DUTIES AND RESPONSIBILITIES OF CONTROLLERS

11.1. One of the issues raised in the Working Party's Discussion Paper was whether the provisions in the Corporations Law dealing with duties and responsibilities of controllers who are not receivers, which commenced in 1993, are necessary and appropriate.[1]

BACKGROUND

11.2. Rather than allowing for appointment of a receiver or receiver and manager over corporate property to enforce a security, it is possible for security documents to provide for a secured creditor to become a mortgagee in possession (or appoint an agent to carry out the function of such a mortgagee) on default by the debtor corporation. The popularity of this form of administration increased markedly after a decision in 1975 in which the High Court found that a receiver and manager appointed over the whole of a corporation's property under a fixed and floating charge was a 'trustee' for the purposes of section 221P of the *Income Tax Assessment Act 1936* and, therefore, was required to grant priority to the liability of the debtor corporation for unremitted group tax debts.[2] The preferred status from a taxation perspective of mortgagees in possession was confirmed in the late 1980s following court decisions to the effect that an agent for a mortgagee in possession was not a 'trustee' for the purposes of section 221P.[3]

11.3. A further possible advantage, from a secured creditor's perspective, of appointing an agent of a mortgagee in possession, rather than a receiver, was that the reporting requirements and other regulatory provisions in the companies legislation did not apply, provided the agent did not take control of the company concerned. There was no need for agents to be registered or have any formal qualification

---

1 See the Discussion Paper released by the Working Party at paragraphs 234–239 and Attachment J.

2 *FCT v Barnes* (1975) 133 CLR 483.

3 *General Credits Ltd v Chemineer Nominees Pty Ltd* (1986) 4 ACLC 570; *Deputy Commissioner of Taxation v General Credits Ltd* (1987) 5 ACLC 1103.

notwithstanding that their role, in many respects, was very similar to the role of a receiver.

11.4. This somewhat anomalous situation was addressed by the ALRC in the Harmer Report, which recommended that certain provisions in the companies legislation concerning powers, duties and reporting obligations of receivers should also be extended to mortgagees in possession and their agents.[4]

11.5. The Government responded to the recommendations by introducing into Part 5.2 of the Corporations Law the concept of 'controller' and 'managing controller'.[5] Under these provisions, 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*.[6] A managing controller is a receiver and manager, or *any other controller who has functions or powers of management of the corporation*.[7]

11.6. The abolition in 1993 of the priority in favour of the Commissioner of Taxation, together with the introduction of the controller provisions into the Corporations Law, means that the appointment of a mortgagee's agent instead of a receiver is now less attractive than it was. However, there are still many instances where a non-receiver controller is appointed, particularly where the secured property concerned makes up only a minor part of the debtor corporation's assets.

CURRENT PROVISIONS

11.7. The Corporations Law requires controllers to:

- open and maintain a bank account in respect of money of the debtor company coming into the hands of the controller;[8]

- lodge a notice with the ASC and a corresponding notice in the *Gazette* when the controller enters into possession of, or assumes control over, relevant property, or when the controller ceases to be a controller;[9]

---

4 Australian Law Reform Commission, *Report No 45, General Insolvency Inquiry*, (Mr R.W. Harmer, Commissioner-in-charge), AGPS, Canberra, 1988, paragraph 188.

5 The amendments were part of the package of insolvency reforms in the *Corporate Law Reform Act 1992* (Cth).

6 Section 9, Corporations Law.

7 Section 9, Corporations Law.

8 Section 421, Corporations Law.

9 Section 427, Corporations Law.

- lodge a notice of address with the ASC within 14 days of becoming a controller and notify the ASC of subsequent changes of address;[10]

- serve notice on the corporation when the controller enters into possession or assumes control;[11]

- comment upon and lodge with the ASC a copy of the report as to affairs required to be provided to the controller by the reporting officers of the debtor company;[12] and

- lodge with the ASC six monthly accounts in respect of the controller's receipts and payments.[13]

11.8. In addition to the above, managing controllers with functions or powers in respect of the management of the company must lodge a report as to the affairs of the company with the ASC within two months of taking possession or control of the corporate property.[14]

Perceived Difficulties

11.9. The concerns raised by the Working Party in its Discussion Paper in relation to the provisions mentioned above were essentially that:

- the notification and reporting obligations on controllers may impose undue compliance costs where only a minor item of corporate property is involved; and

- the reporting obligations on managing controllers apply whether or not the controllers actually exercise their powers of management, which means those controllers are subject to the requirement to lodge with the ASC a report as to the affairs of the company when they are not necessarily in a position to prepare such a report.

---

10 Section 427, Corporations Law.
11 Section 429, Corporations Law.
12 Section 429, Corporations Law.
13 Section 432, Corporations Law.
14 Section 421A, Corporations Law.

OPTIONS FOR CHANGE

11.10. In the responses to the Working Party's Discussion Paper, there was a general consensus that the current provisions require amendment to address one or more of the difficulties mentioned above. There are essentially two types of options for reform of the provisions. The first type focuses on reducing the situations in which the obligations apply. The second type focuses on reducing the content of the obligations themselves.

Scope

11.11. There were a number of suggestions for reducing the scope of the reporting and notification requirements.

Obligations Confined to Receivers, Receiver and Managers and Managing Controllers Only

11.12. One suggestion was that Part 5.2 of the Corporations Law should not apply to controllers who are not receivers and do not have management powers in relation to the corporation concerned. This would generally exclude mortgagees acting under bills of mortgage, bills of sale or mortgages of goods.

11.13. It was argued that there is no justification for imposing notification and reporting obligations on persons who are not carrying on the business of the corporation or incurring debts in the company's name. The fact that a secured creditor happens to enforce a charge over the secured property does not make any difference to the position of an unsecured creditor since the secured property would not have been available for general distribution in any event.

Obligations Confined to Persons Controlling the Whole, or Substantially the Whole, of the Corporation's Property

11.14. Another option considered was to confine the obligations to persons who control the whole, or substantially the whole, of the corporation's property. This view draws support from a passage in the Harmer Report which suggests that only persons taking control of the whole, or substantially the whole, of the property of a corporation should be regulated by companies legislation.[15]

---

15 Australian Law Reform Commission, *Report No 45, General Insolvency Inquiry*, (Mr R.W. Harmer, Commissioner-in-charge), AGPS, Canberra, 1988, paragraph 186.

Obligations Confined to Assets Whose Value Exceeds Prescribed Limits

11.15. Under this option, an arbitrary limit could be set so that the requirements in the Law would not apply to controllers of assets worth less than the threshold amount. This would address a significant criticism of the current provisions because the requirements would no longer apply to minor items of property.

Obligations Confined to Certain Types of Financing Arrangements

11.16. It would also be possible to exempt certain types of financing arrangements from the scope of the provisions. One difficulty with this option is that it may require the enactment of provisions to prevent parties structuring transactions so that they have the appearance of an exempt transaction when they are not, in substance, of that character. However, transactions such as mortgages over real property would not appear susceptible to that sort of practice.

Obligations of Managing Controllers Confined to those Controllers Who Actually Exercise Management Powers

11.17. The Corporations Law currently applies to controllers who have powers of management, whether or not they actually exercise those powers. This means that a controller who has powers of management will be subject to the full range of obligations in the Law, even where they merely take possession of property for the purposes of sale and do not take any part in the management of the corporation.

11.18. It was suggested that the definition of 'managing controller' should be amended so that only those controllers who actually exercise management functions would be required to comply with the relevant obligations.

Content

11.19. Some submissions proposed a different approach which involves changing the content of the obligations, rather than the circumstances in which the obligations apply.

Restrict Controllers' Obligations to Notification and/or Settlement Statement

11.20. It was argued in one submission to the Working Party that the current obligations on controllers who do not exercise management powers should be restricted to lodging a notice at the ASC that a person is in control of an asset.

11.21. In support of this view, it was argued that the chargor itself does not benefit from any of the requirements as there are already obligations on the chargee at general law to account for receipts, payments and expenses. Third parties dealing with the company or the chargee in relation to the charged property would benefit from a notification to the ASC which sets out details of the property involved and details of the chargee. However, there does not appear to be any reason to extend the requirements beyond this notification.

11.22. As to unsecured creditors, one view is that they do not benefit at all from the requirements on controllers since they do not have any interest in the charged property. However, another view is that unsecured creditors have a legitimate interest in finding out what prices were obtained for sold assets and the expenses involved with the sale, so that they may assess whether the controller has complied with its obligation to obtain the best possible price. The extent of any shortfall or surplus on the sale directly impacts on unsecured creditors. In addition, the reporting requirements provide other creditors, whether secured or not, with notice that the company may be in financial difficulty.

Restrict Obligations Regarding Bank Accounts

11.23. The current obligations in the Corporations Law require a bank account to be opened, arguably, whenever a controller is appointed. This means that an account must be opened even where there is no likelihood of the chargor's money passing into the hands of the controller.

11.24. It has been suggested that the obligation to open a bank account should be restricted to circumstances where the controller comes into possession of money of the chargor corporation.

11.25. The ASC has issued a policy statement dealing with this issue.[16] The ASC concluded that no policy objectives are served by requiring a bank account to be opened where there is no money of the debtor corporation to be deposited. Accordingly, the ASC will not take any action against a controller who fails to open and maintain a bank account in those circumstances.

11.26. Although the view expressed in the ASC's policy statement appears appropriate, there is a possible problem determining what constitutes 'money of the corporation' for this purpose. The ASC's policy statement indicates that it does not necessarily agree with the view that money is only 'money of the corporation' concerned if it exceeds the value of the amount secured by the charge. The ASC considers that whether this is correct in any given case 'depends on the relevant

16 ASC Policy Statement 106, *ASC Digest* PS 5/61.

security documentation evidencing the charge and the transactions entered into under such documentation.'[17]

11.27. Accordingly, restricting the requirement to open a bank account to those instances where a controller comes into possession of 'money of the corporation' will not necessarily mean the requirement will only apply if there is a surplus. It is possible that some loan transactions are structured so that the entire proceeds realised from sale of the property concerned are legally the property of the chargor, at least for an instant, before they are remitted to the chargee. In these cases it would still be necessary for a controller to open an account and deposit the proceeds, even if the provisions were to be amended in the manner suggested. However, in many cases it is likely that the chargor would not have an interest in the proceeds except to the extent of any surplus.

Conclusion

11.28. In light of the above discussion, the Working Party considers that there is scope for reducing the burden of the administrative requirements on controllers and managing controllers while still maintaining an adequate level of protection for third parties by addressing both the scope, and the content, of the obligations.

Notification

11.29. The Working Party considers that the current requirements for notification of appointments and cessation of each and every controllerships by publication in the *Gazette*[18] is of little benefit. The requirements are intended to provide the public and, in particular, creditors and potential creditors, with notice of controllerships. However, gazettal is a very expensive requirement to fulfil and the beneficiaries usually would only include those persons who regularly scan the *Gazette* for such notices. It is likely that only major credit providers would have cause to regularly scan the *Gazette* and the Working Party has not received any evidence suggesting that even those organisations actually do so.

11.30. Most creditors would be interested only in controllerships affecting companies with which they are currently dealing and such information can be obtained by conducting periodic searches of the files of relevant companies as they appear on the ASC database.

11.31. The ASC has recently introduced a new mechanism called the 'ASC Alert' system. Using that system, a client may set up an 'alert profile' on the ASC's database, whereby documents lodged in relation to one or more specified companies may be

---

17 ASC Policy Statement 106, *ASC Digest* PS 5/61 at PS 5/63.

18 Section 427, Corporations Law.

monitored automatically. The client may specify which sort of lodgements in relation to specified companies it wishes to be informed about. If a document of the type specified is lodged in relation to a company on the client's alert profile, the client will be advised automatically by facsimile of the lodgement. Clients may also set up the alert profile so that they automatically receive (by facsimile) an updated company extract from the database when the document is lodged and/or a copy of the lodged document. The alert system has the potential to be a more effective and efficient way for interested persons to monitor the appointment of controllers to specified companies rather than scanning the *Gazettes* for this information. To ensure that credit controllers are aware of the existence and potential benefits of the Alert database, the ASC may wish to consider conducting suitable advertising.

11.32. The Working Party considers that the content of the notifications to the ASC should contain sufficient detail so that the public can obtain at least a description of the property of corporations which are currently subject to controllerships. This will allow persons to conduct dealings with the corporation and/or the controller accordingly. For this purpose, a notice should be lodged at the commencement of the controllership and at six-monthly intervals noting any changes to the property covered by the controllership.

Reporting

11.33. The Working Party has noted the arguments regarding the utility (or lack thereof) to parties other than the corporation itself of a statutory requirement to account for the proceeds of sale by way of lodging accounts with the ASC. However, on balance, the Working Party favours an obligation to provide an account containing details of the proceeds of sale and how they were applied at the end of a controllership. This requirement serves two purposes. First, knowing the information will be publicly available imposes an extra layer of accountability. Controllers will be encouraged to obtain the best price for property and contain costs. Secondly, the Working Party considers that details of matters such as the residual amount which is remitted to the chargor corporation is of relevance to unsecured creditors. This is particularly so in cases where the charged property is substantial, since this information could have implications for the corporation's general financial situation.

11.34. The Corporations Law recognises that creditors and members have an interest in the conduct of the controllership as these parties are permitted (unless the court orders otherwise) to view detailed accounting records of the controller.[19] Allowing free access to fundamental information concerning the controllership, such as total proceeds of sale and expenses, enables creditors and members to assess whether to view the detailed records. It would be preferable to make this information available at

---

19 Subsection 421(2), Corporations Law.

the earliest possible date, rather than relying on the annual reporting obligations of the corporation itself.

Managing Controllers

11.35. The Working Party notes the view expressed in a number of submissions that the current definition of 'managing controller' is too wide in that controllers who do not actually exercise powers of management are required to comply with the reporting obligations. Arguably this could be addressed if chargees were to draft their security documents so that powers of management were only conferred if there is a real likelihood that they will be needed, rather than including these powers in charge documents as a standard practice. This would mean that the number of controllers having powers of management which are not exercised would be substantially reduced. Furthermore, introducing a test based on whether powers are actually exercised may be open to abuse and difficult for the ASC to enforce, since it will not be apparent on the face of the relevant documents whether a controller is or is not a managing controller.

11.36. On balance, however, the Working Party considers that the current position in the Law should be changed because it imposes inappropriate obligations on controllers who possess powers of management but do not actually exercise them. Accordingly, the definition of managing controller should be amended so that those controllers who actually exercise powers of management will be subject to the reporting obligations.

11.37. The Working Party further considers that if a controller is in control of the whole, or substantially the whole, of the assets of a corporation, they are effectively in control of the activities of the corporation. In these circumstances, the powers of the directors to control the corporation in the ordinary way would be severely curtailed. Accordingly, controllers in such a position should be considered managing controllers and should be required to comply with the additional obligations on such controllers, without the need to address the issue of whether they are actually exercising the powers of management.

11.38. The Working Party considers that the current obligations for controllers in relation to the report as to affairs, which is required to be prepared by the reporting officers of a corporation, should be modified.

11.39. The Corporations Law currently requires a controller to serve on the corporation a notice that the person is a controller of the corporation's property.[20] The reporting officers[21] of the corporation must, within 14 days of receiving the

---

20 Paragraph 429(2)(a).

21 The 'reporting officers' of a corporation are usually persons who were a director or a secretary of the corporation—see subsection 429(1), Corporations Law.

controller's notice, provide the controller with a report as to affairs.[22] The controller is then under an obligation to lodge this report with the ASC within one month of its receipt.[23] A notice must also be lodged setting out any comments which the controller has on the report as to affairs.[24] If the controller does not consider it necessary to make any comment, the notice must state this.[25]

11.40. The Corporations Law also allows the reporting officers to apply to either the controller or the court for an extension of time in which to submit the report as to affairs to the controller.[26] A copy of the notice or court order granting an extension of time must be lodged with the ASC within a reasonable time of granting the extension.[27]

11.41 Although the controller is responsible for the lodgement of the report, its preparation is the responsibility of the reporting officers. In the view of the Working Party, it would be preferable not to split responsibility in this fashion as it may give rise to uncertainties about which party is in default in cases where the report is lodged late or not at all.

11.42. It is proposed that the obligation to prepare and lodge the report as to affairs be placed on the reporting officers of the company alone. In the event that the reporting officers are unable to finalise the report within the specified time-frame, they will be required to apply to the ASC for an extension of time. Once the report has been lodged with the ASC, it is proposed that the reporting officers will be required to provide controllers with a copy of the report. The controller will then be required to lodge with the ASC a notice setting out any comment which they have on the report as to affairs within one month. In accordance with the current requirements of the Corporations Law, this notice may simply state that the controller has no comment to make. If a controller requires an extension of time for preparing this notice, the controller will be required to apply to the ASC.

11.43. It is proposed that the requirements regarding the report as to affairs by company officers will only apply to controllers, as opposed to managing controllers. The managing controller will still be required to prepare and lodge their own report as to affairs within two months of appointment and comments on the report as to affairs prepared by the reporting officers may be made in that context.

11.44. The Working Party has also considered whether the current obligations of receivers to report to the ASC possible offences on the part of directors and other

---

22 Paragraph 429(2)(b), Corporations Law.
23 Paragraph 429(2)(c), Corporations Law.
24 See note 23.
25 See note 23.
26 Subsection 429(3), Corporations Law.
27 Subsection 429(4), Corporations Law.

officers[28] should be extended to managing controllers. In this regard, the fact that managing controllers do not necessarily have to be registered liquidators and, accordingly, may not have as great a knowledge of the Corporations Law, may be a factor which weighs in favour of restricting the obligations to report possible misconduct.

11.45. On the other hand, managing controllers are arguably in as good, if not a better, position than receivers to discover such matters in the course of their administrations and, if they do, they should be obliged to report the possible misconduct. It is properly a matter for the ASC to determine whether there is any substance to the allegations. On balance, the Working Party considers that the obligations of receivers to report possible misconduct of company officers should be extended to managing controllers. The ASC may wish to consider whether it would be of assistance to formulate guidelines or develop some other mechanism to educate managing controllers about the type of actions by directors which should be reported to the ASC.

Bank Accounts

11.46 The current requirement on the part of all controllers to open and maintain a separate bank account for each controllership is designed to prevent the mingling of funds and make accounting for, and tracing of, the proceeds of the sale or profits from controllerships straight-forward and transparent.

11.47. The objective of the requirements is clearly a worthy one. However, debate concerning what constitutes 'money of the corporation' for the purposes of the provisions,[29] together with the reality that, in many instances, even if the entire proceeds of sale were paid into the account, they could legitimately be paid straight out again in full to the controller, has meant that the requirement to open a separate bank account is seen as burdensome and unnecessary.

11.48. In the view of the Working Party, the requirement to record and explain all transactions that the controller enters into as controller is the main mechanism of accountability. Even if 'money of the corporation' is given a broad interpretation, the requirement to open a separate account where there are very few transactions during the course of the controllership does not appear to add significantly to the level of accountability.

11.49. The situation is different, however, where there are potentially numerous transactions involved. In the more complex controllerships where there are multiple incoming and outgoing transactions, it is important from the controller's perspective as

---

28 Section 422, Corporations Law.

29 Section 421, Corporations Law.

well as the perspective of the chargor corporation, that the funds in relation to each controllership are accounted for and kept separate from the controller's own funds and funds relating to other controllerships.

11.50 The more complex controllerships in terms of financial transactions are likely to occur where the controller is a managing controller. The Working Party acknowledges that this may not be true in all cases. Some managing controllerships may involve only a handful of transactions and some ordinary controllerships may involve numerous incoming and outgoing payments. However, unless a line is drawn somewhere it would be necessary to either retain the separate bank account requirement in all cases, or do away with it entirely. The Working Party considers that neither of those options is desirable and recommends that the requirements be retained for managing controllers only in cases where money for which they are obliged to account comes into their hands.

11.51 The Working Party recommends that the preferred approach regarding reform of the duties and responsibilities of controllers is as follows:

I. the ASC should become the source of public information concerning controllerships and the Gazettal requirements should be abolished;

II. all controllers should be required to notify the ASC and the chargor company that they have been appointed over corporate property and the nature of the property concerned;

III. all controllers should be required to provide a status update every six months after appointment which details the property still subject to the controllership and any property which has been disposed of or returned;

IV. all controllers should be required to provide a final report to the ASC when an appointment has lapsed due to disposal or return of the assets concerned and, where applicable, provide a report on sale proceeds and dispersal of proceeds;

V. 'managing controllers' should be redefined to include only those controllers who have taken control or possession of the whole or substantially the whole of a company's assets or those controllers who actually exercise powers of management (with the question of what is substantial left to the common law);

VI. the company officers should be responsible for preparing and lodging a report as to affairs themselves and, if an extension of time is needed, they should be required to apply to the ASC rather than to the controller;

VII. controllers other than managing controllers should be required to lodge a notice with the ASC commenting on the report as to affairs provided by the company officers within one month of receipt;

VIII. managing controllers should be required to prepare and lodge a separate report as to affairs within two months of appointment and that report should include comments on the report as to affairs prepared by the company officers;

IX. only managing controllers should be subject to a requirement to open a separate bank account where they have received money which is required to be accounted for;

X. managing controllers should be required to report possible misconduct on the part of company officers to the ASC; and

XI. the suitability of the forms required to be lodged by controllers should be reviewed.