The Law
Reform
Commission

Report No 45

GENERAL INSOLVENCY INQUIRY

Summary of Report

Australian Government
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Canberra 1988

Note: This volume sets out in summary form the Commission's main recommendations on the issues raised in the Terms of Reference. The full Report, separately available in two volumes, sets out in detail the material on which the recommendations are based as well as the draft legislation. In this volume paragraph references in square brackets are references to the full Report and draft legislation.

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The Law Reform Commission is established by section 5 of the Law Reform Commission Act 1973 to review, modernise and simplify the law. The first members were appointed in 1975. The offices of the Commission are at 99 Elizabeth Street, Sydney, NSW Australia (Tel (02) 231 1733; VOCADEX (02) 223 1203).

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Contents of Summary Report

Terms of reference

I, GARETH EVANS, Attorney-General of Australia, HAVING REGARD TO:

(a) the Report of the Law Reform Commission (No 6) entitled 'Insolvency: The Regular Payment of Debts' in which it was suggested that a general reference be given to the Commission on insolvency; and

(b) the desirability of examining all aspects of the law and practice relating to insolvency,

in pursuance of section 6 of the Law Reform Commission Act 1973, HEREBY REFER to the Law Reform Commission —

the law and practice relating to the insolvency of both individuals and bodies corporate, in particular —

(i) the provisions of the Bankruptcy Act 1966, in its application to both business and non-business debtors;

(ii) Parts VIII, X, XII of the Companies Act 1981 so far as they are related to or are concerned with the insolvency of companies;

(iii) any related matter.

IN PERFORMING its functions in relation to this Reference, the Commission shall:

(a) consult the States and the Northern Territory, the National Companies and Securities Commission, the Companies and Securities Law Review Committee and such other persons and bodies as it thinks appropriate;

(b) have regard to

(i) overseas developments in bankruptcy and company law and practice, including in particular the recommendations contained in the report of the United Kingdom Insolvency Law Review Committee; and

(ii) the agreement made on 22 December 1978 between the Commonwealth and the States for establishing and implementing a co-operative scheme for the administration of laws relating to companies and to the securities industry (which agreement forms the Schedule to the National Companies and Securities Commission Act 1979).

Gareth Evans
Attorney-General

20 November 1983

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The Division of the Commission constituted under the Law Reform Commission Act 1973 for the purposes of the Insolvency Reference comprised the following members of the Commission:

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The Honourable Justice MD Kirby, CMG, BA, LLM, BEc (Syd) (resigned September 1984)

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* The recommendations, statements of opinion and conclusions in this Report are the responsibility of the members of the Law Reform Commission. They do not necessarily represent the views of consultants or of the organisations with which they are associated.

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Outline of full report

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Definitions

The following terminology has been adopted in this Summary:

- *Bankruptcy Act*: the Bankruptcy Act 1966 (Cth)
- *CAC*: the office conducting the regulation of companies in a State or Territory
- *Clyne Committee*: the Committee appointed by the Attorney-General of the Commonwealth of Australia on 23 February 1956 to Review the Bankruptcy Law of the Commonwealth
- *companies legislation*: the Companies Act 1981 (Cth) which applies directly to the Australian Capital Territory and the Companies Codes of the States and Northern Territory (the Companies Codes are constituted by Companies (Application of Laws) Acts which adopt the provisions of the Companies Act 1981 subject to local modifications)
- *company*: a body corporate which is described as either a 'company' or a 'corporation' in the companies legislation (the distinction is not adopted in this Report)
- *DP 32*: ALRC DP32, *General Insolvency Inquiry*, August 1987
- *NCSC*: the National Companies and Securities Commission
- *the court*: in the context of the Bankruptcy Act, the court prescribed by that Act; in the context of company insolvency, the court prescribed either by the companies legislation or by the Corporations Bill 1988 (Cth) if it is enacted

Part I — Introduction and general issues

The reference [chapters 1 and 2]

Terms of reference

1. On 20 November 1983, the federal Attorney-General asked the Law Reform Commission to inquire into

> the law and practice relating to the insolvency of both individuals and bodies corporate, in particular —
>
> (a) the provisions of the Bankruptcy Act 1966, in its application to both business and non-business debtors;
>
> (b) Parts VIII, X, XII of the Companies Act 1981 so far as they are related to or are concerned with the insolvency of companies;
>
> (c) any related matter.

The need for the reference

2. Insolvency law is a matter of considerable importance to the Australian community and the reference to the Law Reform Commission provided for the first time the opportunity for a comprehensive review of the relevant law in Australia. The law of corporate insolvency has never been reviewed. The last review of the law relating to bankruptcy (which is solely concerned with the insolvency of individuals) was conducted between 1956 and 1962 by the Clyne Committee. Shortcomings with the present law and procedure have become apparent as a result of significant economic and social changes. In the 25 years since the report of the Clyne Committee there has been an extraordinary increase in the use of credit. Inflation has become a fact of economic life. Interest rates fluctuate. There has been high unemployment. These factors have led to a large increase in the number of insolvencies. This increase has further indicated shortcomings in the present insolvency procedures.

General issues

3. ***Terminology.*** In Australian legislation the word 'bankruptcy' is used to describe the process for dealing with an insolvent individual and the phrase 'winding up' is used for insolvent companies. It was suggested to the Commission that the word 'bankruptcy' refer both to individuals and companies. While appropriate changes in terminology may promote greater clarity and understanding the Commission remains unconvinced that a sufficient case has been made to justify such a change. However, in relation to companies there is a need to distinguish between the winding up of a solvent company and the

winding up of an insolvent company. The term 'winding up in insolvency' is used throughout the Report to distinguish it from the winding up of a solvent company. This distinction would be further emphasised if there were a separate Division within the companies legislation providing specifically for the winding up of companies in insolvency. [**para 23**]

4. *A single Act.* The integration of individual and corporate insolvency into a single Act may be more efficient and result in cost savings through the use of common procedures. A single statutory scheme, controlled by one government, would also allow better control of policy and changes to the legislation could be made more expeditiously. On other other hand, there are many areas peculiar to individuals and corporations which may make complete fusion difficult, if not impossible. The issue of which courts would exercise jurisdiction would also need to be resolved. There does not appear to be any overriding need for unity. Substantive reforms in particular areas of insolvency law are more important. However it is desirable to promote uniformity of the substance of the provisions relating to individual and corporate insolvency. [**para 31–2**]

5. *Principles of contemporary insolvency law.* The following principles guided the Commission in formulating its specific recommendations.

- The fundamental purpose of an insolvency law is to provide a fair and orderly process for dealing with the financial affairs of insolvent individuals and companies.
- The insolvency law should provide mechanisms that enable both debtor and creditor to participate with the least possible delay and expense.
- An insolvency administration should be impartial, efficient and expeditious.
- The law should provide a convenient means of collecting or recovering property that should properly be applied toward payment of the debts and liabilities of an insolvent person.
- The principle of equal sharing between creditors should be retained and in some areas reinforced.
- The end result of an insolvency administration, particularly as it affects individuals, should, with very limited exceptions, give effective relief or release from the financial liabilities and obligations of the insolvent.
- Insolvency law should, as far as convenient and practical, support the commercial and economic processes of the community.
- As far as is possible and practical, insolvency laws should not conflict with the general law.
- An insolvency law should enable ancillary assistance in the administration of an insolvency originating in a foreign country. [**para 33**]

6. *Insolvency offences.* No extensive study of insolvency offences was conducted during the course of the reference. There is a need for a comprehensive review to be undertaken of all insolvency offences and the relationship between such offences and the general criminal law. [**para 35**]

7. *Information and statistics.* Better statistical information is needed, particularly relating to corporate insolvencies. Statistical information on corporate insolvency should be published by the NCSC on a quarterly basis with a yearly summary which should provide further details of insolvency administrations. Insolvency practitioners should be required to complete a form setting out details of each corporate insolvency administration. The classification of business insolvencies for the purposes of collecting statistics should be based on either the Australian Standard Industrial Classification (ASIC) or the Standard Industrial Classification (SIC). [**para 39–43**]

Part II — Company insolvency

Voluntary administration of insolvent companies [chapter 3]

8. *A new voluntary procedure.* There are four methods currently available for a company to deal with its affairs in a voluntary fashion: scheme of arrangement, official management, creditors' voluntary winding up and court winding up. These do not provide a satisfactory range of alternatives by which an insolvent company might deal with its affairs: no one procedure provides an ordered method of dealing with the company's affairs that is sufficiently swift, cost-effective and flexible. Consequently, a new voluntary procedure for insolvent companies is needed. The main features of the recommended procedure are as follows.

- *Companies that can use the procedure.* The procedure will be available to companies with a debt problem, not just those that are hopelessly insolvent. [**para 60, s VA2**] A reasonable prospect of insolvency will be sufficient.

- *Declaration and appointment of administrator.* A company may make a declaration of financial difficulty and appoint a registered insolvency practitioner as administrator. [**para 63, s VA5, VA6**] A holder of a floating charge over all the property of a company may also appoint an administrator. [**para 66, s VA5**] Declarations are not revocable [**para 77, s VA8**] and there is a penalty for false declarations. [**para 76, s VA7**]

- *Notice.* Notice of the appointment of an administrator must be lodged with the CAC. [**para 73, s VA6**] The appointment is also to be advertised and notified on the company's documents. [**para 73, s VA25**] Where a chargeholder appoints an administrator, notice of the appointment must be served on the company. [**para 75, s VA12**]

- *Rights of certain secured creditors.* A company using this procedure must give notice of the declaration to any secured creditor holding a registered charge over all the property of the company. Such a creditor may then, within 7 days of the appointment of the administrator (but not afterwards), take possession of the property or appoint an agent or receiver to take possession of the property of the company. [**para 67–8, s VA5**] If the chargeholder elects to enforce the charge, the administrator will continue in office, although the administrator's powers will be subject to those of the chargeholder, receiver or other agent of the chargeholder under the charge. [**s VA20**]

- *Control by administrator.* Subject to the exercise of rights by a secured creditor whose security covers all the property of a company, the

administrator will take full control of the company and its property for a period which would not normally exceed 28 days. [**para 79, s VA14**]

- *Stay.* The 'control' period brings about a stay (or a moratorium) on actions or proceedings against the company and its property. [**para 94, s VA22**] The stay applies to
  - all unsecured creditors
  - all secured creditors (with limited exceptions) and
  - all owners or lessors of property possessed, used or occupied by the company.
- *Duration of stay.* The stay should generally last for 28 days although it may extend to 35 days or, with the approval of the court, a longer period. [**para 95, s VA22**]
- *Restraints during stay.* During the stay
  - secured creditors are restrained from bringing or proceeding with a claim against the company or with respect to property of the company
  - secured creditors are restrained from taking steps to enforce their security
  - owners or lessors of property in the possession or use of the company or occupied by the company are restrained from taking steps to take possession of or recover it. [**para 101, s VA22**]
- *Exceptions to the restraints.*
  - All persons affected would have a general right to exemption, either with the consent of the administrator or by court order.
  - An application for winding up, if made during the period of restraint or before, may, if the court is satisfied that it would be to the advantage of creditors for the company to remain under administration, be adjourned pending the meeting of creditors. Where the company executes a deed of company arrangement, an application for a winding up must be dismissed (but the court may order that the company pay the costs of the application).
  - Receivers or other persons who have entered into possession or assumed control of property of the company for the purpose of enforcing a charge prior to the appointment of the administrator would be able to continue to exercise their powers.
  - Notice in consequence of default under a charge over property or under any agreement relating to property possessed used or occupied by the company may be given.

- A secured creditor who has taken certain steps toward a sale of the security property before the appointment of the administrator may proceed provided the court does not order to the contrary.
- A secured creditor may exercise powers under a charge in relation to perishable property and the owner of perishable property in the possession of the company may take possession of that property. [**para 103–4, s VA22–23**]

- *Restraint on execution.* An administrator will have power to prevent persons proceeding with uncompleted executions and attachments against property of the company. [**para 105, s VA24**]

- *Directors to assist administrator.* During the period of 'control' the directors are required to give the administrator all necessary information. [**para 81, s VA16**] The administrator has suitable powers to control the continued operation of any business of the company effectively. [**para 86, s VA20; para 106, s VA26**] The administrator is also entitled to the books of the company except where they are in the possession of a secured creditor (other than a lienee) in which case the administrator is entitled to have access to and take copies of the books. [**para 82, s VA17**]

- *Personal liability of administrator.* Administrators who continue with trading operations of companies to which they are appointed will be personally liable for debts or liabilities incurred as a result, including rent and similar payments for property which the company continues to occupy after the appointment of the administrator. [**para 89–90, s VA 21**] However, they are entitled to be indemnified out of the assets of the company. [**para 93**] The indemnity postpones unsecured creditors (including government creditors). It will also permit the administrator to have access to the assets subject to a floating charge, except where the charge is being enforced and the administrator has received notice of that fact. Administrators are not liable at all where a secured creditor is enforcing its security or where the court orders that the administrator ought fairly to be excused with respect to a particular liability. [**para 91–2**]

- *Meeting of creditors.* An administrator must, within 21 days of appointment, call a meeting of creditors to be held within 28 days of the initiation of the procedure. Notice of the meeting must be accompanied by a statement of the financial affairs of the company together with the administrator's recommendation as to whether the company should be wound up, a proposed arrangement considered or the company cease to be under administration. [**para 110–1, s VA28**] If an arrangement is proposed, full particulars must be given.

- *Resolution of creditors.* At a meeting called by an administrator, the creditors can resolve that the company is to be wound up, to accept a deed of company arrangement or that the company cease to be under administration. [**para 112, s VA28**] The remuneration of the administrator is also fixed at the meeting. [**para 114, s VA30**]

- *Winding up.* If the creditors resolve that the company be wound up, a notice to that effect must be filed. The company is then wound up in insolvency as if a winding up order had been made on the day the company became a company under administration. [**para 112, s VA29**]

- *Deed of company arrangement.* The deed will be a document in more concise and simpler terms than documents presently forming the basis of schemes of arrangement. It can incorporate (by reference) standard provisions contained in a schedule to the companies legislation, as well as many provisions of the legislation dealing with, for example, admissible claims, order of distribution to creditors and avoidance of antecedent transactions (such as preferences and similar voidable transactions). [**para 116, s VA31 and Schedules 1 and 2 to the VA legislation**] The creditors will choose a registered insolvency practitioner to be the administrator of the deed. [**para 115, s VA31**]

- *Effect of deed.*

  - A deed of company arrangement will bind all creditors of a company except that secured creditors and owners or lessors or property used by the company will only be bound to the extent that they agree or the court orders.

  - Persons bound by the deed will not, without the leave of the court, be able to make or proceed with an application for the winding up of the company, enforce a remedy against property of the company or property used by the company or commence or continue with a legal proceeding against the company. [**para 119, s VA32**]

- *Role of the court.* The court has a general supervisory power throughout the procedure [**s VA4**]. However, there is no requirement for any part of the procedure to be sanctioned by the court. The principal powers of the court are to remove an administrator [**para 85, s VA19**], to give directions in relation to meetings [**s VA 4**] and to avoid or terminate a deed. [**para 122–3, s VA35, VA36**]

- *Role of CAC.* Because there is no requirement for court proceedings, the involvement of the CAC in the procedure is also more limited than under schemes of arrangement. The CAC must be notified of all relevant stages of the process [**s VA6, VA10, VA29, VA31, VA34**] and has standing to seek the avoidance or termination of a deed of company arrangement. [**s VA35, VA36**]

9. *Consequences of adopting the Commission's recommendations.* If the Commission's recommended voluntary procedure for insolvent companies is adopted, official management and the existing form of a creditors' voluntary winding up should be abandoned as a form of voluntary administration but schemes of arrangement should be preserved for, in particular, larger private or public companies. [**para 57**]

The winding up of insolvent companies [chapter 4]

10. *The general approach.* The existing legislative scheme for the winding up of a company in insolvency is well understood and generally works satisfactorily. However, some aspects can be improved so that the procedure operates in a more orderly and efficient manner.

11. *Circumstances for winding up.* A single provision should set out all the circumstances in which a company may be wound up in insolvency. These circumstances are

- where an order is made by the court that the company be wound up in insolvency
- where, at a meeting convened under the voluntary administration procedure, creditors resolve that the company be wound up in insolvency
- where a deed of company arrangement (under the voluntary administration procedure) is avoided or terminated by the court and the court has, in consequence, made an order that the company be wound up in insolvency
- where an application for winding up on grounds other than insolvency has been made and the court can declare from evidence before it that the company is unable to pay its debts and orders that the company be wound up in insolvency and
- where a liquidator, appointed to a seemingly solvent company, whether by the court or in a members' voluntary winding up, determines that the company is in fact insolvent and files the appropriate declaration. [**para 134, s WU2**]

12. *Evidence of insolvency.* Companies legislation s 364(2) which deems that a company is insolvent in certain circumstances should be repealed and replaced by a provision which specifies the following circumstances from which it may be presumed that a company is unable to pay its debts

- non-compliance with a statutory demand
- unsatisfied execution
- the fact that the company is being administered under the voluntary administration procedure
- the appointment of a receiver to, or the entry into possession or taking control of, property of the company in the enforcement of a floating charge.

Proof by other means that a company is unable to pay its debts should also be available (as at present). Contingent or prospective liabilities of a company may be taken into account in determining whether it is unable to pay its debts. [**para 141, s WU3.**]

13. *Who may apply?* An application for winding up in insolvency may be made by the company, a creditor (which includes a secured creditor and a contingent or prospective creditor), a member or director of the company, the NCSC or a prescribed authority (for example the Insurance Commissioner). An application by a member or a director of the company and the NCSC would require leave of the court. [**para 143, s WU3**]

14. *Statutory demands.* No fundamental changes should be made to the procedure of using statutory demands to initiate steps for insolvency proceedings. However, to clarify the formal requirements of a statutory demand, a demand should

- be in writing in accordance with a prescribed form
- be verified by affidavit as prescribed, except where the debt relied upon is a judgment debt
- be in respect of a debt that is not less than $2000
- require the company to pay the debt claimed or to secure or compound for it to the reasonable satisfaction of the creditor within 21 days after service
- be served on the company (there should be no change to the existing requirements for service). [**para 147, s WU7**]

15. *Setting aside a demand.* A company may apply to set aside a statutory demand before time for compliance expires. The application must be supported by an affidavit setting out the reasons for objection. Once the application is filed, time for compliance would be automatically extended by seven days or until such later time as the court determines. [**para 149, s WU8**]

16. *Grounds for setting aside a demand.* A demand may be set aside if the court is satisfied that

- there is a substantial dispute whether the debt is owing
- the company appears to have a counterclaim, set-off or cross demand and the amount specified in the demand less the amount of the counterclaim, set-off or cross demand is less than the prescribed amount.

The court would have the power to order that the company pay an undisputed debt within a specified time and that, in default, the creditor may apply for the winding up in insolvency of the company. Furthermore, a demand would not be liable to be set aside because of a defect or irregularity unless the court considers that substantial injustice would be caused if it were not set aside. [**para 151, s WU8**]

17. *A role for the lower courts.* Lower courts should have jurisdiction to determine applications in relation to the setting aside of a statutory demand. This should reduce existing burdens on the Supreme Courts. [**para 153, s WU8(9), (10)**]

18. *Time limits.*

- *Duration of presumption of insolvency.* A winding up application based upon non-compliance with the statutory demand should be commenced within three months after that event.
- *'Life' of winding up application.* An application for a winding up order should lapse after six months unless, within that time, the court orders that the period be extended. [**para 151, s WU9, WU10**]

19. *Defects or irregularities in proceedings.* Proceedings for winding up in insolvency should not be affected by a defect or irregularity unless the defect or irregularity is such that the court concludes that there has been a substantial injustice that cannot be remedied by an appropriate order (such as an adjournment or order for costs). A defect would include a material misstatement of the amount due to a creditor and a material misdescription of the debt in a statutory demand. [**para 157, s WU12**]

20. *Opposition to an application.* Any person (including the company) seeking to oppose an application for a winding up order must file and serve on the applicant notice of the grounds of opposition (verified by affidavit) within the prescribed time. A company should not be permitted to oppose an application based upon failure to comply with a statutory demand on the ground that there is a dispute over the debt if they could have made, but did not make, application to set aside the demand. [**para 159, s WU13**]

21. *Joint debtors.* A single application for an order for the winding up of two or more companies in insolvency should be available where the companies are joint debtors, whether partners or not. [**para 160, s WU15**]

22. *Commencement of insolvent winding up.* A winding up in insolvency commences at the following times

- for a company ordered to be wound up in insolvency — the day on which the order for winding up was made
- for a company where the creditors, meeting under the voluntary procedure, resolve that the company be wound up — the day on which the notice is filed with the CAC following the resolution for winding up
- for a members' voluntary winding up which is converted to a winding up in insolvency — the day of the resolution to wind up
- in any other case — the day on which the order for the winding up was made.

23. *Power to restrain secured creditors.* A liquidator should have the power to apply to the court for an order to restrain a secured creditor from realising or otherwise dealing with the security property. In considering an application the court would have regard to the conduct of the parties, proposals for the

continued performance of any agreement between the company and a secured creditor and the degree of prejudice (if any) likely to be suffered by the company or its creditors generally. The position of a secured creditor would also be protected by giving the court the power to impose terms as to costs and to award damages for the period for which the exercise of rights is restrained and to stipulate the consequences of any further or other default by the company. [**para 164, s WU20**]

24. *The owner or lessor of property.* The power to seek an order to restrain a secured creditor from realising or otherwise dealing with the secured property should not extend to the owner or lessor of property. [**para 165**]

25. *Books and records and the provision of information.* Subject to the rights of secured creditors (other than mere lienees), persons with custody or control of books of the company should not be entitled to retain them but should have to deliver them to the liquidator upon notice being served. The liquidator should be authorised to have access to and to take copies of any books in the possession of secured creditors. [**para 169, s WU20(4) and s WU21**]

26. *Appointment of an insolvency practitioner to a winding up.* The following procedure should be adopted in the appointment of an insolvency practitioner to administer the winding up of a company in insolvency.

- The appointment to a winding up in insolvency ordered by the court would be based on rotation with appropriately qualified practitioners only being eligible for appointment.
- The appointment to other windings up in insolvency would be on the basis of a resolution of the creditors. The nominated practitioner should make a declaration disclosing any prior association with the company, its directors and creditors. If no resolution is made the court would have the power to make an appointment. [**para 171**]

27. *Special powers of restraint.*

- An interim liquidator, liquidator or a person who would otherwise be able to make application for an order for the winding up of a company in insolvency may apply for orders for the arrest of persons in defined circumstances and also for the seizure and delivery into custody of any property or books of the company. [**para 174, s WU24**]
- The liquidator or an interim liquidator would also be able to apply to the court for an order prohibiting an officer of the company or a related person from transferring money or property of the company or of the officer or person out of the jurisdiction. The court would also have the power to appoint a receiver to the property of the person and to order an officer or related person to deliver up his or her passport or to prohibit an officer or related person from leaving Australia. [**para 176, s WU23**]

Receivers and floating charges [chapter 5]

The Commission's approach

28. Implementation of the recommendations of the Commission on this topic would not represent a codification of the existing law. The recommendations address problems which became apparent to the Commission in the course of its review of the insolvency laws. They can be divided into five areas

- expanding the range of persons who should have the same responsibilities as a receiver
- crystallisation of a floating charge
- appointment and conduct of a receiver
- removal of a receiver from office
- duties of a receiver.

Expanding the range of persons

29. Sections of the companies legislation which deal with receivers should be amended to include mortgagees and their agents by the use of wording similar to companies legislation s 324(1) and 331(1). [**para 188**]

Crystallisation of a floating charge

30. *Circumstances of crystallisation.* Subject to a prior review of the legislation dealing with charges and priorities between charges, the crystallisation of a floating charge would only operate in law when

- a notice that the charge has become fixed by virtue of the occurrence of an event stipulated in the charge agreement has been lodged with the CAC
- a receiver of property of the company, an agent of a chargee or a chargee itself has entered into possession of the property under the terms of the charge or another charge or
- a liquidator or administrator of the company has been appointed. [**para 196**]

31. *Order to set aside notice.* A company or a creditor of the company may seek an order setting aside a notice of crystallisation on the ground that the event stipulated in the charge agreement had not occurred at the date the notice was given. [**para 198**]

Appointment and conduct of a receiver

32. *Validity of appointment.* A corporation, a creditor of a corporation or receiver or other person enforcing a charge may apply for a determination of the validity of the appointment of a receiver or any entry into possession. [**para 203, s R3**]

33. *Protection for receivers.* Where a receiver or other person enters into possession or assumes control of property of a company for the purpose of enforcing a charge and acts in accordance with a direction of the court, that person may rely on the direction as a defence to a claim in respect of anything done or omitted to be done in accordance with the direction. [**para 205, s R8**]

34. *Information by receivers.*

- Receivers and other persons who have entered into possession or assumed control of property of a company for the purpose of enforcing a charge must file a report on the affairs of the company within two months of the person's appointment. All creditors should have access to the report.
- Confidential information which could materially prejudice the receiver or other person in the exercise of the person's powers or functions would not have to be included in the report. [**para 209, s R7**]

35. *Sale of charged assets: elements of an application.* A receiver or person who has entered into possession or assumed control of property of a company for the purpose of enforcing a charge may apply to the court for an order authorising the sale of property subject to a prior security. [**para 213, s R4**] The receiver would have to establish that

- the property in question is subject to a fixed charge which takes priority over the charge of the floating chargeholder under which the receiver has been appointed
- the sale of the property would be in the interests of the company and its creditors (this would be the case if a sale or disposal of that property would be likely to promote a more advantageous realisation of the company's assets than could otherwise be effected)
- a sale of the property would be unlikely to realise sufficient to discharge the debt for which the property is security
- the receiver has taken reasonable steps to obtain the consent of the chargee of the property to the sale of the property and has been refused or cannot conveniently obtain the consent and
- the rights of the chargee will not be substantially prejudiced.

36. *Sale of charged assets: protection of fixed chargeholder.* The court can impose conditions to protect the rights of the holder of the fixed charge. [**para 214, s R4(3)**] Such conditions may include:

- that the net proceeds of the disposal of the property (including property the subject of the fixed charge) be applied to discharge the sum secured by the fixed charge
- that the receiver or other person enforcing a charge make up the difference between the net amount realised on the sale of the property the subject of the fixed charge and the net amount which would be realised on a sale of that property in the open market by a willing vendor.

37. *Liability of a receiver.* The formulation of the extent of a receiver's liability in companies legislation s 324(1) will remain. [**para 217**]

38. *Liability under leases.* A receiver or other person enforcing a charge should be liable for rent or similar payments payable by the company in respect of property that the company continues to occupy or use except for an initial seven day period. [**para 220, s R2**] However, as in the case of the administrator [**para 91**] the court would have a power to excuse the receiver or person from that liability. This would, for example, assist a receiver or person who is unaware of the existence of certain property of a company or of the fact that the legal title to the property belongs to another person.

39. *Powers of receiver after appointment of liquidator.* A receiver may continue to carry on a business as agent for the company after the commencement of winding up with the consent of the liquidator or the approval of the court. [**para 222, s R5**]

Removal of receiver

40. *Express statement of power of court.* The power of the court to remove a receiver from office or to terminate the possession or control by a person of property of the company where the person is enforcing a charge over the property should be expressly stated in the companies legislation. [**para 227, s R1**] The power will be exercisable on the application of the company.

41. *Expeditious realisation of assets.* A liquidator of a company being wound up in insolvency may apply for an order that a receiver or other person who has assumed control of property for the purpose of enforcing a charge cease acting altogether or only continue to act in respect of certain property. In exercising its discretion, the court must have regard to the interests of the company, other persons affected and the person entitled to the benefit of the charge. [**para 230, s R1**]

Duties of receivers

42. *Duty to take reasonable care.* The duty of a receiver, a chargee who takes possession and the agent of a chargee should be expressly stated to be to take reasonable care in the exercise of that person's powers. [**para 236, s R6**] In particular, the duty would be to take reasonable care in the management of property and, if the property is sold, to ensure that it is not sold at a price below the best price reasonably obtainable.

43. *Action for breach of duty.* A company the property of which is in the possession or under the control of a person enforcing a charge could bring an action for breach of duty. A guarantor of the liabilities of the company to the chargeholder which appointed the receiver could also bring an action.

Corporate trading trusts [chapter 6]

44. *The trading trust.* Trading trusts have become a popular device for conducting trade and commerce in Australia. Because a trust is not a legal entity, a person who acts as trustee is personally liable for all debts and liabilities incurred in that capacity (particularly in the operation of a business on behalf of the trust). To limit this liability, it is common for a company to be incorporated (usually with no assets except for paid up capital of $2) to act as trustee. This combination whereby a limited liability company acts as the trustee of a trust which engages in trade and commerce, has produced many difficulties and uncertainties, especially where the business involved becomes insolvent. The companies legislation makes little or no provision for corporate trustees which become insolvent. Assuming that trading trusts will continue to be used for commercial purposes, it is important that the existing law be clarified to promote certainty in the event of the insolvency of the business of a trading trust. It seems appropriate that the principles for winding up should apply to an insolvent corporate trustee, while maintaining as far as possible consistency with the general principles of trust law. The following matters require resolution

- the power of the liquidator of a corporate trustee to administer the trust property
- the power of the liquidator of a corporate trustee to administer not only the affairs of the company but also the affairs of the trust
- limitations on the right of indemnity and of the exercise of the right of indemnity
- the circumstances in which the corporate trustee may be removed as trustee
- the extent to which trust property may be applied to meet the claims of creditors of the company especially where the terms of the trust did not provide for the company to engage in the particular transactions that resulted in the liability
- the order of distribution of trust property among creditors.

45. *Administration of the business and affairs of an insolvent corporate trustee.* So that the liquidator will be able to control all aspects of the business activity of the company, including its activity as a trustee, a reference to the business or affairs of a company for the purpose of the operation of the insolvency provisions should be taken to include a reference to its business or affairs as trustee. [**para 245, s T1**]

46. *The power to deal with property.* A reference in the companies legislation to the property or assets of a company that is being wound up in insolvency should be taken to include property and assets held by the company as trustee to the extent that the company is entitled to a charge or other beneficial interest in respect of the property or assets. The expression 'charge or other beneficial

interest' is designed to cover both the right of a company to recoup expenses and liabilities paid or met by the company from its own resources and the right of a company to exoneration out of trust property for debts or liabilities properly incurred. [**para 247, s T2**]

47. *Limitations on the right of indemnity.* A term or condition in a trust instrument or agreement that might have the effect of excluding or barring a company from exercising the equitable right of indemnity against trust property for debts and liabilities properly incurred by the company in the conduct of the trust should be void as against the liquidator. However there should be no change to the existing law which allows a beneficiary to contract out of a similar liability. [**para 251, 253, s T3**]

48. *Removal of the company as trustee.* There should be limits on the power to remove a trustee in the event of insolvency. If a company is acting as the trustee of a trust and becomes subject to an application for winding up in insolvency, any provision in the trust instrument allowing for the removal of the company as trustee or the exercise of any power that allows for the removal of the company as trustee should have no effect. The liquidator or administrator would be able to cause the company to resign as trustee in which case a new trustee or trustees could be appointed. However, restriction on the power of removal should be subject to any order of the court removing the company as the trustee. Thus, the existing powers in State and Territory Trustee Acts, which allow for the court to remove the trustee are not excluded. [**para 258, s T4**]

49. *Exercise of the right of indemnity.* Upon the insolvency of a corporate trustee, the exercise of the right of indemnity against both the trust property and the beneficiaries (if such a right exists) should be a collective right exercisable by the company, through its liquidator, on behalf of all trust creditors. The rights of the liquidator to exercise the right of indemnity should, however, be subject to an order of a court. Thus the rights of a secured creditor under a mortgage debenture where a receiver has been appointed may be protected. [**para 261, s T5**]

50. *Distribution of proceeds among trust creditors.* To remove doubts concerning the operation of the existing law, the following order for distribution of property among trust creditors should be specified.

- *Company and trust property should be kept separate.* The proceeds obtained from the exercise of a right of indemnity should be reserved for creditors who have legitimate claims on those proceeds, namely, the creditors whose debts or liabilities have been incurred in the conduct of the trust to which the indemnity relates. [**s T6(1)**]

- *The order of distribution.* Proceeds should be distributed as follows: first, the costs associated with the exercise of the right of indemnity and of the administration of property obtained as a result of the exercise of that right; secondly, the administration costs of the winding up (in the order

specified in the proposed new section 441(1)(a)–(f) inclusive) to the extent that the assets owned by the company in its own right are sufficient to pay those costs. The statutory priorities must be observed when distributing the proceeds of the exercise of the right of indemnity. Unsatisfied claims by trust creditors are admissible to share in any property of the company available for general distribution. [**s T6(3), (4)**]

- *Extension of the right of indemnity.* The right of indemnity should include not only the amount of the trust debts and liabilities, but also the total costs associated with the winding up (where the assets of the company available for general distribution are not sufficient to cover those costs). [**s T6(2)**]

51. *Improper dealing by trustee.* There should be no change to the existing law which affects a trustee which acts outside its powers. The distribution of the proceeds of the exercise of the right of indemnity should not be extended to include payments in respect of debts or liabilities which have resulted from improper dealings by the corporate trustee, such as where the trustee has acted in breach of trust. [**para 268**]

52. *Extended application of the recommendations.* The recommendations, applicable to the insolvency of a corporate trustee, should so far as practical also be applied to individual trustees. They should also be made applicable so far as relevant to the situation of a company under voluntary administration.

Director liability and director disqualification [chapter 7]

53. *A new legislative scheme.* Although directors may be held civilly and criminally liable for a broad range of conduct which may be detrimental to companies, there is a need for provisions which turn the minds of directors to their responsibilities when incurring debts. The existing provisions (companies legislation s 556 and 557) have various deficiencies. [**para 279**] Those provisions should, to the extent that they deal with the liability for insolvent trading, be repealed and the responsibilities of directors with regard to insolvent trading expressed as a positive duty to the company to prevent the company from engaging in that activity. There should be new legislation as follows.

- The legislation imposes on directors a duty to the company to prevent it from engaging in *insolvent trading.* [**para 285–6, s D2**] The legislation would not apply to directors of unlimited companies, liquidators, receivers, receivers and managers and administrators. [**para 284, s D1**] Nor would it apply to persons (other than directors) engaged in the management of a company. [**para 325**]
- *Insolvent trading* involves
  - the incurring of debts when circumstances of insolvency in relation to a company exist and

- the subsequent winding up in insolvency of the company. [**para 285, s D3**]

- *Circumstances of insolvency* exist when there are reasonable grounds for suspecting that a company is *unable to pay its debts* after taking into account contingent and prospective liabilities. [**para 287, s D4**]

- Breach of the duty gives rise to a *civil liability* to the company. There is *no criminal liability* for breach. [**para 323, s D11**]

- *Action for breach* of the duty is brought *by the company* through the liquidator or, if the liquidator takes no action and the court grants leave, through a creditor. In either case, the court has a discretion with respect to the distribution of the proceeds of such an action to favour those creditors who have taken the risk of financing the action. [**para 316, s D8**]

- Proof of the existence of circumstances of insolvency is assisted by three presumptions.

  - a presumption that circumstances of insolvency exist at a particular time where it can be shown that the liabilities of the company, including its contingent and prospective liabilities, exceeded its assets at that time or that current liabilities exceeded current assets and there were insufficient assets reasonably capable of being realised or charged so as to enable the company to pay its current liabilities
  - a presumption that circumstances of insolvency exist where proper and adequate accounting records detailing the company's financial affairs are, for whatever reason, not available to the liquidator and the company is unlikely to pay its unsecured creditors more than 50 cents in the dollar
  - a presumption that circumstances of insolvency, once established to exist at a particular time within the 12 months preceding the commencement of the winding up, continued to exist. [**para 294, 296, 300, s D5, D6**]

- Where it is shown that a company has engaged in insolvent trading, a director of the company may avoid liability by establishing at least one of three defences

  - the director had reasonable grounds to expect that the company would have been able to pay its debts from its own resources
  - the director took reasonable steps to minimise the possible loss to creditors
  - the director was not able, for good reasons, to participate in the management of the company at the relevant time. [**para 305, 311, 312, s D7(1)**]

- The first defence will be established if the director had reasonable grounds to believe that a competent and reliable person had responsibility for providing directors with sufficient information to prevent the company from engaging in insolvent trading and apparently discharged that responsibility. [**para 309, s D7(3)**]
- The second defence will be established if the director endeavoured to prevent the insolvent trading or endeavoured to place the company under a form of administration in insolvency. [**para 310–1, s D7(2)**]
- If a director is found liable, the amount of the liability will be determined by the court and measured by reference to the *loss or damage sustained by the creditors*. [**para 319, s D9**] There is a need for the court to have a broad discretion as to damages because of the range of factors which may be relevant to quantifying the loss to the company. [**para 318**]
- An amount recovered in an action for breach of duty is available for distribution in a winding up for the benefit of *all unsecured creditors* in accordance with s 441 of the companies legislation, subject, however, to the court ordering otherwise. [**para 321, s D10**] The court may make such an order, for example, where some of the creditors of the company knew that it was trading while insolvent yet continued to trade with it.

54. *Fraudulent conduct — criminal liability.* Criminal liability for conducting business with a specific intent to defraud should be retained. [**para 327**]

55. *Fraudulent conduct — civil liability.* An action for civil liability for fraudulent conduct should be available, independently of criminal liability. The provision would be based on companies legislation s 229(7) which provides a right to compensation for breach of directors' duties. Individuals would also have rights under the Trade Practices Act 1974 (Cth). However, there should be a reduction of liability where a director has been found liable under the Trade Practices Act 1974 (Cth) (this provision would be modelled on companies legislation s 229(8)). [**para 329**]

56. *Acting while disqualified — personal liability.* Directors will have unlimited personal liability where they have acted as directors or as managers while disqualified from so acting or have permitted others to act as directors or managers while disqualified. [**para 333, s D12**]

57. *Liability for the debts of a related company.* The court will have a discretion to order that a company that is or has been a related company pay to the liquidator all or part of an amount which is an admissible claim in the winding up 'if it is satisfied that it is just'. Three specific criteria to which the court must have regard are

- the extent to which the related company took part in the management of the company
- the conduct of the related company towards the creditors of the company generally and to the creditor to which the debt or liability relates

- the extent to which the circumstances that gave rise to the winding up of the company are attributable to the actions of the related company. [**para 336, s D13**]

Assetless companies fund [chapter 8]

58. *The problem: no assets, no administration.* Many insolvent companies are never formally wound up because creditors perceive that there will be few, if any, assets available for distribution and are reluctant to incur further loss by commencing proceedings for a winding up order or providing money for administration which would allow inquiry into the companies affairs. The result is that, if a company is assetless, there will often be either no administration or a perfunctory one. In bankruptcy, on the other hand, the Official Trustee will generally be appointed to administer the estate of a person with no assets. Because the Official Trustee is a publicly funded officer, there will be an administration, at least to the extent of investigating the affairs of the bankrupt, reporting to creditors and exercising some control over the bankrupt's discharge, even though there are no funds in the estate.

59. *The need for investigation of assetless companies.* The present system whereby assetless companies are not investigated or ever formally wound up is unsatisfactory and has been the subject of criticism by the commercial community. It encourages abuse by directors of companies. Unless insolvent companies are investigated directors will not become subject to the antecedent transaction provisions or other civil or criminal provisions of the companies legislation. Reform is needed to overcome the perception that insolvency law does little to counter, and may even encourage, this type of abuse.

60. *Insolvent (Assetless Companies) Fund.* It is recommended that a Fund should be created to enable the winding up and investigation of insolvent assetless companies. The Fund would have the following features.

- The Fund would be created by a levy on all companies. The levy would be payable annually at the time of filing a companies annual return. [**para 349, s ACF5**]
- A detailed costing should be carried out to determine the appropriate amount of the annual levy for companies to contribute to the Fund; such amount should be prescribed in regulations. [**para 350, s ACF5**]
- The Fund would be administered by the NCSC. [**para 358**]
- The NCSC would pay from the fund a prescribed amount to
  - the creditor who brings the application to wind up an assetless company in respect of the taxed costs of the winding up
  - the liquidator, for the costs of inquiry into the business, property and affairs of the company and reporting to creditors. [**s ACF6**]

- An 'assetless company' is a company being wound up in insolvency which has unencumbered assets immediately available to the liquidator to enable the winding up to proceed, the value of which is less than the prescribed amount. [**s ACF1**] Assets immediately available would include cash, bank deposits, plant and equipment and other assets control of which can immediately pass to the liquidator.

- A liquidator may apply for an additional payment from the Fund so that proceedings relating to the business, property or affairs of the company may be instituted, continued or defended or so that further enquiries may be conducted into the business, property or affairs of the company. The NCSC should have the power to impose conditions on such payment. [**para 355**]

- The liquidator should if requested be required to report to the NCSC on the expenditure of money obtained from the Fund. [**s ACF9**]

- To ensure that the Fund is always recompensed when assets are recovered, the Fund should have a first priority over such assets. [**s ACF8**]

Part III – Individual insolvency

Proceedings in bankruptcy [chapter 9]

61. *The present procedure.* Bankruptcy proceedings are based upon a creditor establishing that a debtor has committed an 'act of bankruptcy'. The present procedure has been widely criticised as unduly antiquated, time-consuming and costly. In particular, the 'act of bankruptcy' has been criticised as being a concept ancient in origin and some 'acts of bankruptcy' as being largely irrelevant, rarely, if ever, used and even a deterrent to a debtor seeking a compromise with creditors.

62. *The Commission's approach.* Bankruptcy proceedings should, where possible, be modernised, simplified, made less time-consuming and less expensive. [**para 364**]

63. *Evidence of insolvency.* The concept of the 'act of bankruptcy' should be abolished. Jurisdiction to make a bankruptcy order should rest upon proof of insolvency by reference only to the following presumptive evidence.

- A person has not complied with a statutory demand, being a demand that has not been set aside.
- Execution issued against a debtor in respect of a judgment debt has been returned unsatisfied in whole or in part.
- A debtor has departed from or remained outside Australia with the intention of defeating, delaying or obstructing a creditor.
- In relation to a debtor who has signed an authority under Part X, either the debtor has failed to comply with a statutory obligation under that Part or control under that Part over the debtor's property is terminated.

Evidence of insolvency should be required in all applications except where the application is made by a person (termed a 'prescribed person') who has been appointed to administer a business or trust fund as a result of its mismanagement by the debtor. [**para 368, s B1–4**]

64. *A statutory demand.* The existing form of bankruptcy notice should be replaced by a statutory demand with the following features [**s B5**].

- The demand would require the person to whom it is addressed either to pay or to secure or compound for the debt claimed to the reasonable satisfaction of the creditor within a specified time (usually 21 days) and

warn the person that, if the demand is neither disputed nor complied with, the creditor may seek a bankruptcy order against the person. The demand should notify the person, in clear and simple language, of the nature and effect of the demand and of the procedures available to the person. [**para 369**]

- The demand must be in respect of a final judgment or order that is not less than the prescribed amount ($2 000 is recommended), being a judgment or order the execution of which has not been stayed. [**para 373, 393**]

- The demand would be sealed and issued out of the court in the same way as any other originating process of the court, so that where it appeared to comply with the statutory form it would be issued without further scrutiny by the court. [**para 375**]

65. *Setting aside a statutory demand.* A person disputing the debt claimed in a demand may apply to set aside the demand. If the application is made before time for compliance with the demand expires, the time would be automatically extended for a period of 7 days or such longer time as the court determines. [**para 377, s B6**]

66. *Grounds for setting aside a demand.* A demand may be set aside if the court is satisfied that one of the following grounds is established.

- The judgment upon which the demand is based is set aside, reversed or reduced below the prescribed amount.

- The debtor appears to have a counterclaim, set-off or cross demand which could not have been set up in the proceedings in which the judgment was obtained and the amount claimed in the demand less the amount of the counterclaim, set-off or cross demand is less than the prescribed amount.

- Execution of the judgment has been stayed.

- The demand ought to be set aside on other grounds. [**para 379, s B6(5)**]

If the court is satisfied that the demand should not be set aside, the court may

- if it is also satisfied that the debtor is likely to be able to pay or to secure or compound for the debt to the satisfaction of the creditor, within a reasonable period, order that the debtor do so and that in default the creditor may make an application for a bankruptcy order against the debtor or

- dismiss the application and make an order authorising the creditor to make an application for a bankruptcy order against the debtor immediately or after a specified date. [**para 379, s B6(6)**]

67. *Technical disputes.* There should be a specific provision that prevents a statutory demand being invalidated by reason of a defect or irregularity. There should also be a provision that applies generally to proceedings for an involuntary bankruptcy order (notwithstanding Bankruptcy Act s 306) to the effect that such proceedings are not affected by a defect or irregularity unless the court finds that substantial injustice has been caused and that the injustice cannot be remedied by an appropriate order. [**para 382, s B6(8), (9), s B15**]

68. *Time limits.* Bankruptcy applications should be based upon contemporaneous evidence of insolvency.

- *Duration of presumption of insolvency.* A bankruptcy application based upon non-compliance with a statutory demand would have to be commenced within 3 months after the non-compliance. [**para 386, s B7**]
- *'Life' of bankruptcy application.* An application for a bankruptcy order would lapse after six months unless, within that time, the court orders that the period be extended. [**para 386, s B14**]

69. *Application for a bankruptcy order.* The existing form of bankruptcy petition should be replaced with a prescribed form of application seeking a bankruptcy order against the debtor. The application should

- state details of the debt
- give particulars of the facts or matters upon which the creditor will seek to rely to establish that the debtor is insolvent (this requirement should not apply to an application by a prescribed person) [**s B1, B2, B9(2)**]
- if based upon failure to comply with a statutory demand, annex a copy of the demand and set out particulars of service and of the failure to comply with the demand
- if relevant, state particulars of any security held in respect of the debt (there should be no requirement that such a creditor should have to surrender that security for the purpose of making the application)
- be verified by affidavit. [**para 387, s B9**]

There would be no necessity to state in the application that the debtor has a relevant territorial connection with Australia. [**para 397**]

70. *Opposing an application.* A debtor who has not, within the prescribed time, filed and served on the applicant notice of the grounds of opposition verified by affidavit should not, without leave of the court, be entitled to oppose a bankruptcy application. Where a bankruptcy application is based upon non-compliance with a statutory demand the debtor should not be entitled to oppose the application on the ground that

- there is a dispute whether the debt is due or
- there is a misstatement or misdescription of the debt

unless the court is satisfied that the subject matter of the dispute, misstatement or misdescription is material to proof of the solvency of the debtor. [**para 388, s B11**]

71. *Procedural changes relating to bankruptcy applications.*

- On the hearing of an application for a bankruptcy order the present requirement for proof that the debt continues to be due and owing should be replaced by a presumption to that effect.
- The requirement that a creditor search the bankruptcy registry indexes and swear an affidavit as to whether the debtor is already bankrupt should be replaced by a requirement that the registry, on the day of the hearing of the application, issues a certificate to that effect.
- A bankruptcy application should, as at present, be served personally upon the debtor unless the court otherwise orders. It should be sufficient for prima facie proof of service that a photocopy of the original application served on the debtor is annexed to the affidavit of service. [**para 390**]

72. *Minimum amount of debt.* A minimum amount of debt should be a precondition to the issue of a statutory demand and a bankruptcy application. The amount would be prescribed in the regulations. It should presently be $2 000. [**para 393**]

73. *Territorial connection.* The existing jurisdictional criteria of territorial connection should be retained with the amendment that the criteria relate to the time at which the debt was incurred. [**para 397, s B2(2)**]

74. *Commencement of bankruptcy.* An involuntary bankruptcy should commence on the day when the order is made. [**para 398, s B19**]

75. *Retention of certain provisions.*

- The possibility for creditor substitution should be retained. [**para 400, s B10**]
- Leave of the court should continue to be required for the withdrawal of a bankruptcy application. [**para 401, s B9(6)**]
- The court's wide discretion to dismiss a bankruptcy application should be retained. [**para 403, s B12**]

76. *Bankruptcy rules.* The Federal Court Rules should govern all aspects of bankruptcy practice and procedure. Where rules peculiar to the bankruptcy jurisdiction are necessary, they could form a distinct Part of the Federal Court Rules. [**para 406**]

77. *Bankruptcy applications against joint debtors and partners.* The Bankruptcy Act should be amended to reflect the decided law that for a bankruptcy

order to be made against the members of a partnership, proof of insolvency must be established against each partner. [**para 409, s B8**]

78. *Control over the debtor before bankruptcy.* The existing power of the court to appoint a trustee to take control of property of a debtor after presentation of and prior to the hearing of a bankruptcy petition should be revised as follows.

- The appointee should be termed an interim receiver, to reflect more precisely the standing and function of the appointee.
- The right to appoint an 'interim receiver' would be exercisable at any time after the issue of a statutory demand or after the filing of a bankruptcy application.
- The powers of the interim receiver would be clearly specified. Certain fundamental powers should automatically apply upon the appointment: the power to collect, protect and maintain the property of the debtor; the power to sell or otherwise dispose of perishable property and any other property the value of which is likely to diminish if it is not disposed of; and the power to take into custody the books of the debtor relating to the trade dealings, property or affairs of the debtor. In addition, the court would be empowered to confer upon the receiver such other powers, functions and duties as may, in the circumstances, be required. [**para 414, s B16**]

79. *Prohibition on application by debtor.* Where a bankruptcy application is pending against a debtor, the debtor should not, without the applicant's consent or court leave, be entitled to file a voluntary bankruptcy application. [**para 417, s B18**]

Voluntary bankruptcy and debts payment plans [chapter 10]

80. *Debts payment plans.* There should be an alternative form of voluntary administration (that is an alternative to bankruptcy or Part X) aimed at stabilising and dealing with the current commitments of insolvent debtors who, either seek to avoid bankruptcy or would find the cost of an administration under Part X prohibitive. This is the subject of the Commission's recommended legislation 'Part IX Bankruptcy Act — Debts Payment Plan'. [**para 432, 441–460, s PP1–PP27**] The scheme differs in important respects from the Commission's previous recommendation for a Regular Payment of Debts scheme. [**para 439**] The scheme has the following features.

- *Persons who may make a plan.* A 'debtor' (as defined) is eligible to make a debts payment plan where there is a reasonable prospect that the debtor may satisfy unsecured debts (whether in part or in full) in most cases out of regular income. In some circumstances, such as where a debtor's financial affairs have been previously administered either under that Part

or under a debts payment plan within a recent specified period, leave of the court is required to advance another debts payment plan. [**para 442, s PP1, PP2**]

- *Initiating of plan.* A plan is initiated by a debtor appointing a registered 'debt plan agent' and the agent consenting to act for the debtor in promoting a plan. [**para 444, s PP2**]

- *Debt plan agents.* Only a registered debt plan agent is eligible to act on behalf of a debtor in respect of the procedure. Financial counsellors prepared to assume the role of administering such plans, as well as other insolvency practitioners [**chapter 18**], are eligible to become registered debt plan agents. [**para 445, s PP1**]

- *Stay of rights following appointment.* There is an initial moratorium on creditors of 14 days. The stay also applies to a secured creditor unless, before commencement of the stay, the secured creditor has taken specified steps in exercise of the creditor's rights under the security. The stay does not prevent an application for a bankruptcy order against the debtor, but the court has a discretion to adjourn an application where a proposal is advanced. [**para 446–7, s PP3**]

- *Proposing a plan.* During the moratorium the debt plan agent assists the debtor to formulate a debts payment plan. A plan will have to be in writing and include provision for

  - periodic or lump sum payments, or both, in respect of the unsecured debts of the debtor
  - the payment in full of each admissible claim or the payment of the same proportion of each admissible claim in full satisfaction
  - all payments under the plan to be made to the agent within a specific period not exceeding 3 years after the agent's appointment
  - the payment of any remuneration and expenses of the agent administering the plan.

  The plan must be approved by the agent who, in determining whether to approve a plan, must be reasonably satisfied that the debtor will be able to fund the plan. The agent must also take into account other specified considerations. [**para 448, s PP4, PP5, PP7**]

- *Debts included in a plan.* A plan will encompass the 'admissible' claims of a debtor, which means claims that would have been admissible in the debtor's bankruptcy had the debtor become a bankrupt on the day on which the appointment of the agent was made. A plan will also be capable of making provision for payments in respect of a secured debt, but only if the secured creditor agrees. [**para 450, s PP1, PP6**]

- *Continuation of stay after filing of plan.* If the agent approves the plan, the plan and particulars of the debtor's affairs are filed in the court registry and copies are sent to those creditors to whom the plan is intended to apply. If those documents are filed before the end of the 14 day stay, the stay continues for a further 21 days, except in relation to a secured creditor whose secured debt is not included in the plan. [**para 449, 451, s PP8, PP9**]

- *Acceptance of plan.* A plan becomes effective if 50% or more in value of creditors included in the plan who vote within the further 21 day stay period, vote in support of the plan. Voting should be by postal vote. [**para 452, s PP10**]

- *Stay of creditors' rights while plan in force.* Once a plan is accepted, until it is completed or terminated, an absolute stay (including the filing or service of a statutory demand and a bankruptcy application) applies to creditors in respect of admissible claims and to secured debts included in the plan. [**para 453, s PP11**]

- *Creditor's application to amend a plan.* A creditor may apply to the agent to amend the filed particulars of the debtor's affairs where the creditor considers that an admissible claim of the creditor was either not included in the particulars or included at an incorrect value. If dissatisfied with the agent's decision, the creditor may appeal to the court. If acceptance of the creditor's claim results in reducing the payments to creditors included in the plan, those creditors may apply to the court to terminate the plan. [**para 454–5, s PP12, PP13**]

- *Varying plan following report by agent.* There is provision for varying the terms of a plan where the agent considers that, because of a change in the debtor's circumstances, the arrangement for payments included in the plan should be varied. A report by the agent explaining why, having regard to prescribed matters, the plan should be varied together with the proposed variation must be sent to creditors who have 21 days to vote on the variation. [**para 456, s PP14**]

- *Termination of plan.* A debtor who remains in default of a plan for 14 days, is to be notified by the agent to remedy the default within a further 14 days. If the debtor fails to do so, the agent must immediately file a notice of default and send a copy of the notice to each creditor. The plan is terminated on the day the notice is filed, whereupon each creditor has the same rights against the debtor as if the plan had never been accepted and as if the amounts paid under the plan had been paid toward satisfaction of the debt. A plan may also be terminated by the court if it is proved that the debtor has misled creditors in some material respect. [**para 457, s PP15–PP18**]

- *Completion of plan.* A plan is completed when all payments under the plan have been made to the agent. The debtor is then be released from

liability in respect of the debtor's admissible claims and any secured debt to the extent that it is included in the plan. A debtor may complete a plan before the time provided in the plan. [**para 458, s PP19**]

- *Remuneration of debt plan agents.* The remuneration of the agent may not exceed a prescribed amount and can only be paid by deduction from the periodic or lump sum payments under the plan. The agent is empowered to waive part or all of the maximum remuneration. [**para 460, s PP23**]

81. *Voluntary bankruptcy.* Voluntary bankruptcy should continue to be generally available to all debtors. [**para 425**] However, a debtor's petition should not be able to be accepted by the court registry unless it has a prescribed certificate annexed. The certificate would have to be signed by a financial counsellor, solicitor, accountant, clerk of court, chamber magistrate or such other person who may be prescribed as eligible to give the certificate. The certificate would state that

- the debtor has consulted the person
- the person has advised the debtor as to bankruptcy and the possible alternatives available to the debtor
- if relevant, the debtor has made a proposal in respect of the debtor's current creditors either under Part X or the Debts Payment Plan and either the proposal has been rejected or, if accepted, that the debtor has defaulted under the Part X administration or plan or the administration or plan has otherwise been terminated. [**para 468**]

82. *A public insolvency advice service.* A federally funded public insolvency advice service should be set up to provide a basic information and referral service. The service would be staffed on a sessional basis by the type of professional eligible to give the certificate referred to in the previous recommendation. The service should be located near court registries. If there is no court locally, the service could be centrally located at, for example, a shopping centre, government agency, or other centre open to the public. The availability of the insolvency advice service should be widely advertised. [**para 475**]

Part X [chapter 11]

83. *The Commission's approach.* Part X is the only binding form of voluntary administration available to an insolvent individual. Although recent experiences in some Part X administrations have brought the procedure into disrepute, the Commission considers that the abuses have been overmagnified. Some curative and preventative measures (many of which were proposed by the Commission in DP32) have already been introduced by the legislature. Part X is considered superior to the corresponding laws of countries such as England, Canada and New Zealand. The Commission considers that Part X should be retained in its present form. Recommendations for reform of Part X have proceeded from two main considerations

- inefficient procedures
- the possibility for manipulation of the procedure. [**para 479**]

84. *Declaration of association.* A trustee or solicitor (or other qualified person [**chapter 18**]) who accepts an authority under Part X should, at the time of acceptance, make and file a statement of any previous or existing association with the debtor and a declaration that there are no circumstances, other than the association, known to the appointee which should prevent that person from acting impartially. [**para 484, s PX 1**]

85. *Control over the property of the debtor.* There should be control over the debtor's financial affairs pending a decision as to a possible administration under Part X. To that end, only a registered insolvency practitioner could accept an authority under Part X. Solicitors should be eligible for registration as insolvency practitioners. [**chapter 18**] As long as they are not eligible, however, there should be no change to the present position whereby either a solicitor or registered trustee can accept an authority. [**para 487**]

86. *Information to creditors.* The recent amendment to the Bankruptcy Act, new s 189A, requiring certain information to be made available to creditors in advance of the meeting should be modified to provide that the report to creditors be prepared in all cases, whether a registered trustee or a solicitor is appointed under a s 188 authority. In addition, the report would state whether the debtor's proposal, when compared with bankruptcy, is in the best interests of the creditors. [**para 493**]

87. *Extended powers of the controlling trustee.*

- Where it is in the interests of the creditors that the controlling trustee exercise more effective control over the financial affairs of the debtor, the trustee should be entitled to apply to the court to be appointed interim receiver of the debtor's property. [**para 497, s PX2**]
- A controlling trustee should be empowered to apply to the court for directions in respect of exercising any powers of the controlling trustee. [**para 499, s PX3**]

88. *Stay of proceedings.* Acceptance of an authority under s 188 should operate to stay all proceedings or enforcement of remedies in respect of admissible claims against the person or property of the debtor for 28 days. The stay could be earlier extinguished by an order of the court or a special resolution of creditors terminating control. The stay would also apply to a secured creditor unless, before commencement of the stay, the secured creditor has taken specified steps in exercise of the creditor's rights under the security. The stay would not prevent an application for a bankruptcy order against the debtor. [**para 503, 507, s PX4**]

89. *Conduct evidence of insolvency.* The initiation of the Part X procedure should not, of itself, expose a debtor to the possibility of bankruptcy proceedings

by a creditor. However, a debtor who has signed an authority under Part X could be the subject of a bankruptcy application where the conduct of the debtor is inconsistent with a genuine attempt by the debtor to reach an accord with creditors or where control is terminated. [**para 510, s B3(d)**]

90. *Proxy voting.* Many proxies are given in favour of the chairperson of a meeting under Part X. To prevent manipulation of such proxies it is recommended that

- a person who is proposed to chair a meeting under Part X and is prepared to do so makes a declaration of association to the meeting before the vote is taken. [**para 514, s PX6**]
- a creditor may, under Bankruptcy Act s 200(3A) (the new proxy provision), specify either a range of proposals the creditor is prepared to accept or confer on the proxy a discretion as to voting in respect of further proposals. [**para 518**]

91. *Abortive meetings.* If, at a meeting of creditors, no special resolution is passed dealing with the future administration of the debtor's financial affairs and the meeting is not adjourned, control should automatically cease and the person authorised to call the meeting of creditors must immediately inform the creditors accordingly. [**para 521, s PX7**]

92. *Successive authorities.* A debtor should not be permitted to give more than one authority within any one period of six months without leave of the court. Leave could only be given if the court is satisfied that the financial circumstances of the debtor have materially altered since the previous authority was given, and that a new proposal of greater benefit to the creditors than the one previously proposed is to be advanced. [**para 523, s PX8**]

93. *Types of Part X administration.* There should be no change to the availability under Part X of the three types of administration: assignment, arrangement and composition. [**para 524**]

94. *Application of bankruptcy provisions to Part X administrations.*

- The provisions enabling avoidance of antecedent transactions should apply to deeds of arrangement unless expressly excluded from a deed by a special resolution of creditors. [**para 528, s PX9**]
- The priority provisions should apply to all forms of voluntary administration under Part X. [**para 531, s PX10**]
- The provisions of Part X should be amended by incorporating into Part X the actual wording of provisions which are to apply in that Part. [**para 537**]

95. *Variation of arrangements and compositions.* A deed of arrangement or composition should be capable of variation by the following procedure.

- The trustee sends a report and a statement of the proposed variation to those creditors bound by the deed or composition.
- The trustee then convenes a meeting of the creditors.
- If the creditors approve the variation, the deed or composition is altered accordingly.
- A creditor may apply to the court to avoid a variation. [**para 535, s PX11**]

96. *The treatment of claims in Part X.*

- All claims admissible in bankruptcy should be admissible under Part X.
- All such claims would be released upon completion of a deed of assignment and a composition.
- In the case of a deed of arrangement, debts could be released only to the extent provided in the deed.
- A creditor would be entitled to vote in respect of an admissible claim at any meeting under Part X.
- If the quantification of the claim of a particular creditor is in doubt or cannot be ascertained, the creditor could exercise a vote with a value of one dollar. [**para 540**]

Discharge from bankruptcy [chapter 12]

97. *The period of bankruptcy.* There should be no change to the three year period before which bankrupts may automatically be discharged from bankruptcy. [**para 549, s DB1(2)(d)**]

98. *Early discharge on trustee's certificate.* A further means of obtaining a discharge from bankruptcy should be introduced enabling bankrupts to be discharged earlier than after three years following the issue by the trustee of a certificate of eligibility for discharge. [**para 554, s DB1, DB2**] This form of discharge should operate as follows.

- Where the trustee administering a bankrupt estate is of the opinion that the bankrupt should be discharged from bankruptcy before automatic discharge would normally occur, the trustee may sign a certificate to that effect.

- In forming an opinion whether a certificate should be issued, the trustee must have regard to a number of prescribed considerations.
- A certificate operates to discharge the bankrupt at the expiration of a specified period (for example, two months after the date the certificate is filed) unless, within that period, an objection is filed by a creditor.
- The trustee must file the certificate and a prescribed report summarising the administration and then immediately send to creditors copies of both those documents together with a statement explaining the effect of the certificate.
- A creditor may object to discharge by operation of the certificate. If such objection is filed by a creditor, discharge of the debtor would be postponed until the objection is determined by the court. [**para 547, s DB2**]

99. *A prior or subsequent bankruptcy.* A bankrupt who has been a bankrupt within a period of the five years preceding the present bankruptcy should not be eligible for automatic discharge or discharge pursuant to a trustee's certificate. Such a bankrupt should be required to apply to the court for an order of discharge. [**para 557, s DB1(3)**]

100. *Objections to discharge.*

- The trustee should be required to specify, in detail, on the form of notice of objection the reasons why the objection to discharge has been entered. The form should also contain an explanation to the bankrupt of the effect of the lodging of an objection and how the bankrupt might deal with the objection. [**para 562**]
- The grounds upon which objections can be made should be revised as follows.
  - The bankrupt has failed to comply with an income contributions order or agreement. [**chapter 17**]
  - Termination of the bankruptcy would prejudice proper administration of the estate.
  - The commercial conduct of the bankrupt either prior to or during bankruptcy has been unsatisfactory.
  - If discharged the bankrupt is likely to engage in undesirable commercial conduct.
  - Any other circumstances (which must be specified) that would prevent the bankruptcy from being terminated. [**para 562, s DB 3**]

A creditor may apply to enter an objection on the additional ground that the bankrupt has been able to, but has not, contributed any or sufficient income for the benefit of the estate.

101. *Income contributions and discharge.* A bankrupt's ability to make contributions to the estate should only be a ground for objection to discharge by the trustee where a bankrupt has failed to comply with an income contribution order or income contribution agreement. [**para 565, s DB3(1)(a)**]

102. *Matters to be considered by the court.* In determining a bankrupt's eligibility for discharge, whether on the application of the debtor or otherwise, the court should have regard to prescribed considerations. Those considerations should include the following

- the circumstances in which the bankrupt's debts were incurred, including the conduct of the bankrupt and the conduct of the creditors in relation to the incurring of the debts
- the extent to which the bankrupt has co-operated with the trustee
- the extent to which any detailed investigation of the circumstances of the bankruptcy is required
- if the bankrupt is able to make contributions from income to the estate, whether the bankrupt has made and complied with an income contribution agreement or has complied with an income contribution order
- the financial rehabilitation of the bankrupt
- a prescribed report in writing by the trustee
- if the bankrupt has previously been bankrupt, the circumstances that led to the previous bankruptcy and the conduct of the bankrupt in relation to that bankruptcy. [**para 567, s DB4(4)**]

The court would, as at present, be entitled to have regard to such other matters and to receive such other evidence as it considers appropriate.

103. *The court's discretion.* When the court is considering an application for discharge, it should have a wide discretion to

- dismiss an application — in which case the bankrupt is discharged as provided for in the statute
- order that the bankrupt be discharged — such order either to take effect immediately or to have suspended effect (the order may be conditional or unconditional)
- make an order disqualifying the bankrupt from automatic discharge of the bankruptcy — in which event the bankrupt will have to apply to the court for an order of discharge
- order that no application may be made by the bankrupt within a specified period without leave of the court. [**para 567, s DB4(2), (3)**]

Part IV — Issues relating to company and individual insolvency

Insolvency administration [chapter 13]

Scope of the recommendations

104. The Report makes recommendations in relation to five areas

- voting powers of creditors
- examinations
- powers of insolvency administrators
- disclaimer
- contributories.

Voting powers of creditors

105. *Method of voting.*

- Voting in all cases will be by simple majority in number of all creditors present and voting either in person, by proxy, by attorney or by such other means as may be permitted (for example by an 'absentee' vote).
- If two or more creditors so request, voting will be by majority in number and value.
- If a vote according to majority in number and value results in a deadlock, the insolvency administrator may apply to the court for a resolution of the conflict.
- A dissatisfied creditor may appeal to the court. [**para 579**]

106. *Insider voting.*

- Creditors may apply to the court to set aside a resolution on the basis that the resolution was carried by the votes of related persons (as defined in the provisions relating to the avoidance of antecedent transactions [**para 636, s AT2(2)**]) and favours those persons to the prejudice of other creditors.
- The court will have a specific power to order that a meeting be reconvened and that the related persons be excluded from voting. [**para 583**]

Examinations

107. *Compulsory examination.*

- There should be provision for the examination, without court order, of any person who is acting or who has previously acted in the capacity of director, secretary, executive officer, administrator, receiver or liquidator of a company that is being wound up in insolvency. [**para 586, s A2**]
- A trustee in bankruptcy or a liquidator would have express power to require production of documents at the time of issue of the summons for such an examination either from the examinee (the documents might in that case be required in the summons for examination) or by way of an order for production of documents directed to third parties who may have possession of documents relevant to the examination. [**para 586, s A4(14)**]

108. *Examinable affairs.* The interpretation of 'examinable affairs' of a company should be similar to the interpretation of that expression in the case of bankruptcy, namely

- the company's dealings, transactions, property and affairs and
- the financial affairs of an associated entity of the company, insofar as they are, or appear to be, relevant to the company or the company's conduct, dealings, transactions, property and affairs. [**para 590**]

109. *Evidence in support of application.* Applications to the court for examination of persons other than officers of the company must be supported by evidence on affidavit. An affidavit supporting an application to the court for the examination of persons other than officers will not be available for inspection unless the court orders otherwise. [**para 593, 595, s A3**]

110. *Right to inspect documents in respect of the examinable affairs of the company.* The liquidator of a company will have a right to inspect any books, securities or other documents relating to the examinable affairs of the company. [**para 597**]

111. *Aspects of procedure.*

- Examinations are, in general, to be conducted in public.
- The court should have power to direct that the examination (whether compulsory or by order) be in private under the control of the court.
- The court will have specific power to exclude a person from an examination.
- Such power will be accompanied by a power to give directions as to the conduct of the examination and a power to order that access to the record of the examination be restricted.

- Creditors will have a right to take part in an examination and be represented for that purpose. Creditors, as well as the CAC, must be given notice of the examination. [**para 601, s A4(2)–(7)**]

112. *Self-incrimination.*

- An examinee must answer questions, notwithstanding the possibility of self-incrimination, if the court so directs.
- Evidence given in an examination which is claimed by the examinee to be self-incriminating will not be able to be used in any criminal proceedings against the examinee (other than in proceedings for perjury in respect of that evidence). [**para 606, s A4(10)**]

Powers of insolvency administrators

113. *Powers of trustees in bankruptcy and liquidators.* Except for the power to compromise debts above a prescribed amount (the Commission suggests a present level of $20 000) and the power to enter into long-term commitments such as mortgages, charges or leases, the powers of a trustee in bankruptcy or a liquidator should be exercisable without the need for the approval of the creditors or the court. Creditors would still have power to give directions to which the relevant insolvency administrator must have regard and the actions of insolvency administrators will remain open to review by the courts. [**para 610**]

Disclaimer

114. *Disclaimer of contracts.* Liquidators will have a power to disclaim contracts similar to that exercisable by trustees in bankruptcy. [**para 613, s A5(2)(a)**]

115. *Disclaimer of shares.* The definition of property which may be disclaimed in both individual and corporate insolvency will include property of the company which is unsaleable or not readily saleable or is such that it may give rise to a liability to pay money or perform any other onerous act. [**para 614, s A5(2)(b)**] This definition would include partly-paid shares, calls on which may render the owner liable to pay money even though the shares themselves are saleable.

116. *Time limit.* The time limit of 12 months presently applying to the exercise of the power of disclaimer in the winding up of an insolvent company should be abolished. [**para 616**]

117. *Time from which a disclaimer operates.* Although provision for public notification should be retained in the case of bankruptcy and extended to corporate insolvency, the emphasis would shift from notification of a public official (the Registrar in Bankruptcy or the CAC) to the notification of persons having an interest in the relevant property. The requirements for notification would be as follows.

- Notice of disclaimer is given to persons who have an interest in the property being disclaimed and also filed with the appropriate registry as a matter of public record.
- The persons having an interest in the property have a right to apply to the court objecting to the disclaimer within a limited time.
- If no application to the court has been made within the time allowed or, if made, the application is unsuccessful, the disclaimer operates from the time the notice was given to the persons interested. [**para 618, s A5 (6), (8), (9)**]

118. *Disclaimer of leases.* No distinction will be drawn between the disclaimer of a lease and disclaimer of other onerous property. The Commission's recommendation for notice to be given to a person affected by a disclaimer will provide adequate protection to a person affected by the disclaimer of a lease. Such persons would still be able to protect their interests, but not require the trustee or liquidator to apply for leave to disclaim. [**para 620**]

119. *Extension of power of disclaimer to other office holders.* The administrator of a deed of company arrangement will have a power of disclaimer if the creditors vote to give the administrator of the deed that power. [**para 115–7, 621**] Receivers will not have power to disclaim, since the receiver's powers promote the interests of secured creditors only. [**para 622**]

Contributories

120. *Settling a list of contributories.* The existing procedure for settling a list of contributories appears to be unnecessarily lengthy and complicated. It involves the sending of two notices to contributories and the holding of a meeting. The following simpler, but equally effective, procedure should be adopted.

- The liquidator compiles a list of contributories from whatever information is available (including the register of members and the other books and papers of the company).
- The liquidator notifies all contributories of the contents of the list and invites them to submit any objections. The contributories are entitled to object both to their own inclusion (which they may wish to do if it appears likely that the assets of the company will not be sufficient to cover its liabilities), to the inclusion of other contributories (which they may wish to do if it appears that there will be a surplus) or to the exclusion of other contributories.
- The liquidator determines any objections and notifies the relevant persons of that determination.
- Contributories who disagree with the liquidator's determination have a right of appeal to the court within a specified time. [**para 626**]

In addition, a liquidator would only be required to settle a list of contributories where it appears likely that

- there are contributories liable to contribute to the assets of the company or that there will be a surplus available for distribution and
- it will be necessary to make calls on or adjust the rights of contributories. [**s A6**]

121. *Procedure for making calls.* The liquidator in a court winding up will have power to make calls on shares without reference to the court or the committee of inspection. [**para 627, s A7**]

Avoidance of antecedent transactions [chapter 14]

122. *The Commission's approach.* The existing policy of the law should be continued whereby transactions may be avoided if they involve the disposal of property of an insolvent within a relevant period prior to the commencement of formal insolvency in circumstances that are unfair to the general body of unsecured creditors. Implementation of that policy involves balancing the interests of the unsecured creditors of the insolvent and persons who have engaged in fair transactions with the insolvent. [**para 629**]

123. *A new legislative framework.*

- There should be separate provisions regulating antecedent transactions in both the bankruptcy and companies legislation.
- Both sets of legislation would be substantially uniform, with appropriate modifications to take account of relevant differences between individuals and companies.
- The antecedent transaction provisions should be capable of application to an arrangement with creditors by an individual outside of bankruptcy and by a company outside of a winding up in insolvency. [**para 633**]

The recommendations below apply to a company that is being wound up in insolvency. Amendments to the Bankruptcy Act should be modelled on these recommendations.

124. *The 'relevant day'.* A key aspect of the antecedent transaction provisions is the time period during which they have application. The pivotal point for the calculation of time in respect of the provisions, the 'relevant day', should be

- for a company ordered to be wound up as an insolvent company — the day on which the application for the order for winding up was filed
- for a company that has progressed through a voluntary administration procedure to a winding up — the day on which the initiating declaration of insolvency was made

- where the winding up commenced as a members' voluntary winding up but is later converted into a winding up in insolvency — the day upon which it was resolved by the members that the company should be so wound up
- where a company was initially ordered to be wound up otherwise than as an insolvent company but the winding up subsequently became a winding up in insolvency — the day on which the application for the original winding up order was filed. [**para 635, s AT2(1)**]

125. *'Related person'.* There should be introduced into the legislation dealing with antecedent transactions a category of 'related person'. Experience has shown that 'related person' creditors are more likely to be favoured by an insolvent when financial difficulties emerge. [**para 636, s AT2(2)**]

126. *'Transaction'.* The definition of this term should embrace the wide range of means by which property may be disposed of. [**para 637, s AT2(3)(c)**]

Preferential transactions

127. *Definition.* The definition of a preference should be redrafted to express the nature of a preference in clear and simple terms as a transaction

- that is made when the debtor was insolvent
- to or for the benefit of a person on account of a past debt or liability
- that occurs within the prescribed time period and
- which enables that person to receive more toward satisfaction of the debt or liability than should otherwise be the case in the winding up. [**para 638, s AT3(1)**]

128. *Presumption of insolvency.* There should be a rebuttable presumption that a company being wound up in insolvency has been insolvent during the period of 90 days immediately preceding the relevant day. Further, insolvency should be deemed to exist from the relevant day through to the date of commencement of winding up. [**para 641, s AT3(3)**]

129. *The time period.*

- The existing six month period for review of preferential transactions involving non-related creditors should be retained.
- Where related persons are involved the period should be two years. [**para 643, s AT3(2)**]

130. *Defence to a preference claim.*

- There should be a single ground of defence to a preference claim, namely that, in the circumstances in which the transaction was made, the creditor did not have reason to suspect that the company was insolvent at the time of the transaction. [**para 648, s AT3(4)**]

- A related person should have to establish, in addition, that the transaction was made by the insolvent person without knowledge on the part of that person that the transaction would be likely to produce the result that the related person would receive more than other unsecured creditors. [**para 652, s AT3(5)**]

- It should not, in itself, be a defence to a preference claim that a transaction was effected as a result of an order of a court. [**para 653 and s AT3(7)**]

131. *'Running' accounts.* There should be a statutory provision which allows the court to have regard to the relationship between the parties and, if appropriate, the history of transactions between them to determine if there has been a preferential transaction or transactions. [**para 655, s AT3(6)**]

132. *Creditor giving up benefit of a preference.* It should be expressly provided that a creditor who has given up the benefit of a preference is entitled to claim the full amount in the winding up. [**para 656, s AT3(8)**]

133. *Transactions under the new voluntary administration procedure.* Transactions under the recommended voluntary administration procedure for companies should be exempt from the preference provisions. [**para 657, s AT3(9)**]

134. *Related person guarantors.* The existing provision should be extended so that if the effect of a preference is to reduce the liability of a related person under a guarantee, the liquidator may recover from that person the amount by which the liability under the guarantee is reduced. [**para 661, s AT4**]

Void settlements

135. *Transactions at an undervalue.* Bankruptcy Act s 120 (void settlements) should be replaced with a provision which concentrates on the element of undervalue in a transaction — not the method by which the property has been disposed of. A transaction should be considered to have occurred at an undervalue where

- there has been an outright 'gift'
- the transaction (other than an outright gift) is one where the company received no consideration, for example, where it is intended that the subject matter of the transaction be maintained in some permanent form
- the consideration provided by the other person is significantly less than that provided by the company. [**para 665, s AT5**]

136. *Wider definition of 'transaction'.* The term 'transaction' should be expanded to include an agreement for the provision of services by a company to a related person or to a company by a related person. [**para 670, s AT5(9)**]

137. *Time zone during which solvency is relevant.* There should be a single time zone of two years for reviewing transactions with non-related persons where the solvency of the person disposing of the property is, at the time of the

transaction, a relevant factor. In the case of a related person, the period would be four years. [**para 673, s AT5(2)**]

138. *Defences and ancillary relief.* A transaction should not be avoided where

- it is proved that the company was, immediately after the transaction, able to pay its debts.
- the transaction was made honestly and in the interests of the company.

In addition, where a person who received the benefit of a transaction has acted in good faith and has altered his or her position as a result of the transaction and the court considers it would be inequitable to avoid the transaction the court should have the power to make an order that is 'just' in the circumstances. [**para 674–6, s AT5(4)–(6)**]

Fraudulent dispositions

139. *Intent to defraud.* Bankruptcy Act s 121 should be amended as follows:

- the expression 'intent to defraud creditors' should be replaced with an expanded and better understood expression 'an intention of defeating, delaying or obstructing one or more of the creditors of the company'
- it should have to be shown that the transaction had the effect intended
- for the purposes of determining whether a transaction was made with the necessary intention, the court should consider, among other things, whether
  - the company was insolvent at or about the time of the transaction or became insolvent as a result of the transaction
  - the company was engaged in business, or was about to engage in business or a transaction, the nature of which was such that the value of any property remaining with the company was or would be unreasonably low or
  - the company intended to incur, or believed that it would incur, debts that it would not be able to pay.
- the insolvency administrator would bear the onus of establishing the relevant intention unless the transaction occurred with a related person, in which case there would, unless the contrary is proved, be a presumption of intention. [**para 681, 683–4, s AT6(1)–(3)**]

140. *Defence.* It should be a defence if it is established that the disposition

- was for valuable consideration and
- was made with a person who did not have reason to suspect that it was made with the intention of defeating, delaying or obstructing creditors. [**para 685, s AT6(4)**]

141. *A time element.* The provision would apply to transactions that occurred up to ten years immediately prior to the relevant day. [**para 686, s AT6(1)**]

142. *Applications in respect of avoidable transactions.* There should be an enabling provision for applications in respect of preferences, transactions at an undervalue and transactions made with the relevant intention giving the court wide powers to make the appropriate orders to fit the particular circumstances. *Bona fide* transferees for value (other than the person involved in the transaction) would be protected from the avoidance provisions. [**para 687, s AT7**]

143. *Time limit for taking proceedings.* Instead of the current six years, a liquidator should have three years (or such further time as the court allows) to commence an action to recover the proceeds of a void execution, a preference, a transaction at an undervalue or a transaction made with the relevant intention. [**para 688, s AT8**]

144. *Avoidance of floating charges.* The provision dealing with the avoidance of floating charges should be altered to provide that a charge will be exempt from invalidity if it

- secures not only money paid to the company but also money paid at the direction of the company
- secures payment of the amount of any liability under a guarantee or other obligation undertaken on behalf of or for the benefit of the company at the time of or after the creation of the charge
- secures payment of the amount of the market value of goods or services supplied to the company at the time of or after the creation of the charge together with interest. [**para 690, 693, s AT9**]

A charge may be avoided to the extent that the advance which it secures was applied to satisfy or discharge, directly or indirectly, an unsecured debt or liability. [**para 694, s AT9(4)**]

Related issues

145. *Relation back.* The concept of relation back should be abolished. [**para 698**]

146. *Dispositions of property under the Family Law Act.* A maintenance agreement should be capable of being avoided through the operation of any of the antecedent transaction provisions. [**para 702**]

147. *Certain provisions in agreements void.* Provisions in contracts should be void if they have the effect that, if the company becomes insolvent or becomes a company under administration, then

- the agreement is to terminate, or may be terminated
- the operation of the agreement is to be modified or
- property to which the agreement relates may be repossessed by a person other than the company. [**para 705, s AT10**]

148. *Retention of existing provisions.* Existing avoidance provisions such as restricting a change in the membership of a company after the relevant date, a restriction on execution of a judgment debt, recovery of money obtained as a result of execution on a judgment debt and avoidance of a disposition of property after the relevant date, should be retained substantially in their present form. If the Commission's recommendation for a new preference provision is adopted, companies legislation s 368 (avoidance of dispositions after the relevant date) will have to be made subject to the operation of the preference provision. [**para 706**]

149. *Revenue receipts.* If the Commissioner of Taxation recovers money pursuant to Income Tax Assessment Act 1936 (Cth) s 218 and Sales Tax Assessment Act (No 1) 1930 (Cth) s 38 and the taxpayer concerned becomes subject to formal insolvency proceedings within six months of receipt of the funds by the Commissioner, it is recommended that the Commissioner be obliged to repay the amount recovered to the insolvent estate. [**para 709, s AT11**]

150. *Sub-contractor liens.* There should be a provision to the effect that statutes (such as Subcontractors Charges Act 1974 (Qld) and Workmen's Liens Act 1893 (SA)) that

- permit or require the payment to some other person of money due to a company or confer security for payment in favour of some other person of money due to a company and
- provide that the payment discharges the liability of the company

shall be of no effect in a formal insolvency administration. [**para 711, s AT12**]

Priority among creditors [chapter 15]

151. *Classes of creditors.* The companies legislation and the Bankruptcy Act contain provisions which have the effect of specifying the order of priority in which creditors are to be paid from the realised assets of an insolvent company or individual. The effect of these provisions is to create three classes of unsecured creditors:

- priority or preferential creditors — those creditors paid out in the order specified in s 441 of the companies legislation and s 109 of the Bankruptcy Act
- ordinary unsecured creditors and
- deferred creditors — those creditors who may only make a claim after all other debts have been paid.

In addition, the Income Tax Assessment Act 1936 (Cth) accords a paramount priority to the Commissioner of Taxation in respect of certain taxes.

152. *Fundamental principle of equality.* As far as possible the fundamental principle of insolvency law which requires a rateable distribution among unsecured creditors should be reinforced. The existence in the insolvency laws of a long list of priority creditors runs contrary to this principle.

153. *Overview: two broad categories of priority creditors.* Section 441 of the companies legislation and s 109 of the Bankruptcy Act should be repealed and replaced with provisions which provide for only two broad categories of priorities

- first, administration costs and
- secondly, employee benefits.

154. *Administration costs.* The rationale for this priority is that creditors have a community of interest in having a common agent to maximise a fund for distribution among them. The following ranking of the costs, charges and expenses of administration should be applied:

- first, fees (other than remuneration) and expenses incurred by a liquidator, interim liquidator or administrator in protecting or realising assets or carrying on the business of the company
- secondly, costs of the application for winding up
- thirdly, costs of the report as to the company's affairs
- fourthly, costs of an audit of a liquidator's accounts
- fifthly, other necessary disbursements and the remuneration of the liquidator, interim liquidator or administrator
- sixthly, out of pocket expenses of the committee of inspection. [**para 720**]

155. *Employees.* The rationale put forward for the priority for employees is that they are in a particularly vulnerable position if their employer becomes bankrupt or is wound up. The development of a sophisticated social welfare system has to some extent diminished the significance of the rationale for the employee priority. The following options are put forward.

- The most effective way to ensure employees are paid in the event of their employer becoming insolvent is through the introduction of a *wage earner protection fund.* Such funds exist in many overseas countries. They are generally financed by employers. Such a fund would ensure that employees are paid in every insolvency, a result which the current priority does not guarantee. [**para 727**]

- If a wage earner protection fund is not created the priority for employees should be retained. However, no recommendations are made as to the appropriate monetary limits for various employee benefits. This is a matter of policy which is more appropriate for the government to determine.

156. *Excluded employees.* While there is justification for maintaining a class of excluded employees, the current provision (s 441(2)) should be amended to make clear that the exclusion from priority applying to an excluded employee

should only relate to the claims of that employee for the period that the person is regarded as an excluded employee. A de facto spouse should be included in the definition of excluded employee. [**para 732**]

157. *The Commissioner of Taxation.* The priority accorded to the Commissioner of Taxation by s 221P, 221YHJ. 221YHZD and 221YU of the Income Tax Assessment Act 1936 (Cth) should be abolished. [**para 741,s P1**]

158. *State and Territory taxes.* The existing priority accorded to State, Territory and local government tax should be abolished. [**para 743**]

159. *Costs of an investigation.* The priority accorded to the costs of an investigation under s 309 of the companies legislation or s 33 of the Securities Industry Code should be abolished. [**para 746**]

160. *Deferred creditors' claims.* Certain claims are deferred until all other unsecured creditors are paid in full. In the view of the recent repeal of Bankruptcy Act s 111 (the claim of a spouse of a bankrupt) and s 112 (claims for interest in excess of 12%), s 88 and 89 of the Bankruptcy Act should also be repealed and s 148 (c) amended to provide for the payment of interest or debts that have been admitted in the bankruptcy. If there is a surplus after payment of all admitted claims, a common rate of interest (as prescribed) should run on all such claims (regardless of whether they were interest-bearing) from the commencement of the administration until a final dividend is declared. Furthermore, the claim of a member which arises by reason of membership of the company should not be admitted as a claim unless, after payment in full of all admitted claims, there remains a surplus. The claim of a member should not be admitted until all contributions payable by the member have been paid in full. [**para 750, s P4**]

161. *The special position of certain creditors.* Special considerations arise in relation to the priority of certain creditors.

- *Reservation of title clauses.* There are significant advantages in a system of registration for agreements for sale of goods which provide for reservation of title to the goods notwithstanding their delivery. The Personal Property Security Act 1967 (Ontario) provides a useful model as the basis for such legislation. [**para 755**]

- *Creditors supplying necessary services or goods.* If a request is made by an insolvency administrator for the supply of gas, electricity, water or a telecommunications service (including supply of the same telephone number) the supplier should not be able to make it a condition of supply that outstanding charges are paid although the supplier may demand personal guarantees for payment of the charges for subsequent supply. Such provision should apply to a company under administration or which has executed a deed of company arrangement or to which a liquidator, interim liquidator or receiver has been appointed. [**para 758, s P3**]

- *Insurance and reinsurance.* Companies legislation s 447 should be amended so that it does not automatically apply to a contract of reinsurance. Contracts of reinsurance are fundamentally different, for the most part, from contracts of insurance. However, the court should have the power to apply s 447 in appropriate circumstances in respect of reinsurance proceeds. The matters that the court should take into account in deciding whether to make an order include the circumstances under which the contract of reinsurance was entered into and any prejudice likely to be suffered by the insured if an order is not made. [**para 764, s P5**]

- *Subordinated claims.* There is some doubt whether companies legislation s 440, which provides that all debts rank equally, conflicts with a provision of an agreement which subordinates (that is, postpones) payment of the debt due to a creditor to the claims of one or more other creditors. The subordination of debts is not an uncommon commercial device and has advantages to both borrowers and lenders. The operation of s 440 and 441 should not prevent a creditor's debt being deferred until another creditor's debt is paid in full or in part. [**para 768, s P6**]

- *Prepayment by consumers.* A sufficient case has not been made regarding a special new priority for prepaid consumer contracts. [**para 771**]

Claims in insolvency [chapter 16]

162. *Scope of the recommendations.* The Report makes recommendations in relation to three areas

- admissible claims
- the procedure for making claims in insolvency
- quantification of claims.

Admissible claims

163. *Tort claims.* The right to make a claim for unliquidated damages in an insolvency may depend merely on a technical distinction between framing the claim in contract and framing it in tort. If a claim cannot be framed in contract, the claimant recovers nothing. In bankruptcy, the claim against the bankrupt remains and impairs the philosophy of a 'fresh start'. In a corporate insolvency, the claimant receives nothing and the entity against which the claim is held ceases to exist. Claims for unliquidated damages arising from tort should be admissible. [**para 786, s C1**]

164. *Fines — corporate insolvency.* Fines imposed before or after the commencement of a winding up with respect to offences committed before the commencement of the winding up will be admissible in a corporate insolvency. Costs ordered to be paid with respect to proceedings for the offence will also be admissible. [**para 790, s C3**]

165. *Fines — individual insolvency.* Fines will be admissible as claims in bankruptcy but not automatically released on discharge. [**para 792**]

166. *Liability under a maintenance agreement.* The court will have a discretion to release a liability under a maintenance agreement or maintenance order. [**para 792**] Such a liability is currently not released on discharge.

167. *Debts incurred by fraud.* Debts incurred by fraud will be released on discharge, but the relevant creditor should have a right before the discharge of the bankrupt to apply for an order that the debt not be released on discharge. [**para 792**]

Procedure for making claims

168. *Procedure generally.* The following basic framework for making claims is recommended.

- The liquidator may admit a claim without formality.
- The broad procedure for making a formal claim would be specified in the legislation rather than in the Companies Regulations as at present.
- The detailed procedure by which the liquidator requires claims to be made formally would remain in the Regulations. [**para 793, s C6(1),(2),(3)**]

169. *Admission or rejection of claims.* At present, there is provision for the situation where a claim has been wrongly admitted and where a claim has been wrongly rejected in whole, but not where a claim has been wrongly admitted in part and rejected in part. The Commission recommends a provision permitting a trustee in bankruptcy or a liquidator to revoke a decision in respect of a claim that has been wrongly admitted or rejected in whole or in part. Once the decision has been revoked, the trustee or liquidator can make a fresh determination. [**para 794, s C6(4)**]

170. *Employees' claims.* The provision for the making of claims by employees in both the Bankruptcy Act (s 85) and the companies legislation (Companies Regulations, reg 117) should be redrafted so as to link the claims that can be made with sums due to employees under the priority provisions and to make it clear that it applies to claims by two or more persons. [**para 795, s C7**] In the case of the companies legislation, the provision would be in the legislation itself rather than in the Regulations.

Quantification of claims

171. *Procedure for quantification.* There should be a procedure for quantification in both individual and corporate insolvency where the amount of claims is not certain. The procedure would be based on the Bankruptcy Act (s 82(3)–(7)) but with the following differences.

- Whereas the Bankruptcy Act requires the trustee to make an estimate of the value of a debt or liability, the trustee or liquidator will either make an estimate or refer the claim to the court for valuation. The right of appeal from an estimate made by the trustee or liquidator would then be treated as if that person had referred the claim to the court.

- The court will have a power to specify a mode of determining the value rather than necessarily requiring the court to determine the value itself. It would still be open to appeal to the court from a valuation determined in the specified manner. [**para 797, s C2**]

172. *Further procedural matters.* The following procedural matters should be provided for in the Bankruptcy Act and Companies Regulations.

- A claimant for unliquidated damages should be advised by the liquidator of the estimate of the value of the claim or the reference of the claim to the court.

- The time period prescribed for objecting to the quantification should be the same as that prescribed for objecting to the rejection of a claim.

- Claimants aggrieved by an estimate should be accorded similar rights to those given to a creditor whose claim has been rejected by a liquidator. [**para 799**]

173. *Interest.*

- Interest will be payable up to the commencement of the winding up at whatever rate is provided for in particular contracts.

- After that date, all creditors will be permitted only a statutory rate of interest on their debts after payment in full of all admitted claims other than claims by members.

- The statutory interest will be payable from the commencement of the winding up to the day on which the payment is made. [**para 802, s C5**]

174. *Extortionate transactions.* The court will have power to re-open transactions and make various orders for relief from transactions in an insolvency where the court is satisfied that the interest charged in respect of the loan or any amount charged in relation to the lending of the money was unfair having regard to the commercial risk, the value of any security taken for the loan, the time of repayment, the amount of the loan and other relevant circumstances. [**para 804, s C11**]

175. *Foreign currency claims.* The date for conversion of a foreign currency claim should be the date upon which the insolvency administration actually

commenced. This should apply equally to the amount of claims which are liquidated after the date of commencement of the winding up. [**para 807, 811, s C4(2)**]

176. *Debts payable at a future time.* Provision should be made for discounting where debts are repaid early but only for debts which would be due and payable after six months following the day of commencement of the winding up. [**para 814, s C8**] Thus the liquidator need not be concerned with cases where the creditor receives payment only slightly ahead of the due date.

177. *Mutual credit and set-off.* There should be no right of set-off where

- a transaction giving rise to a claim of set-off was made within the six months immediately preceding the commencement of the winding up and
- at the time of the transaction the person had reason to suspect that the company was unable to pay its debts. [**para 819, s C9**]

In the case of a related person, there should be no right to set-off where the company knew that the transaction would enable the person to receive more towards satisfaction of the debt than the person would receive or be likely to receive in a winding up. In addition

- a member who is liable for contributions of capital to the company will not be entitled to set-off those obligations against debts owed to him or her by the company and
- a member will not be entitled to claim the benefit of a set-off in respect of a claim made by the member in respect of a debt owed by the company to the member in his or capacity as member. [**para 819, s C9(4), (5)**]

178. *Government departments.* Where a claim is made against the Crown with respect to a particular activity (not being a commercial or trading activity), the Crown will not have a right of set-off if the subject matter of the set-off relates to some other activity. [**para 822, s C10**] An exception will be made in the case of commercial and trading activities.

Property available for distribution [chapter 17]

179. *Scope of the recommendations.* This topic is principally concerned with individual insolvency, since in corporate insolvency all of the existing property rights of the company are available for distribution. In individual insolvency, property available for distribution must be carefully defined so as to distinguish property assigned to the trustee in bankruptcy from property which remains available to the individual to cater for the individual's needs and financial rehabilitation. Two principles should govern the operation of insolvency law in this area. As far as possible, the insolvency law should be consistent with general principles of property law, and the claim to title in property and the right of the insolvency administrator to control that property should be no better or worse than that of the insolvent.

180. *Reputed ownership.* The concept of reputed ownership will not be reintroduced. [**para 827**]

181. *Delays in vesting.* The trustee of a bankrupt (who is registered as the holder of shares in a company) will be entitled to the same dividends and rights (whether in relation to meetings, documents, including notices of meeting, voting or inspection of records) as the bankrupt. [**para 831, s PR1**]

182. *Restrictive provisions in articles.* The following recommendations are made to overcome articles which restrict transmission of shares or otherwise purport to constrain the trustee in bankruptcy in the realisation of the value of the shares.

- Where a part of the property of a bankrupt consists of shares in a company, the trustee can exercise the right to transfer the property to the same extent as the bankrupt might have exercised it if he or she had not become bankrupt.

- A person whose act or consent is necessary for realising the shares must, at the request of the trustee, do whatever is necessary to enable the transfer to be completed.

- Where consent is required for the transfer of any such share then, notwithstanding anything to the contrary in the memorandum or articles of association of the company, that consent must not be unreasonably withheld.

- Where, in accordance with the memorandum or articles of association of a company, any such shares must be offered for sale to a member of the company, any member who agrees to purchase those shares must pay a reasonable price. [**para 833, s PR2(1)–(4)**]

These measures are necessary, particularly in the case of a closely held company, to counter obdurate attitudes which operate in favour of the bankrupt and persons related to the bankrupt to the prejudice of the creditors.

183. *Loss of rights attached to shares.* Provisions in memoranda or articles of association to the effect that rights attached to shares of a shareholder are lost when the shareholder ceases to be entitled to the shares through bankruptcy will be void as against the trustee. [**para 835, s PR2(5)**]

184. *Units in a unit trust.* Provisions should be enacted to prevent the restriction of rights attached to units in a unit trust when the unitholder becomes bankrupt. [**para 837**] The provisions would correspond to those recommended in relation to shares.

185. *Discretionary trusts.* A trustee will not have the right to make a claim in respect of an expectation the bankrupt may have to distributions from a discretionary trust.

186. *Partnership — inspection of books and records.* A trustee in bankruptcy will have an express power to inspect books and records of a partnership of which the bankrupt was a partner and to obtain an account of the financial position of the partnership business. [**para 844, s PR3, PR4**]

187. *Partnership — winding up.* A trustee of a bankrupt will not have any special right to wind up a partnership of which the bankrupt is or was a member. [**para 846**]

188. *Financial resources — application of capital sum.* There will be no provision additional to the existing law to enable the court to have regard to the financial resources available to, although outside the legal control of, the bankrupt and order the application of a capital sum out of those resources by either the bankrupt or a third party for the benefit of creditors. [**para 852**]

189. *Seizure of property.* There should be a provision to facilitate the seizure and delivery into the custody of the trustee in bankruptcy of any property to which the trustee may have a claim under Division 4A of Part VI of the Bankruptcy Act. [**para 853**]

190. *Pooling of assets in the winding up of related companies.* There should be a provision to enable the court to disregard the separate entities of related companies in certain circumstances so that the companies can be wound up together as if they were the one company. [**para 857, s PR9**]

Exempt property

191. *Property held on trust.* Property held on trust will be removed as a category of exempt property in Bankruptcy Act s 116 and a provision enacted to the effect that property of a bankrupt includes property held by the bankrupt as a trustee so far as the bankrupt is beneficially entitled to the property. [**para 870**]

192. *Clothing and household effects.* The exemption for domestic property covers clothes and household effects necessary for satisfying reasonable domestic needs. A list of categories of exempt household effects will be published. The list would not be exclusive: it would be open to a bankrupt in a particular case to apply to the court for an order that items of property not included in the list are necessary for satisfying reasonable domestic needs. A creditor may apply for an order that property not be retained by the bankrupt as household effects even though the property is included in a published list of categories. This would remove the incentive for a bankrupt to buy expensive items prior to bankruptcy. Creditors would also be able to permit the debtor to retain other household property not included in the list of items specifically exempted. [**para 874, s PR5**]

193. *Tools and equipment.*

- The present exemption for tools, equipment and other like property having an aggregate value up to a prescribed monetary limit will be retained although the limit should be raised.
- The bankrupt will have a right to choose, within the prescribed monetary limit, the tools and equipment used by the bankrupt in a trade, occupation or profession from which he or she derives (or is expected to derive) income, which are to be exempt. [**para 880**]

194. *Transport.* The exemption for a motor vehicle the value of which does not exceed $2 500 or such greater amount as the creditors determine will be retained. [**para 881**]

195. *Life assurance and other like policies.* No change to the current exemption is recommended. [**para 883**]

196. *Damages.* Damages and compensation for personal injury and similar claims will remain exempt. [**para 887**]

197. *Restraint on anticipation.* Most States have abolished the protective doctrine of property law whereby a married woman could be given property subject to a restraint on her transferring it or the income from it. The policy on which it is based is no longer socially relevant. Consequently, this category of exempt property should be removed from the Bankruptcy Act. [**para 889**]

198. *Rural assistance grants.* No change to the current exemption is recommended. [**para 890**]

199. *Meaning of 'income'.* 'Income' should be defined as 'the proceeds from personal earnings either in a profession or business or from wages or salary', but that definition should be subject to the current exclusion of pension entitlements from the operation of the provision. [**para 895, s PR6**] That exclusion would have the effect that, not only are the entitlements not available to creditors, but they could not be made available by order of the court.

200. *Tax refunds.* The present law, whereby tax refunds are characterised as income and thus subject to s 131 of the Bankruptcy Act, will remain unchanged. [**para 898**]

201. *Contributions from income.* The factors which the court may take into account when making an order for contribution from income should be made explicit. The court should have regard (among other factors) to

- what appears to be necessary for meeting the reasonable domestic needs of the bankrupt and the bankrupt's dependants
- the occupation of the bankrupt and what appears to be reasonably necessary to maintain the earning capacity of the bankrupt in that occupation and

- the property and financial resources (including income from that property and those resources) available to the bankrupt or to a dependant of the bankrupt including the income, property and financial resources of a company, trust estate or partnership from which the needs or expenses of the bankrupt might be reasonably capable of being met in whole or in part. [**para 901, s PR6**]

202. *Relationship between contribution from income and discharge.* An order for contribution from income should continue notwithstanding discharge. However, so that a bankrupt is not put in a worse position than under the present law

- the order may not be able to continue for more than 5 years and
- an order may not be able to be made after discharge has taken place. [**para 903, s PR6**]

203. *Debts payment plan.* As an alternative to the continuation of an order for contribution of income notwithstanding discharge, Bankruptcy Act s 73 and 74 should be amended to enable a bankrupt to enter a debts payment plan as a prelude to annulment of the bankruptcy by the court on the filing of a plan approved by creditors. If this is done, the definition of 'insolvent under administration' under the companies legislation should not include a bankrupt who has entered into a debts payment plan. [**para 904**]

204. *Income contribution agreements.* Provision is needed for income contribution agreements between bankrupts and their trustees in bankruptcy. [**para 907, s PR6**] An agreement will have the following features.

- It is filed with the Registrar in Bankruptcy and have effect as if an order of the court for contributions from income had been made.
- As in the case of a court order, the agreement has effect notwithstanding discharge, but does not have effect after five years from the commencement of the bankruptcy.
- It includes a statement setting out the income and expenses of the bankrupt so as to indicate whether it is reasonable for the bankrupt to make the arrangement.
- It includes a certificate signed by a legal practitioner that the bankrupt was given advice about the effect of the agreement.
- It can be varied by agreement between the bankrupt and the trustee.
- It can be varied or terminated by the court on application by the bankrupt or the trustee.

205. *Time within which property should be realised.* The trustee in bankruptcy should only be able to make a claim to property of the bankrupt within six years of the date of discharge rather than 20 years from the day on which the person became bankrupt as at present. [**para 908, s PR7**]

206. *Rule in ex parte James.* The rule in *ex parte James*, under which the court does not permit trustees in bankruptcy or liquidators in court windings up, as officers of the court, to retain money paid under a mistake of law if the estate would be unjustly enriched, should be abolished. [**para 911, s M1**] The fact that courts of equity considered it necessary to formulate the rule points to the need for a wider review of the law as to the consequences of mistakes of fact and mistakes of law.

207. *Residence of the bankrupt.* A provision for postponement of sale of the family home is needed. The recommended provision has the following features.

- *Time of postponement.* Unless special circumstances can be shown, there is no entitlement to obtain possession and complete a sale of a residence prior to the expiration of six months after the commencement of the bankruptcy. The trustee is not, however, precluded from applying for the appointment of a trustee for sale, even though the sale itself cannot take place within the six month period.
- *Relevant persons.* The postponement operates if the home is occupied by any one of the following dependants of the bankrupt (either with or without the bankrupt): the spouse or de facto spouse of the bankrupt, the former spouse or de facto spouse of the bankrupt, a child of the bankrupt or a parent of the bankrupt or of the spouse of the bankrupt.
- *Altering the period of postponement.*
  - The trustee may apply for an order that the statutory period of postponement be reduced.
  - The bankrupt may apply for an order that the statutory period of postponement be extended. [**para 920, s PR8**]

Insolvency practitioners [chapter 18]

208. *Existing registration schemes.* The administration of the affairs of an insolvent individual or company requires involvement of a person who is suitably qualified, experienced, independent and trustworthy to perform the administration. At present, there are two parallel systems for the registration of persons who are permitted to administer an insolvency.

- *Administration of a bankrupt estate.* In the case of a bankrupt individual, the estate may be administered by the Official Trustee or a registered trustee. The Official Trustee is a government official. Registered trustees

are from the private sector. Most bankruptcies are administered by the Official Trustee, although a registered trustee is equally eligible for appointment either by the court or by the creditor. A person who seeks to become a registered trustee must apply to the Federal Court and if successful enter into a bond of $100 000. The Federal Court is empowered to suspend or cancel the registration of a trustee on the application of the Registrar.

- *Administration of insolvent companies.* The administration of the affairs of an insolvent company is confined to private administrators. To be eligible to act as the liquidator of a company, the official manager of a company, the trustee or manager of the scheme of arrangement or the receiver of a company, a person must be registered as a liquidator. To administer the affairs of a company which is being wound up by order of a court, the registered liquidator must, additionally, be appointed or registered as an official liquidator. The registration of liquidators is controlled by each State CAC, as the delegate of the NCSC. An applicant that becomes registered must lodge a security of $50 000 with the CAC. The power to cancel or suspend registration is exercised by the Companies Auditors and Liquidators Disciplinary Board of each State and Territory.

209. *Shortcomings of the existing regulatory system.*

- The dual registration systems of trustees and liquidators is wasteful and serves no practical purpose. Neither the functions to be performed in either capacity nor the qualifications required are so distinct as to require separate registration systems.

- The resources of the Federal Court should not be expended on maintaining such a registration system.

- Maintaining the registration system and supervising the conduct of liquidators is a burden on the CACs limited resources.

- The dual regulatory systems cannot provide the necessary prompt response to complaints against liquidators or trustees nor the process for their determination.

- The existing regulatory system does not cover important matters such as the determination and review of remuneration scales and the setting of appropriate rules governing professional conduct and ethics.

210. *The need for regulation.* An insolvency practitioner is above all else a trustee of whom the highest standard of honesty, competence, skill and diligence is required. A regulatory system for insolvency practitioners is needed to maintain appropriate standards and protect persons who may be affected by a departure from those standards.

211. *A new regulatory scheme.* A new regulatory scheme for insolvency practitioners should be introduced. The scheme would operate at two levels, first by the creation of a statutory board and secondly through an enhanced role for the professional associations.

- *Statutory board.* All the powers and functions for the registration and regulation of insolvency practitioners should be vested in a statutory board. The board should be jointly funded by the IPAA, ICAA, ASA (from a statutory interest account) and the government. Its membership should consist of seven persons appointed by the Attorney-General
  - three registered insolvency practitioners chosen from persons nominated by the IPAA, ICAA and ASA
  - a nominee of the Attorney-General
  - two lay persons who are not registered insolvency practitioners
  - one legal practitioner chosen from persons nominated by the Law Council of Australia.

  Members of the board should be appointed for three years.
- *Functions of the board.* These would include
  - determining appropriate standards for registration and classification of insolvency practitioners
  - classifying insolvency practitioners according to their experience, knowledge and ability
  - administering a fidelity fund
  - arranging for the audit of administrations conducted by insolvency practitioners
  - acting upon complaints received against insolvency practitioners
  - overseeing standards of ethical and professional conduct
  - delegating responsibility for certain functions to the professional bodies
  - issuing annual practising certificates
  - setting relevant rates of remuneration.
- *The professional bodies.* The professional bodies would exercise powers delegated by the statutory board. These could include
  - conducting the registration system for insolvency practitioners
  - conducting continuing education courses and
  - conducting investigations into complaints concerning insolvency practitioners and reporting to the board. [**para 940–1**]

212. *Classification of insolvency practitioners.* The present registration system which classifies insolvency practitioners as registered trustees, liquidators and official liquidators should be abolished. In its place the following registration system should be implemented and insolvency practitioners should seek registration in one of the following categories.

- Class A: This category of practitioner would be eligible for nomination or appointment to all insolvency administrations but practitioners in this category would be the only persons eligible for appointment in insolvent windings up ordered by the court and administrations under the recommended new voluntary administration procedure.
- Class B: This category of practitioner would be excluded from undertaking the two specific types of administration mentioned under Class A but would otherwise be eligible for nomination or appointment in all other administrations, such as bankruptcies, receiverships and Part X administrations.
- Class C: This category of practitioner would only be able to administer a members' voluntary winding up where there is no element of insolvency, and a debts payment plan. [**para 945**]

Persons, other than accountants, would be eligible for appointment as insolvency practitioners.

213. *Remuneration.* As noted above, the statutory board would have exclusive power to determine remuneration scales. In relation to particular administrations the following scheme should apply for approving remuneration.

- Approval of a practitioner's remuneration should first be sought from the committee of inspection or a meeting of creditors. If this is impractical or approval has been refused, application may be made for the approval of the court.
- Approval of remuneration at a meeting of creditors should be by an ordinary resolution (majority in number and value).
- Remuneration may not be approved without full details of how it is calculated being given to creditors seven days before the meeting seeking their approval.
- A creditor or the insolvency practitioner may ask the court to review their remuneration approved by a committee of inspection or a meeting of creditors. [**para 951**]

214. *Debt plan agents.* A person wishing to administer a debts payment plan should be registered as a debt plan agent. The registration of debt plan agents should be the responsibility of the statutory board. [**para 957**]

Cross-frontier insolvency [chapter 19]

215. *The issues.* The administration of an insolvency will generally originate and be wholly conducted in the place of domicile of the insolvent. The law of that place will govern the conduct of the administration. In most cases it may be expected that all of the property of the insolvent will be located in that place. If, however, some property of the insolvent is located in a jurisdiction other than the one in which the insolvency administration originates, issues may arise in relation to the right of the insolvency administrator to protect and control the property. The existence of any form of property out of the jurisdiction can cause difficulties and prejudice the administration, particularly where the insolvent attempts to deal with the property or where creditors seek to enforce remedies against the property. The aim of insolvency law in this context should be to avoid the cost and inefficiency of two or more competing administrations and to promote an administration that approaches the ideal of a single insolvency administration in which the claims of all creditors are marshalled and all the property of the insolvent, wherever situated, is dealt with and distributed by the one administrator. Where there is similarity between the insolvency law of the place in which the insolvency administration originates and that of the place in which the administration is sought to be enforced, the most suitable solution would be a system of full recognition and enforcement which promotes the ideal of unity. However, if the laws in the two or more relevant jurisdictions are different other issues arise.

216. *Domestic cross-frontier insolvency.*

- *Bankruptcy Act.* The Bankruptcy Act applies throughout Australia and its provisions enable the property of the bankrupt to be dealt with no matter where it is situated. No changes to the Bankruptcy Act in this regard appear to be required. However it is preferable for the Bankruptcy Act to apply throughout the external territories which it does not do at present.

- *Companies legislation.* The present companies legislation, under which insolvent companies are administered, is not a national law. However, there are reciprocal provisions which enable the compulsory winding up, for example, of a company which has originated in a particular State or Territory to be recognised and enforced in another State or Territory. Were it not for such provisions there would be separate and possibly competing insolvency administrations in relation to the same company with resulting waste and inefficiency. The present system is not ideal: it is complicated and causes administrative inconvenience and additional costs. The present provisions (companies legislation s 465–468) should be repealed and provision made for the automatic recognition of a winding up in insolvency or a voluntary administration initiated under the corresponding law of a participating State or Territory as though that winding up or administration had been initiated under the legislation of the relevant State or Territory. [**para 966, s CF1**]

217. *International cross-frontier insolvency.* In seeking to resolve difficulties of international cross-frontier insolvency, Australia should actively promote multilateral international treaties with respect to

- the adoption of common basic elements of insolvency laws and
- the recognition of insolvency laws between nations.

Furthermore, Australia's insolvency law should contain provisions which facilitate the recognition of foreign insolvency administrations. These provisions should

- require the court to give aid to the administrator of a foreign insolvency initiated in prescribed countries which should include the English common law countries
- permit the court to give aid to the administrator of a foreign insolvency initiated in a country other than a prescribed country
- give the court a broad discretion as to the aid which is most appropriate in all the circumstances and
- specify the criteria to which the court will have regard when determining whether to grant aid to the administrator of a foreign insolvency initiated in a country other than a prescribed country. [**para 975, s CF2**]