Review of the Draft Insolvency Law Reform Bill 2014

and

Insolvency Practice Rules (**the proposed reform**)

Submission of SV Partners Pty Ltd
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Online submission to Treasury by 17 December 2014

Email submission to the Australian Restructure, Insolvency and Turnaround Association (**ARITA**) by 12 December 2014

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1. Introduction

1.1 Who we are

SV Partners Pty Ltd (**SV Partners**) provides professional corporate and personal insolvency advice to accountants, financial institutions, corporations, financial and legal advisors, and individuals.

With a team of over 100 insolvency specialists across the eastern seaboard, our expert advisors focus on recovery, reconstruction advice and formal insolvency appointments to corporations and individuals. We also operate one of the largest private bankruptcy practices in Australia.

1.2 Our experience

Our executive team has extensive experience in the insolvency and turnaround industry and hold memberships with: Australia Restructure, Insolvency and Turnaround Australia (**ARITA**), Institute of Chartered Accountants in Australia (**ICAA**), Certified Practicing Accountants (**CPA**), Institute of Public Accountants (**IPA**), Australian Institute of Credit Management (**AICM**), Turnaround Management Association (**TMA**), Australian Institute of Company Directors (**AICD**), QLD Master Builders Association (**QMBA**) and hold positions on the Australian Securities and Investments Commission (**ASIC**) and the Australian Taxation Office (**ATO**) Liquidator panels.

The proposed reform will impact the way in which we deliver our service as a specialist accounting practice.

1.3 Disclaimer

This submission has been prepared on the proposed reforms as they were presented for comment, as at the date of this submission. We have not had the opportunity to review the proposed changes to the Bankruptcy and Corporations Regulations, Insolvency Practice Rules and the complete Explanatory Memorandum at the time of writing this submission. Accordingly our views could change once these documents are released in full. We specifically disclaim all liability to any person who relies on this submission and offer no legal opinion or interpretation on any issue.

1.4 Our approach to this submission

We make our submission with the object of improving the relevant legislations and making sure that they work as intended and in a commercial context. In doing so, we have taken into account our experience as Insolvency Practitioners (**IPs**) and the experience of our staff and stakeholders.

We largely support the government's efforts to improve the simplicity and integrity of the system and to ensure that it achieves clear and appropriate outcomes for stakeholders. We would welcome the opportunity to discuss our submission if this would assist.

We have approached this submission so as to comment on:

- Our agreement or disagreement with the proposed reform; and

- In the event we disagree with a specific reform, we have endeavoured to provide an explanation and a recommendation, for your consideration.

In addition to our comments on the proposed reform, we have included suggestions for your consideration in respect of further reforms, to remove practical issues and problems that have been created by recent court decisions.

1.5 Summary of our submission

We are largely supportive of the proposed reform in its attempts to align legislation, increase efficiency and transparency and enhance the professionalism of IPs. Our comments identify issues we foresee with the proposed reforms in terms of its application in private practice.

Our submission can be summarised as follows:

1.5.1 We largely support the government's efforts to reform the system, but hold concerns with the scope and meaning of various key reform proposals. The reform ideas that add further administrative burdens on professional practice (like the requirements for annual trustee/liquidator returns) or increase the costs of administering estates (like unreasonable review requests or unreasonable attempts by creditors to terminate the appointment of an external administrator or trustee) are of great concern for us.

1.5.2 We understand the aims of the proposed reform in increasing the power of creditors to: access information, require the appointee to call meetings, obtain a review of remuneration and remove an appointee. However, these are not qualified by other circumstances that may occur at the time the request for information, meeting, review or removal is instigated. For example, we may have commenced recovery on an antecedent voidable transaction against a creditor and rather than dealing with the matter, they could use these powers to frustrate the recovery process. This will ultimately be at the cost of all creditors and would not apply the legislation in the way it was intended.

1.5.3 Further to 1.5.2, in the absence of a complete version of the Insolvency Practice Rules detailing how creditors can remove an appointee from a personal or corporate appointment, we disagree with this reform. Creditors usually have no experience in these type of matters and are generally unaware of the high: risk, administrative burden and obligations that the appointee holds. In order to complete the appointment efficiently, we do not want a situation where creditor dissatisfaction in the situation is channelled into the removal of an appointee. We believe that only the Industry Regulator or Court should be given such a power.

1.5.4 Whilst we agree with the Courts ability to oversee and make orders in relation to the regulation and discipline of appointees, we do not see the need to give Courts their own initiative. We are concerned that this may result in inconsistent determinations and unnecessary uncertainty.

1.5.5 Finally, there are several areas of the current legislation that create issues in practice, due to Court decisions that have applied the literal meaning, rather than the purpose of the legislation, such as: charging clauses over real property, the timely and free receipt of bank statements, the application of s 588FJ to both OL and CVL appointments, employee entitlements and secured creditor rights, the non-application of equitable lien's and section 553C to voidable transaction claims that we would welcome reform on.

2. Comments on the ILBR

2.1 Schedule 1 – Amendments relating to the Insolvency Practice Schedule (Bankruptcy)

We largely agree with the proposed registration and disciplinary reform to the *Bankruptcy Act 1966* (**the Bankruptcy Act**), which is aimed at ensuring that high professional standards in the industry are maintained.

Reform surrounding remuneration of trustees, conflicts of interests, procedural changes to meetings and increased creditor powers will aid in transparency and is welcome. However, we are concerned that the proposed reforms which deal with creditors' unreasonable requests (by providing funding for the appointee and providing security for costs) will negatively impact the profession if creditors are acting out of self-interest rather than a genuine desire for true accountability. In our view, these negative impacts are:

- Inefficiencies in conducting the administration, thereby increasing compliance costs;
- Potentially reducing our ability to obtain remuneration approvals from creditors and increasing the cost of obtaining approvals;
- May allow for documents to be produced that may unfairly prejudice recovery of Antecedent Voidable Transactions (**AVR**); and
- Delay our professional staff from dealing with matters on other appointments, the cost of which is unable to be recouped.

Our comments in relation to the key components of the proposed bankruptcy reform is as follows:

Proposed Reform	Notes	Agree	Comments, queries and reasons for disagreement
Definitions to accommodate all changes, but, specifically, the introduction of "a regulated debtor" concept	2.1.1	Yes	Agree with the change, however, it will have an administrative burden on industry (i.e. the modification to precedent documents).
Registration, regulation, discipline and deregistration of trustees; including the Inspector-General's (**IG**) new functions	2.1.2	Yes, largely	We disagree with: • The response time for AFSA to respond to an application for a registered Trustee of 3 months and for variation of conditions (if any) of an additional 3 months are, in our view, onerous. Additionally, it is unclear if the above timeframes include the 45 day and 20 day response times, respectively, required for interviews. • The requirement that annual trustee returns (**ATR**) be produced on the anniversary of the registration.
General rules pertaining to remuneration and conflicts of interest	2.1.3	Yes	Reform on remuneration approval and duties of trustees are accepted. The ability for trustees to engage a service firm that may also be a related entity (subject to creditor approval) is a welcomed addition.

Proposed Reform	Notes	Agree	Comments, queries and reasons for disagreement
General rules pertaining to duties of the trustee pertaining to estate property and administration, including funds handling	2.1.4	Yes, largely	The introduction of electronic payments from an Estate Bank Account (**EBA**), the obligation to reconcile the EBA and clear rules on negotiable instruments, ratifies what we do in practice. We request the timeframe to lodge the Annual Administration Returns to be 25 *business* days, so as to avoid timeframe issues between "days" and "business days". Reducing the period of time to maintain books and records to 7 years from 15 years from the end of the administration is responsible. Early destruction options should be considered.
General rules pertaining to creditor meetings and committee of inspection (**COI**)	2.1.5	Yes, largely	We agree with the security for costs of a meeting required by <25% but >10% of creditors, however, no such provision has been carried over for the when creditors request a meeting to determine the need for a COI. A creditors' right to appoint committee members to COI are that a creditor (or as group of creditors) totalling 10% of the value of amounts owed and employees totalling 50% of the value of amounts owed can appoint a member. As total debts owed in an administration vary, this percentage should be calculated as at the date of the meeting.
General rules pertaining to creditors rights to remove / replace the trustee	N/A	Yes, largely	If creditors are successful in removing the trustee and the trustee is subsequently reappointed by an Order of the Court, clarification is required pertaining to: • The duties of the former trustee during the period of removal to reappointment; • Reimbursement of the costs associated with applying to Court to be reappointed; where removal was an improper use of this legislation by creditors; and • Detail who will meet the costs associated with the Court Order to ratify the reappointment.

Proposed Reform	Notes	Agree	Comments, queries and reasons for disagreement
General rules pertaining to review of the administration (including remuneration) by the Court, IG and creditors	2.1.6	Yes, largely	We agree with the ability of creditors to apply to the IG and ultimately the Court to review trustee remuneration, however, we seek clarification around the following points: • Specifically, if the review finds in favour of the trustee, can a reimbursement of costs of the review be recouped and from whom; • If the review finds against the trustee that no reimbursement is allowed; • If at the onset of the review the trustee becomes aware that they have unknowingly made a mistake and that acceptance of same occurs, together with a mutually agreeable remedy; • That creditors must provide adequate reasoning for a review to be conducted as to avoid vexatious reviews; and • A creditor is precluded from requesting a review if involved in litigation with the trustee. E.g. if a trustee commences an AVT recovery against the creditor and they retaliate by requesting a review (and/or removal).

2.1.1 The increased penalties surrounding the failure to produce key documents, particularly the Statement of Affairs (**SOA**) are welcomed, however, additional legislated powers such as the:

- right to maintain a freeze on bank account(s); or
- right to caveat property (if held),

until the SOA is provided, would provide greater assistance in the procurement of the SOA.

2.1.2 As corporate and personal registrations for our 15 directors are obtained at varying times, complying with personal ATR and Annual Liquidator Returns (**ALR**) obligations, will impact our business. It seems more appropriate to have a specific time annually (e.g. 30 June) that all annual returns (for trustees and liquidators) are required.

As IPs, we hold fidelity insurance combined with our professional indemnity insurance, the proposed reforms are silent relating to what constitutes *"adequate and appropriate fidelity cover"*. We anticipate that the IG will produce a practice statement in due course.

2.1.3 The main introduction of a remuneration determination, (approved claim for necessary and proper work performed by the trustee) or reasonable remuneration that does not exceed the maximum default amount ($5,000 exclusive of GST from 1 July 2015 and indexed thereafter) streamlines remuneration processes for trustees.

2.1.4 We query if an allowance should be given to seek early destruction of books and records, similar to what is available in the corporate insolvency context, pursuant to s 542 of the *Corporations Act 2001* (Cth) (**the Corporations Act**).

2.1.5 In our experience, where the IP identifies that a COI is required, a trustee would reasonably hold a meeting to provide the body of creditors with information and at that time seek a resolution for a COI. It is impractical and costly to call a meeting solely for that purpose, particularly for a large body of creditors.

We welcome the inclusion of a set of duties to COI members, so as to prevent a committee member's derivation of profit or advantage and the removal of all voting entitlements on resolutions where they may derive benefit is a welcome inclusion.

Agree with the improved mechanism for resolving a matter without holding a meeting and proposal certificates being provided.

Clarification whether the relevant Commonwealth entity's ability to subrogate the voting rights of a former employee if a claim, made by the former employee, was not paid at the time the meeting was held.

2.1.6 Clarify the rules surrounding the trustee's ability to sell or assign the right to sue (excluding claims regarding misleading and deceptive conduct) under the Bankruptcy Act.

When IPR are made by the minister we would request a consultation requirement, with ARITA and industry, prior to implementation to avoid any adverse rules that are divergent from the aims of the proposed reforms.

2.2 Schedule 2 – Amendments relating to the Insolvency Practice Schedule (Corporations)

We largely agree with the proposed reform to the Corporations Act, with the exception of specific reforms detailed in the table below.

Our comments in relation to the key components of the proposed corporate reform is as follows:

Proposed Reform	Notes	Agree	Comments, queries and reasons for disagreement
Definitions to accommodate all changes, but, specifically, the introduction of a company under "external administration" concept	N/A	Yes	Agree with the change, as it conveys the difference in the status of the company when appointed as a Receiver and Manager (**Receiver**) by a secured creditor (or controller) where the company may be solvent; compared with other formal appointments. These formal appointments being: Voluntary Administration (**VA**), an executed Deed of Company Arrangement (**DOCA**), liquidator appointed by creditors (**CVL**), liquidator appointed by members (**MVL**), liquidator appointed by ASIC pursuant to s 489EA of the Corporations Act (**s489EA appointments**), liquidator appointed by the Court (**OL**) and Provisional Liquidation (**PL**).

Proposed Reform	Notes	Agree	Comments, queries and reasons for disagreement
Registration, regulation, discipline and deregistration of liquidators; including the Australian Securities and Investments Commissions (**ASIC**) new functions	2.2.1	Yes, largely	• The response time to an application of 3 months and for variation of conditions (if any) of an additional 3 months are, in our view, onerous. • The timeframe to lodgement of the Annual Liquidator Returns (**ALR**) on the anniversary of the registration rather that it be a fixed return date across the Industry. • Whilst we agree with the Courts ability to oversee and make orders in relation to the regulation and discipline of registered liquidators, we do not see the need to give Courts their own initiative as provided in Schedule 2, Part 1, Subdivision 45-1(2)(a).
General rules pertaining to duties of the liquidator pertaining to company property and administration, including funds handling	2.2.2	Yes, largely	We agree with the ability to provide information on a website, unless the recipient has advised they do not have access to the internet. This changes the previous obligation on the liquidator to gain approval to issue electronic correspondence. We query the obligation on the liquidator to determine a recipient's ability to access the internet.
General rules pertaining to remuneration and conflicts of interest	2.2.3	Yes, largely	If we are obtaining several remuneration determinations for a large and complex appointment (which may prove complicated and frustrating for creditors or the COI) would it prove more efficient to apply to Court for one large remuneration determination? We agree that ASIC and the Court should be able to appoint a cost-assessor (**the CA**) on application by a relevant party. We agree that creditors should also be able to appoint a CA provided it is resolved at a creditors meeting. Whilst we cannot perceive a situation where we would give up remuneration, we query the relevance of Schedule 2, Part 1, Division 60-25. The ability for an external administrator to engage a service firm that may also be a related entity (subject to creditor approval) is a welcomed addition.

Proposed Reform	Notes	Agree	Comments, queries and reasons for disagreement
General rules pertaining to creditor meetings and committee of inspection (**COI**)	2.2.4	Yes	We welcome the abolishment of the first meeting of creditors and the final meeting of creditors in a CVL. We welcome the introduction of the following processes for both OL and CVL: • Notice of appointment (5 business days); and • Initial report to creditors lodged with ASIC within 1 month after receipt of RATA or 3 months after appointment (comparable with the report required pursuant to s 19 of the Bankruptcy Act). The introduction of the mechanism for resolving a matter without holding a meeting is accepted. Resolutions approved by related party creditors at the detriment to the body of creditors of a company is unclear in terms of the remedies available. It appears that only the Court, rather than the Court and ASIC, can make orders pertaining to these resolutions.
General rules pertaining to creditors rights to remove / replace the liquidator	2.2.5	Yes, largely	If creditors are successful in removing the external administrator (excluding OL appointments) and the external administrator is subsequently reappointed by an Order of the Court, clarification is required regarding: • The duties of the former external administrator during the period of removal to reappointment; and • Reimbursement of the costs associated with applying to Court to be reappointed, where removal was an improper use of this legislation by creditors. It is noted that in Schedule 2, Part 1, Subdivision 90-35(5), there is a requirement for the former administrator to record the costs of the application to be reappointed separately, but fails to address if these costs are an expense in the administration. If after a review of the administration by another registered liquidator, creditors seek to replace the current liquidator; we request that the reviewing liquidator be prohibited from consenting to act, so as to ensure independence.

Proposed Reform	Notes	Agree	Comments, queries and reasons for disagreement
General rules pertaining to review of the administration (including remuneration) by the Court, ASIC and creditors	2.2.6	Yes, largely	We welcome the clarification that the costs of a review of remuneration for reasonableness will form part of the expenses of the liquidation, subject to an Order made by the Court. Subject to the information required in the annual administration returns (**AAR**) for: MVL, CVL, OL, PL, VA and DOCA appointments, we recommend that the requirement to lodge bi-annual statements (ASIC prescribed form 524) be abolished. This recommendation is to save on duplication of information. Whilst we agree with the Courts ability to oversee and make orders in relation to the external administration, we do not see the need to give Courts their own initiative as provided in Schedule 2, Part 1, Subdivision 90-5 & 90-15.

2.2.1 Streamlining the registration for an "external administrator" to cover all functions if appointed as: an Administrator, Deed Administrator, Liquidator, OL or PL will simplify the application of the Corporations Act. It also removes the restriction on liquidators (if not registered as an OL) with respect to Court ordered appointments and dealing with other matters such as:

- Affairs requiring application of the *Cross-Border Insolvency Act 2008* (Cth); and
- It *may* resolve the issue detailed in section 3.3.3 – suggestions on additional areas for reform.

As corporate and personal registrations for our 15 directors are obtained at varying times, complying with ATR and ALR obligations, will impact our business. It seems more appropriate to have a specific time annually (e.g. 30 June) that all annual returns (for trustees and liquidators) are required.

2.2.2 None of these rules apply to companies in receivership.

The provision of information to members and creditors of an MVL on request is supported.

Queries on the proposed changes relating to early destruction of books and records are:

- Removal of the obligation to hold a final meeting - our process is to obtain creditor approval for early destruction, at the initial meeting of creditors, however, our interpretation of the ASIC Form 574 is that a final meeting must be held for ASIC's consent to be provided; and
- We query whether the retention period will change to the end of the external administration, rather than the date of deregistration of the company.

2.2.3 None of these rules apply to companies in receivership.

There is no change to remuneration approvals for s 489EA appointments (by ASIC).

A remuneration determination for an MVL can be made by resolution of the company at a general meeting.

A remuneration determination for a PL is made by the Court. If there is a COI and an agreement can be struck between the COI and liquidator, the committee can approve remuneration. As a further alternative, if there is no Court determination and no COI approval, creditors can make a resolution determining remuneration approvals.

With the exceptions specified above, the main introduction of a remuneration determination, (approved claim for necessary and proper work performed by the liquidator) or reasonable remuneration that does not exceed the maximum default amount ($5,000 exclusive of GST from 1 July 2015 and indexed thereafter) streamlines remuneration processes for liquidators of Small to Medium sized Entities (**SME**).

2.2.4 None of these rules apply to companies in receivership.

We agree with streamlining the purpose of the initial meeting for a VA to determine if a COI is required and the removal of the committee of creditors' process. This simplifies committees and provides one rule in all circumstances.

We query the need for a process of creditor approval for the voluntary Administrator's remuneration in the event that an Official Liquidator is appointed. Applying to Court is an onerous process.

2.2.5 None of these rules apply to companies in receivership.

2.2.6 None of these rules apply to companies in receivership.

We request that in circumstances were no offence is committed, the results of a review of the administration, conducted by another registered liquidator, only be disclosed to relevant parties.

2.3 Schedule 3 – Other Amendments

Our position on the other amendments are contained in the table below:

Part No.	Description	Agree	Comments
Part 1	Payments for property	Yes	Agree with the addition to specify the location of the secured assets in a disclaimer (VA).
Part 2	Contravention of DOCA	Yes	Agree with the addition of notification that there has been/is likely to be a material contravention of the deed.

Part No.	Description	Agree	Comments
Part 3	Company's former name	Yes	Agree to increase the requirement for the Court to grant leave in respect of the obligation to disclose the company's former name on documents beyond just if the company has executed a DOCA (expanding s 161A(6)).
Part 4	Termination of DOCA	Yes	Agree with formalising the situation when the terms of a deed have not been met, that the company is taken to have passed a special resolution to wind up the company voluntarily. Further, if this automatic function is applied and a relevant party seeks to stay or terminate the winding up, they have access to s 482 of the Corporations Act.
Part 5	Relation-back day (**RBD**)	Yes	We note and support the clarity on issues around the RBD (under various appointments) and that it can be affected by prior action to wind up. The table provides for 14 different scenarios together with a coverall in the 15th scenario (i.e. if none of the above apply, the appointment date).
Part 6	Miscellaneous amendments	Yes	Agreed

3. Suggestions on additional areas for reform

3.1 ARITA discussion paper

We acknowledge the discussion paper produced by ARITA called *A Platform for Recovery 2014: Dealing with Corporate Financial Distress in Australia*. We agree with the need to balance the rights of existing and on-going creditors of the company against the opportunities for the business to be restructured and the consequential benefits that may bring. We are largely supportive of the reform that ARITA seek to implement around the following:

- Removal of the insolvent trading (**IT**) provisions to allow directors to have a safe harbour to make decisions on potential restructuring. On this point, the AICD recently published an article about introducing a new defence to IT provisions (as opposed to abolishment), which had merit;
- A Chief Restructuring Officer position be created as to avoid shadow director implications;
- VA and DOCA schemes reworked to include: recovery of director-related voidable transactions, removal of related party voting, voting using purchased debts be limited to value of consideration paid, increased moratorium periods and restriction on use of ipso facto clauses (where contracts automatically terminated on appointment of external administrators) and statutory provision for obtaining financing;
- Streamlining the process of liquidating micro-companies, which would mitigate the impact on the profession and if viable, the adaptation of a restructuring avenue for these micro-companies (similar to Part IX debt agreements); and

- The legislation of "pre-pack" work conducted by consultants, to formalise and promote independence in the restructuring market. This would enable a viable business to continue and maximise returns to creditors, through a legitimate sale or restructure prior to appointment.

ARITA's assessment of the corporate entity by size and ability to restructure are logical and, in our opinion, the industry needs (and should adopt) a "streamlined liquidation" process for companies with liabilities less than $250,000.

3.2 ARITA's submission to Treasury

We have had the opportunity to review and consider ARITA's submission to Treasury (dated 5 December 2014) (**ARITA's submission**) and agree with most of those submissions.

Notwithstanding this, we have highlighted below some (which should not be construed as all) of the key submissions that ARITA have proposed (which we have not otherwise discussed in our submission), to which we agree with:

- ARITA's general discussion on ensuring 'due process' in the discipline of external administrators;
- The request that the proposed s 206BB (which appeared in the 2013 version of the proposed reforms) be included in these proposed reforms;
- Discussion on unfunded work in paragraph 1.8 of ARITA's submission; and
- In respect of the Schedule found on pages 12 to 52 of ARITA's submission to Treasury:
    - The concern with the use of the term "person with a financial interest in the external administration" (see pages 12-13);
    - The concern that external administrators must be afforded the right to due process and the right to appeal (see page 15);
    - The concept of related entity benefits (within the context of paragraph 60-20 of the ILRB) (see pages 20-21);
    - The need for limiting factors for a meeting of creditors to establish a COI (see page 32); and
    - The concern with the definition of the "end of administration of a regulated debtor's estate" (see page 49).

With the greatest of respect to ARITA, we do not agree with paragraph 2.1, in respect of related party votes. In our experience, not all related parties act unreasonably or in bad faith. It would be unfair to those related parties who hold genuine debts to not be afforded the right to vote on things that may have a material effect on their rights. Further, when related parties act in their own interest, there should be equitable remedies available for the body of creditors.

3.3 Our view on additional areas for specific reform

Further to the ARITA reform, in our experience, we consider that the following additional areas of practical reform are needed:

3.3.1 ***Charging clauses over real property in supplier credit applications*** – For instance, since the decision in *Bradnam's Windows and Doors Pty Ltd v Offermans* [2011] QCA 106 (**Bradnam's case**), much doubt has been raised in the industry around whether or not charging clauses in supplier credit applications (over real property) give those suppliers the same position as a

secured creditor. This is particularly relevant when commencing proceedings under ss 588FF and 588FA of the Corporations Act, for unfair preference payments. We propose, either:

- Specifically, excluding the application of Bradnam's case, upon an insolvency event; or
- Provide IPs with the powers to void charging clauses (over real property) in supplier credit applications or any other agreements where the charging clauses are essentially unregistered charges.

3.3.2 ***The requirement of timely receipt of bank statements from Australian Depository Institutions ("ADIs")*** – In our experience, it can be very difficult for IPs to obtain all of the bank statements from ADIs, and in many circumstances, are required to pay large fees. We note that the most common argument that is raised by ADIs is that the company was previously issued with the bank statements. However, in our experience, this does not necessarily translate to us actually receiving same. Further, as bank statements are very important to the proper and timely performance of our duties, we propose an increase to the obligation for ADIs to produce bank statements in a timely manner and for no costs.

3.3.3 ***The voiding of security interests under s 588FJ of the Corporations Act***

Following the introduction of the *Personal Properties Securities Act 2012* (Cth) (**the PPSA**), it has never been more important for IPs to know how to identify secured creditor claims and to know how to void such claims in specific circumstances. Accordingly, sections of the Corporations Act (like s 588FJ) will become more important. However, from various legal advices we have received (in various capacities), it is apparent that s 588FJ may not extend as broadly as some may think.

Section 588FJ of the Corporations Act relevantly provides:

(1) This section applies if:

(a) A company is being wound up in insolvency; and
(b) The company created a circulating security interest in property of the company;
(i) During the 6 month's ending on the relation back day; or
(ii) After that day but on or before the day when the winding up began.

In the cases of *Carter v New Tel* [2003] NSWSC 128, 15, *Re Wilkcorp Pty Ltd* (Supreme Court of Qld, Derrington J, 30 June 1997, unreported) and *ERS Engines Pty Ltd v Wilson* (1994) 35 NSWLR 193, the Courts held that s 588FJ of the Corporations Act applied only to Court Liquidations. Voluntary Liquidators were therefore being forced to apply to Court under ss 462 and 459A of the Corporations Act to wind the company up as an OL in order to enjoy the benefit of s 588FJ of the Corporations Act. Other notable cases are: *Lucas v Currie* [2013] FCA 1404) and *Walker and Moloney v CBA Corporate Services* (NSW) Pty Limited [2012] FCA 328.

Accordingly, we recommend amending s 588FJ to rectify the drafting errors from 15 July 2001 (which remained after the most recent change in 30 January 2012), so that s 588FJ of the Corporations Act may apply to CVL as well as s 489EA and OL appointments.

3.3.4 ***Clarification on payments to priority creditors, namely employees circulating security interests (formerly known as floating charged assets) and rule on the subrogation of secured creditors***

The Court rulings in the following cases have created practical issues for both Receivers and Managers (**Receivers**) and Liquidators:

- *Cook v Italiano Family Fruit Company Pty Ltd* (2010) 273 ALR 349 (**the Italiano case**);
- *Vickers, in the matter of Challenge Australian Dairy Pty Ltd (R&M) (AA Appt)* [2011] FCA 10 (**the CAD case**);
- *Re Great Southern Ltd (Receivers and Managers Appointed)(In Liq); Ex Parte Thakray* [2012] WASC 59 (**the GS case**); and
- *Divitkos, in the matter of ExDVD Pty Ltd (In Liquidator)* [2014] FCA 696 (**the Divitkos case**).

The uncertainty has been created around:

- The distribution of employee entitlements (**EE**) from the company's floating charged assets (now called circulating security interests (**CSI**) after the introduction of the PPSA in terms of the type of entitlement to be paid and whether the entitlement should be paid by the Receiver or Liquidator; and
- The secured creditor's security ability to subrogating into the priority creditor's position in a liquidation, which would give the secured creditor the right to antecedent voidable transaction recoveries. Prior to these Court decisions recoveries of this nature were not available to secured creditors.

Looking at the following circumstances highlights the confusion:

a. <u>When appointed Receiver</u>, according to the GS case, the Receiver should hold sufficient realisations from CSI to cover entitlements required by s 561 of the Corporations Act, rather than the more limited range of entitlements prescribed by s 433 of the Corporations Act and specifically to consider:

   - The possibility that the company will be wound up;
   - Should hold sufficient CSI assets to meet remaining claims, pursuant to s 556 of the Corporations Act, pending determination on where sufficient unsecured assets to meet EE; and
   - If after considering these insufficient unsecured assets, apply funds held to claims.

   In light of the above recommendations, the following practical problems occur:

   - We are unable to resign as Receivers until a liquidator is appointed;
   - Once a liquidator is appointed, in principle, the Receiver should pay the liquidators the retained funds held to cover EE pursuant to s 561 of the Corporations Act. However, the liquidators are only obliged to deal with the funds under ss 556 and 561 of the Corporations Act, which means they can be applied to higher priority claims, such as liquidator's remuneration, before being paid to EE; and
   - In the case where a Receiver is holding these funds for a lengthy timeframe, an interest bearing account should be used if we can earn significant interest.

b. When appointed as Liquidator and no R&M appointed, according to the Italiano and Damilock cases, the Liquidator needs to consider the following before making a distribution to priority creditors from charged assets:

- Make the determination that there will not be enough 'non-charged' assets to pay priority creditor debts;
- Take into account both actual and potential realisations. Potential realisations currently include AVR (until the High Court clarifies the confusion brought about by the Kratzmann, Italiano and Damilock cases);
- Obtain the consent of the secured creditor, prior to distributing the funds; and
- Where the secured creditor consents, confirm (on the authority of the Damilock case) that they will *generally* obtain a right of subrogation to the rights of the priority creditors paid.

c. When appointed Liquidator after a Receiver appointed – by paying EE in accordance with s 561 of the Corporations Act, from the funds provided by the Receivers, creates the following issues:

- Recoveries into the liquidation are pooled and therefore available to creditors in the priorities outlined in s 556 of the Corporations Act. Accordingly, liquidators appear to be able to meet outstanding remuneration and costs prior to making a distribution to any class of creditor; and
- The natural consequence of the above is that employee entitlements would be met by the Fair Entitlements Guarantee (**FEG**), therefore a larger expense of the winding up is borne by the taxpayers.

d. When appointed Receiver after a Liquidator appointed – s 433 of the Corporations Act does not apply, which is significantly easier in calculating the EE payable from CSI. The issue though becomes: who should make the payment to the employees?

As you can see from the above, legislative intervention is required relating to streamlining ss 419, 433, 561, 561 and 558 of the Corporations Act.

3.3.5 ***Abolition of equitable liens in insolvency contexts*** – In addition to the proposed reform in Schedule 2, Part 3, s 70-30, where a lien on books and records is not entitled to be exercised by the former bankruptcy trustee, we would request that extend to former professionals of the individual or company. Our experience is that even when issued with the appropriate notices, pursuant to ss 77(1), 77A and 129AA of the Bankruptcy Act or s 530B of the Corporations Act, professionals such as accountants and solicitors claim liens on the records so that we meet their outstanding accounts first (which would otherwise be an unsecured claim in the administration). These same individuals are also now trying to rely on these sorts of arguments in defence of ATR claims under s 588FF of the Corporations Act.

3.3.6 ***Exclusion of the application of section 553C to section 588FF claims*** – The relatively recent NSW cases of *Buzzle Operations Pty Ltd (In Liq) & Anor v Apple Computer Australia Pty Ltd & Ors* [2011] NSWCA 109 and *Re Parker* (2011) 250 FLR 242 have caused a stir in the market, by proposing (in obiter) that set-off (under s 553C) may apply to preference claims and insolvent trading claims, respectively. With the greatest of respect, we strongly disagree with this application, and propose amendments be made to the Corporations Act to reflect same.

3.3.7 Grant exclusive jurisdiction to the Supreme Court to hear applications made under s 588FF of the Corporations Act.

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Yours faithfully

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