with the Corporations Law and sanctioned by order of the court.[70] An application to the court to order the necessary meetings to consider a scheme of arrangement or compromise may be made by the corporation, a creditor, a member or a liquidator.[71]

2.52. The scheme may provide for the appointment of a scheme manager to oversee the implementation of the scheme. This will often involve ongoing involvement with the affairs of the corporation. Some of the reporting obligations of receivers and receiver managers also apply to scheme managers.[72]

2.53. Only **registered liquidators** can be appointed as scheme managers, although there are limited exceptions which allow certain bodies corporate to administer a scheme.[73] Related persons such as auditors or mortgagees may not administer a

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66 Paragraph 446A(1)(a), subsection 446A(4), Corporations Law.
67 Paragraph 446A(1)(b), Corporations Law.
68 Paragraph 446A(1)(c), Corporations Law.
69 See Part 5.1, Corporations Law.
70 Subsection 411(4), Corporations Law.
71 Subsection 411(1), Corporations Law.
72 Paragraph 411(9)(a), Corporations Law.
73 Subsections 411(7), 411(8), Corporations Law.

scheme, even if they are registered liquidators.[74] The court and the ASC have a supervisory role and are permitted to investigate the conduct of a scheme manager in the same way that they may investigate the conduct of a liquidator.[75]

2.54. The high cost of meeting the procedural requirements and the significant involvement of the court, together with the introduction of the voluntary administration scheme, have resulted in a declining use of schemes of arrangement so that they are now used rarely, if ever, for the sole purpose of effecting compromises with creditors. However, as the scheme of arrangement provisions may also be used for other purposes involving members' rights such as reconstructions which involve varying share structure or amalgamations, a scheme of arrangement may be more suitable than other forms of external administration in those particular circumstances.

Personal Insolvency

2.55. Personal insolvency in Australia is governed by the *Bankruptcy Act 1966 (Cth).* The objective of bankruptcy legislation is essentially to allow action to be taken by a non-corporate insolvent debtor or their creditors, so that the bulk of the debtor's property can be taken and used to pay creditors in proportion to the amounts owed. Once the procedure has been followed and provided there has been no misconduct on the part of the debtor, the law allows the debtor to be released from the burden of the debts and to make a fresh start.[76]

Bankruptcy Proceedings

2.56. Bankruptcy is commenced by either a debtor's petition or a creditor's petition. On acceptance of a debtor's petition by the Official Receiver, a debtor automatically becomes bankrupt.[77] Where a creditor has petitioned the court for the bankruptcy of the debtor and the court exercises its discretion and accepts the petition, a sequestration order against the bankrupt's estate will be made and the debtor will be bankrupt from the date of the order.[78]

2.57. When a debtor becomes bankrupt, their property (subject to some exceptions) becomes vested in the **registered trustee** who has consented to be trustee of the estate.[79] If a registered trustee has not consented to be trustee of the estate, the

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74 Subsection 411(7), Corporations Law.

75 Paragraph 411(9)(b), Corporations Law.

76 D. Rose QC, *Lewis Australian Law of Bankruptcy, 10th ed,* 1994, Law Book Company Ltd, Sydney, p. 1.

77 Paragraph 55(4A)(b), *Bankruptcy Act 1966*.

78 Section 43, *Bankruptcy Act 1966*.

79 Paragraph 58(1)(a), subsection 156A(3), *Bankruptcy Act 1966*.

property vests in the Official Trustee in Bankruptcy.[80] Registered trustees are private insolvency practitioners registered as trustees under the *Bankruptcy Act*. Of the bankruptcy administrations commenced in 1995–96, they performed only 7 per cent, with the remaining 93 per cent being performed by the Official Trustee.[81]

2.58. The role of a trustee in bankruptcy has been described in the following terms:

> 'The getting in, administration and distribution of a bankrupt estate is often a long and intricate task requiring close attention to accounts and sometimes the running of a business. All this requires executive and commercial expertise. Registered trustees are therefore usually chartered or public accountants.
>
> The trustee is the representative of the creditors and has the duty to administer the estate in their interests, subject to the Act and to other legislation, and to the directions of the court and meetings of creditors. The trustee must act with due dispatch and have adequate knowledge and understanding of the bankrupt estate. The trustee should apply to the court for directions where there is a real doubt, not reasonably capable of solution by reference to the committee of inspection or meetings of creditors, and especially if, after taking competent legal advice, there is a real doubt on a legal question.
>
> Trustees, although not strictly officers of the court, are treated as subject to the standards of behaviour to be expected from such an officer. Thus they must be completely honest and impartial in the exercise of any discretions vested in them. They are governed by the law relating to trustees in general, except in so far as their position is modified by the Act or other special legislation.'[82]

2.59. The duties of trustees contained in the *Bankruptcy Act* have been recently amended to reflect contemporary expectations and practices.[83] The duties include:

- notifying creditors of the bankruptcy;
- determining whether the estate includes property that can be realised to pay dividends to creditors;

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80 Paragraph 58(1)(a), section 160, *Bankruptcy Act 1966*.

81 *Bankruptcy Act 1996* — Annual Report 1995-96, AGPS, Canberra, 1996, p. 12.

82 D. Rose QC, cited above, p. 29.

83 The *Bankruptcy Act* has been recently amended by the *Bankruptcy Legislation Amendment Act 1996.*

- reporting to creditors within three months of the date of the bankruptcy on the likelihood of receiving a dividend before the end of the bankruptcy;

- providing information concerning the administration of the estate to a creditor who makes a reasonable request;

- determining whether a bankrupt has transferred property that is void against the trustee; and

- taking appropriate steps to recover property for the benefit of the estate.[84]

2.60. The creditors may appoint a committee of inspection, consisting of three to five creditors or their representatives, for the purpose of advising and superintending the trustee.[85] When all the property is collected, the trustee must determine the claims of creditors, declare a final dividend and distribute the property in the order of priority laid down in the *Bankruptcy Act*.[86]

2.61. Creditors may by resolution fix the remuneration of the trustee. The trustee may be remunerated by way of a commission based on a percentage of the money received, but the percentage may not exceed a prescribed quantum.[87] Trustees may not accept any other benefits or derive any other financial advantage from estate transactions, or give up their remuneration to debtors or others.[88]

2.62. If the creditors fail to fix the remuneration of the trustee, the trustee is to be remunerated in accordance with a scale of charges published by the Insolvency Practitioners Association of Australia ('the IPAA').[89]

2.63. The *Bankruptcy Act* provides for minimum remuneration of registered trustees in bankruptcy cases. Where the total remuneration paid to a registered trustee is less than $1109.00, the trustee is entitled to be paid an additional amount equal to the shortfall.[90] If a bankrupt's estate contains insufficient funds to pay the trustee, the trustee may recover the outstanding amount by court action from the bankrupt as a debt due to the trustee.[91]

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84 Subsection 19(1), *Bankruptcy Act 1966*.

85 Section 70, *Bankruptcy Act 1966*.

86 Subsection 145(2), *Bankruptcy Act 1966*.

87 Subsection 162(2), *Bankruptcy Act 1966* and Regulation 8.07, Bankruptcy Regulations.

88 Section 165, *Bankruptcy Act 1966*.

89 Subsection 162(4), *Bankruptcy Act 1966* and Regulation 8.08, Bankruptcy Regulations. The IPAA scale is discussed in detail in Chapter 10.

90 Subsection 161B(1), *Bankruptcy Act 1966*.

91 Subsection 161B(2), *Bankruptcy Act 1966*. This amount, however, is not to be paid to the trustee in addition to those amounts payable under section 162.

2.64. The regulations governing remuneration of bankruptcy trustees contain a formal facility for the bankrupt or a creditor to challenge remuneration claimed by the trustee if dissatisfied with the amount of the claim.[92] In the event of a challenge, the trustee must provide a taxing officer with a detailed bill of costs.[93] The taxing officer conducts a taxation hearing at which certain items may be disallowed or reduced in amount if the taxing officer considers that the amount charged has been unreasonably high, if the costs or disbursements were incurred or made improperly, unreasonably, negligently or unnecessarily, or if disbursements cannot be proved to the satisfaction of the taxing officer.[94] There is a fee for a taxation which is payable by the person requesting the taxation.[95]

Arrangements with Creditors

2.65. Like corporate insolvency laws, personal insolvency laws contain provisions whereby insolvent persons may avoid formal bankruptcy proceedings by making a binding arrangement with their creditors. These arrangements may be preferable to bankruptcy for both debtors and creditors and they are used extensively. The relevant provisions are located in Part X of the *Bankruptcy Act* and these arrangements are commonly known as Part X administrations.

2.66. The types of Part X administrations are:

- Deeds of Assignment;
- Deeds of Arrangement; and
- Compositions.

2.67. Significant changes to Part X arrangements have been recently introduced. The *Bankruptcy Act* allows a debtor who wants his or her affairs dealt with under Part X to authorise a registered trustee, a solicitor or the Official Trustee to call a meeting of the debtors' creditors and take control of the debtor's property.[96] The period of control by that person will continue until:

- the creditors pass a resolution that the property of the debtor ceases to be subject to control;
- the debtor and trustee make a deed of assignment or deed of arrangement following a special resolution of creditors;

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92 Regulation 8.09, Bankruptcy Regulations.
93 Regulation 8.09, Bankruptcy Regulations.
94 Regulation 8.11, Bankruptcy Regulations.
95 Subregulation 8.11(6), Bankruptcy Regulations.
96 Subsection 188(1), *Bankruptcy Act 1966*.

- the creditors accept a composition;
- four months pass since the authority became effective;
- the court releases the property from control;
- the debtor becomes a bankrupt; or
- the debtor dies.[97]

2.68. A controlling trustee in relation to a debtor will be a registered trustee, a solicitor or the Official Receiver.[98] The functions of a registered trustee and solicitor are aligned and solicitors who become controlling trustees will assume control of a debtor's property in the same manner as a registered trustee.[99] Where an authority is made, a charge is created over the debtor's property thereby providing the trustee with greater control.[100]

2.69. The controlling trustee must call a meeting of the debtor's creditors[101] and the meeting must be held within 35 days after the debtor signs the authority or 45 days in the case of authorities signed in December.

2.70 When the creditors have received all the relevant information and reports from the trustee, generally they will resolve at the meeting to take one of the following courses of action:

- release the debtor's property from control of the trustee;
- require the debtor to execute a deed of assignment or deed of arrangement to be administered by a registered trustee nominated by the creditors;
- accept a composition to be administered by a registered trustee nominated by the creditors; or
- require the debtor to present a debtor's petition for bankruptcy within seven days.[102]

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97 Subsection 189(1A), *Bankruptcy Act 1966*.
98 Sections 187, 188, 192, *Bankruptcy Act 1966*.
99 Subsection 187(1), *Bankruptcy Act 1966*.
100 Subsection 189AB, *Bankruptcy Act 1966*.
101 Subsection 190(1), *Bankruptcy Act 1966*.
102 Section 204, *Bankruptcy Act 1966*.

2.71. At the meeting, creditors are required to nominate either one or more registered trustees, or the Official Trustee, as the trustee of a deed or composition.[103] A resolution at the meeting which purports to appoint a person as trustee of a deed or composition will be void if the person has not consented in writing to the appointment or nomination. A person who has been appointed or nominated as trustee will have to give the Official Receiver a copy of their written consent.[104] This will allow the trustee's details to be entered in the National Personal Insolvency Index.[105]

2.72. During the period in which the trustee has control over the property, the court may make a range of orders which have the effect of imposing a stay on creditors after the debtor has become bankrupt.[106]

2.73. Controlling trustees are required to prepare a report as to the debtor's affairs which summarises and comments upon information regarding the debtor's affairs which is available to the trustee. Where a debtor has provided the trustee with a proposal that his or her affairs be administered under a deed of assignment, deed of arrangement or composition, the controlling trustee must express an opinion whether the creditors' interests would be better served by accepting the proposal or by the bankruptcy of the debtor.[107]

2.74. The controlling trustee is empowered to make further investigations about the debtor's affairs, carry on the debtor's business, and deal with the debtor's property while it is under the trustee's control.[108]

2.75. The controlling trustee or any person affected by an act of the controlling trustee can apply to the court for directions on matters relating to the control of the debtor's property. The court can make any orders it thinks just.[109]

2.76. The obligation on controlling trustees to keep accounts, and the requirements relating to the remuneration of trustees, are now governed by the provisions in Part VIII of the *Bankruptcy Act*.[110]

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103 Subsections 204(4), (5), (8), *Bankruptcy Act 1966*.

104 Section 215A, *Bankruptcy Act 1966*.

105 *Explanatory Memorandum* to the Bankruptcy Legislation Amendment Bill 1996 (Senate), paragraph 158.3.

106 Subsection 189AA(1), *Bankruptcy Act 1966*.

107 Section 189A, *Bankruptcy Act 1966*.

108 Section 190, *Bankruptcy Act 1966*.

109 Subsections 190(4A), (4B), *Bankruptcy Act 1966*.

110 Section 210, *Bankruptcy Act 1966*.

2.77. After the trustee and debtor have executed a deed, or where a resolution has been passed accepting a composition, the trustee must notify each creditor of the debtor as soon as practicable.[111]

Debt Agreements

2.78. The *Bankruptcy Act* now contains a new simple form of insolvency administration known as 'Debt Agreements'. This new regime has been introduced to assist persons with low levels of debt, income and assets who wish to avoid becoming bankrupt but who are unable to afford to enter into Part X arrangements.

2.79. A debtor who has debts which do not exceed a threshold amount[112] can propose a debt agreement which may provide for any matter relating to the debtor's financial affairs,[113] for example:

- payment of less than the full amount of the debt;
- periodic payments; or
- a moratorium on payment.

2.80. A debt agreement proposal must be submitted by the debtor to the Official Trustee for processing.[114] Once accepted for processing, that fact is recorded on the National Personal Insolvency Index and a stay on enforcement and execution against the debtor comes into effect.[115] Processing entails obtaining the views of creditors, for or against the proposal, by way of a meeting or by voting letters.[116] The proposal must be approved by a special resolution of creditors before it will be effective as a debt agreement.[117]

2.81. The processing function, and other powers and functions of the Official Trustee in relation to the proposal (such as power to deal with the debtor's property) can be delegated by the Official Trustee to a registered trustee if the trustee and the debtor consent.[118] The Official Trustee or registered trustee do not necessarily have a role like a trustee in administering debt agreements once they have been approved. The

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111 Section 218, *Bankruptcy Act 1966*.
112 The threshold amount can be varied by regulation. Currently it is approximately $52,800.
113 Subsection 185C(3), *Bankruptcy Act 1966*.
114 Section 185C, *Bankruptcy Act 1966*.
115 Section 185F, *Bankruptcy Act 1966*.
116 Section 185A, *Bankruptcy Act 1966*.
117 Section 185B, *Bankruptcy Act 1966*.
118 Section 185Y, *Bankruptcy Act 1966*.

agreement may provide for debtors to make payments to creditors directly or perhaps by some other person on behalf of the debtor.[119]

2.82. In order to ensure costs of debt agreements remain low, there are restrictions on remuneration for registered trustees in connection with the agreements. Registered trustees cannot receive any remuneration for processing debt agreements. However, they may charge fees in respect of performing other functions delegated to them by the Official Trustee, such as selling an asset, if this is provided for in the agreements.[120] The remuneration of Official Trustees is also regulated.[121]

2.83. The effect of a debt agreement is to release the debtor from debts which would have been be provable in bankruptcy if the debtor had become a bankrupt at the time the debt agreement is registered on the National Personal Insolvency Index.[122]

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119 Explanatory Memorandum to Bankruptcy Legislation Amendment Bill 1996 (Senate), paragraph 48.

120 Section 185Z, *Bankruptcy Act 1966*.

121 Section 163, *Bankruptcy Act 1966* provides that the Official Trustee's remuneration is as prescribed by regulation.

122 Section 185J, *Bankruptcy Act 1966*.