reform

a regular bulletin of law reform news, views and information
Australian Law Reform Commission, Box 3708, GPO, Sydney, 2001, Australia

april 1986 no 42

in this issue

insolvency law reform

> . . . 'short' as you so painfully call it. And yet what else could you say? Hard up? Penurious? Distressed? Embarrassed? Stonybroke? On the rocks? In Queer Street? . . .
>
> Evelyn Waugh *Brideshead Revisited*

Seminars dealing with aspects of insolvency law reform were held recently in Melbourne and Sydney. The two day seminar presented jointly by the Institute of Chartered Accountants in Australia and the Insolvency Prac-

titioners Association of Australia was held on 25 and 26 February 1986 at the Regent, Melbourne and 3 and 4 March 1986 at the Hyatt Kingsgate Hotel in Sydney. The Melbourne seminar was attended by about 100 participants and the Sydney seminar by about 150.

The opening speaker at the seminars was Sir Kenneth Cork who was Chairman of the Committee appointed in 1977 to review the law of insolvency in England and Wales. The Report of that Committee, popularly known as the Cork Report, was completed in 1982. The Report was the first comprehensive review in England or Australia of insolvency law as it affects both individuals and companies.

The Cork Report has led to the enactment of the United Kingdom Insolvency Act 1985. The Act does not in all respects reflect the recommendations of the Cork Report. For example, while the number of preferential claims by revenue-collecting arms of the Government was substantially reduced in accordance with the Report's recommendations, a related recommendation, that 10% of the total realisations of company property which would be covered by a debenture holder's charge be made available to the liquidator for use in investigating the affairs of the company or for distribution among creditors, was not adopted. Furthermore, 1200 amendments were made to the initial Bill before its final passage through the United Kingdom Parliament.

relevance of the cork report to australia. Mr Ronald Harmer, the Commissioner in Charge of the General Insolvency Reference of the Australian Law Reform Commission, spoke at the seminars. He commented on the irony of the fact that Sir Kenneth, as the leading English insolvency law reformer, was participating in a seminar on Australian insolvency law reform at a time when the Queen was visiting Australia and participating in ceremonies to sever the residual constitutional and legal links between Australia and the United Kingdom. Mr Harmer pointed out that the days were gone when Australia would automatically follow English legislative reform. However, Mr Harmer said that the Cork Report was relevant to Australian insolvency law reform for the following reasons:

- Australian and British insolvency law are basically the same and it would be sheer folly to ignore the valuable work of the Cork Committee.
- As stated above, the Cork Report was the first comprehensive review in England or Australia of individual and company insolvency.

Mr Harmer also said that the enactment of legislation in response to the Cork Report did not bring to an end the Report's usefulness. It is still valuable for the following reasons:

- the reasoning behind certain provisions of the legislation can be determined independently of the political motivation which might underlie the specific legislation;
- many aspects of the complicated legislation may be better appreciated in the light of the clear language used in the Cork Report;
- it may yet prove advisable to adopt recommendations which were made in the Cork Report but rejected or ignored by the British Government.

the administrator concept. In his opening speech, Sir Kenneth Cork outlined the proposal adopted in the English legislation for an administrator who could be appointed to take charge of the affairs of a company approaching insolvency. (The British Government rejected the Committee's recommendation that the administrator procedure be available to creditors or shareholders who desired to remove directors who were clearly incompetent or dishonest.) The administrator procedure would involve:

- a petition to the court to appoint an administrator who would usually be chosen by the directors;
- the formulation of a plan over a three to four week period during which time there would be a moratorium on creditors' actions against a company; and
- presentation of the plan to a meeting of creditors for approval.

receivers. The new English legislation also changes the position of receivers. Receivers will be required to report to creditors and call a meeting of creditors which may appoint a committee of their number to oversee the actions of the receiver. The receiver will be required to take all interests into consideration in the course of the receivership. The position of receiver is thus assimilated to the position of administrator.

australian proposals. Mr Harmer outlined tentative proposals which have been developed by the Australian Law Reform Commission for a new voluntary procedure for insolvent corporations. The criteria utilised by the Commission in developing the proposals were that it should be

- capable of quick implementation,
- as uncomplicated and inexpensive as possible, and
- flexible so as to accomodate a broad range of alternatives.

It was also considered important that there be provision for some form of protection of property of the company at least while the decision-making process was underway.

The proposed procedure has the following major features:

- appointment of an administrator by the directors of a corporation facing insolvency;
- a consequent moratorium on the commencement or continuation of proceedings by creditors;
- investigation of the company's affairs followed by either a recommendation to wind up the company or the development of an alternative proposal by the administrator, preferably with the assistance of the directors;
- creditors to have the ultimate right to accept or reject the administrator's proposal, whether it be to liquidate the company's assets or to attempt a rearrangement of the company's affairs.

A major difference between these proposals and the United Kingdom administrator procedure is that the approach developed by the ALRC will not involve an application to the court. It would be for creditors to protect their own interests by the use of their power to accept or reject a proposal and in extreme cases by means of an appeal to the court. The ALRC's proposals also contemplate that the role of the Corporate Affairs Commissions would be limited to monitoring proposals to ensure compliance with the Companies Codes.

The participants in the Melbourne seminar appeared to be generally in favour of the new voluntary procedure developed by the Commission. Although there was also widespread support for the concept at the Sydney seminar, there were reservations. Some who expressed reservations thought that the new procedure would not be a significant improvement on the existing provisions relating to schemes of arrangement and provisional liquidation which can be used by insolvent corporations to reorder their affairs. Others thought that too much responsibility would be reposed with the proposed administrator.

antecedent transactions. On the second day of the seminar, Mr Harmer outlined tentative proposals relating to the recovery of property disposed of prior to the commencement of a formal insolvency.

- Persons related to an insolvent should be treated differently from other categories of creditors.

- Related persons would include such persons as relatives, companies of which the insolvent is an officer or person in control, and partners. In the case of a company it would include officers of the company, their relatives and related companies.
- In particular, the time period within which transactions with a particular creditor may be invalidated should be extended in the case of related creditors. The length of time chosen depends on an assessment of how long a related creditor may be able to 'hold out'. In the United States of America and Canada the period is 12 months. In England the Cork Committee recommended and the Government adopted a period of two years.
- In order to escape the preference provision, a creditor should only be required to prove no knowledge or suspicion of the debtor's insolvency. Proof of this would satisfy the current test of 'good faith'. Also, the requirement of proving that the payment was made in the ordinary course of business is regarded as superfluous and should be deleted.
- The concept of the void 'settlement' is regarded as outmoded. The provision of the Bankruptcy Act dealing with settlements only invalidates transfers of property which is to be retained or preserved in one form or another and enjoyed by the recipient. It is thus capable of missing the straight-out gift. It is tentatively proposed to recast the settlement provision so as to embrace all transactions in respect of property whereby no value or a value significantly less than the value of the property is provided by the recipient in exchange.
- In the area of fraudulent conveyances of property, the ALRC is considering removing the reference to an intent to 'defraud'. The term 'defraud' has unfortunate and unnecessary connotations of criminality and should perhaps be replaced by an intention to defeat, delay or hinder creditors.
- The ALRC is also considering a proposal whereby a related person should be presumed to have knowledge of an intent to defeat or delay creditors on the part of the debtor.

insolvent trading. The concept of limited liability for companies is of central importance when a company becomes insolvent. Once a company becomes insolvent and is wound up, creditors can generally look only to the assets owned by the company for payment of their debts. Some would argue that the concept of limited liability should be abandoned in the case of small companies and retained only for large corporations which conduct extensive business activities.

The legislatures have introduced provisions into Australian companies legislation whereby directors or managers of a company may be held liable for debts incurred by the company in circumstances where it may reasonably be expected that the company will not be able to pay its debts as they fall due. In short, the sections deal with insolvent and fraudulent trading.

Leo Smits, a partner of the Sydney law firm Sly and Russell presented a paper on the sections of the Companies Codes dealing with insolvent and fraudulent trading. The issues considered included:

- in what circumstances should a director or manager be liable for the debts incurred by the company (in particular, what enquiries would a reasonable businessman have made and what action would he have taken to determine the financial circumstances);
- should the provisions enable a creditor to bring for his or her own benefit an action against directors who have permitted a company to trade while insolvent or should the action be brought by a liquidator or some other insolvency adminstrator for the benefit of

creditors generally (this question affects the general principle of insolvency law whereby insolvent estates are distributed rateably amongst creditors of the same class);

- should tests be prescribed which establish a rebuttable presumption of insolvency and thus clarify the concept of inability to pay debts as and when they become due.

In addition to these policy issues, Mr Smits pointed out various inconsistencies in the sections (for example between s229(1) which relates to a director's duty of honesty and which provides for a penalty of $20000 or 5 years' imprisonment or both for a breach of that duty if the breach is committed with intent to deceive or defraud and s561 which provides a penalty of $10000 or 2 years' imprisonment or both for frauds by officers) and areas requiring clarification (for example the extent to which professional advisers may be held liable under s556 for a company's debts).

Mr Smits' paper was received with great interest by the participants in the seminar and aroused a great deal of debate. The issues connected with limited liability and the possible liability of officers of a company who permit that company to trade while insolvent must be examined in the context of a wide-ranging review of insolvency law. The paper presented by Mr Smits will be of considerable assistance to the ALRC in its review of this area of the law.

national sentencing seminar

My object all sublime
I shall achieve in time
To let the punishment fit the crime
The punishment fit the crime
WS Gilbert – 'The Mikado'

agenda. A National Sentencing Seminar was held at the Australian Institute of Criminology from 18 to 21 March 1986. The Seminar was convened at the request of the Australian Law Reform Commission which is collaborating with the Institute in relation to its reference on the Sentencing of Federal and ACT offenders. However, the panned agenda was deliberately wider than the sentencing of federal and ACT offenders. This was because of the interest in sentencing in other jurisdictions and, in particular, because there were current sentencing inquiries in Victoria and New South Wales. The establishment of the Victorian Sentencing Committee is referred to elsewhere in this issue. The New South Wales Law Reform Commission is also considering the issue of sentencing in the context of its enquiry into criminal procedure.

The Conference was attended by well over 100 delegates with a wide range of practical and academic interests in the subject matter, including more than 20 judicial officers from most jurisdictions in Australia.

The topic of sentencing was treated in its widest sense, incorporating not only the problems confronting the sentencing judge, but also those faced by the prosecutor at one extreme and by the administrative and executive arms of government at the other.

After the opening remarks of the Director of the Australian Institute of Criminology, Professor Richard Harding, in which he drew particular attention to problems resulting from imprisonment for fine default, the overuse of short-term imprisonment and the dramatic rate of imprisonment of Aborigines in Australia which he described as an 'abomination', the Conference was officially opened by Mr Jim Kennan, Attorney-General for Victoria. During his address the Attorney drew attention to the notion that prisons were becoming a scarce resource having regard to the enormous costs of imprisonment. This had implications for the decision to imprison, given that it involved a significant allocation of community resources. He referred to the consideration of the wider use of community-based options in Victoria. These issues will be taken up by the recently established Victorian Sentencing Committee, chaired by Sir John Starke, a recently retired