# CORPORATE INSOLVENCY - PROPOSALS FOR REFORM

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I come to this task with the firm view that the law should not be monkeyed with except for good reason. Legislators, as well as judges could recall the wisdom of Lord Eldon, "It is better the law should be certain than that every judge should speculate upon improvements in it". Sheddon v. Goodrich (1803) 8 Ves 481.

The proposals for insolvency reform include a different approach to director's liability, changes to the receivership provisions, changes to the preference provisions (given a quaintly new name antecedent transactions) - proposals for insolvent trustees and to the matters Mr Harmer has spoken on this afternoon a suggestion for a new form of voluntary administration of an insolvent company. We have had so many changes to the Companies Code recently that one's first impression is "not again".

Any reform must achieve an improvement, not just a change. "Update", "reform", "modernisation", "review" are all words used in association with law reform but the only touchstone to my mind is improvement. Reform is the amendment of some faulty state of things; a change for the better; to correct into another and better form: (Oxford Shorter Dictionary). Unless the law therefore is better after the reform than before it then all that has been achieved is to shuffle the pack. It is very easy to under-estimate the expense and inconvenience to the community inherent in any change in the law. the significant effort and money the community puts into its legal system is wasted if there is change without improvement - and I would venture to suggest a significant improvement is necessary to justify the significant cost. Legislators do not always appreciate many of the little things involved in even a procedural reform. Computers have to be reprogrammed, stationery re-formatted, procedure manuals rewritten, staff retrained, all at a quite significant and hidden cost. These expenses and inconveniences and uncertainties need to be stacked on the debit side when assessing the benefit of any reform.

There is great benefit and savings in the law being constant and certain and predictable. In corporate planning most businessmen would much rather know "you certainly cannot do that" than to be told "you possibly can do that -the law is unclear".

Society is sick of paying for unproductive and unwanted words. The professions are sick of spending precious time reading mountains of submissions that correct no faulty state of affairs, and do not convert an existing state of affairs into another and better form.

One need only look at the volume of changes to our Companies Code in the last six years to see that change alone achieves nothing. In this so called deregulated environment our companies legislation has changed more in the last six years than the previous 100 years. It has more than doubled in terms of its volume in the last six years. (Largely because of the draftsman's habit of saying things twice - see for example section 61.) It is in my estimation three times as voluminous as the companies securities legislation in the United States of America and four times as voluminous as Switzerland. It is twice as voluminous as it was in 1981.

The plain facts of the matter are that we are not twice as well governed in a corporate sense than we were in 1981; we are not four times as well governed as the Swiss nor three times as well controlled as the Americans. Activity does not therefore equate directly into reform and I would respectfully suggest that this present amendment is more of the same. It is volume and change for changes sake and does not meet the touchstone of improving and producing a better system. It simply shuffles the pack.

We do not need any more tired ideas dressed up as reform. If we cannot have solutions to the problems which are set to confront us then we are better staying with our present problems. If we cannot produce original solutions then I suggest the legislators leave well enough alone. I am aware that expressing that sentiment before a law reform commission is akin to calling the man from Snowy River a poofter but facts have to be faced.

It seems our companies legislation is constantly under change and expansion. Hardly a year goes by without another major change and I believe it is time for our legislators to pause and ask the question - are these changes which are expensive in money and time justified.

**Abortion**

There is of course one reform that would find considerable support and that is complete abolition. There is [precedent for it in Arkansas where Act No. 17 of 1945 titled innocuously "An Act to Authorise and Permit Cities of First and Second Class and Incorporated Towns to Vacate Public Streets and Alleys in the Public Interest" contained in section 7 the proviso "all laws and parts of laws, and particularly Act 311 of the Acts of 1941, are hereby repealed".

You will note that the phrase "all laws and parts of laws" is not limited by some half-hearted qualification such as inconsistent

with this Act. They come straight out and do it. "All laws and parts of laws ... are hereby repealed". This gem of law reform- quaintly called the Omnibus Repealer came on appeal from the Hot Springs Court before the Arkansas Supreme Court in 1968 on April Fool's Day (which gives you your first clue) when Justice George Rosesmith delivered himself of a humble yet pointed judgment on the construction of the omnibus repealer. After considering the various canons of statutory construction, he felt it his duty to interpret the will of the legislature where it was so clearly expressed, without any regard to the consequences. He excluded from that construction judge made law - the common law, but felt bound to construe the legislation so as to repeal all statutory law (which he remarked in passing was not as essential as common law) and when the chaos that may follow was drawn to his attention he remarked with composure "we dare say however that the general public can and will face that catastrophe with that serene equanimity borne of courage ... we need not extend this opinion by discussing one by one the various bug bears envisaged by counsel's vivid imagination. The truth is that in nearly every instance the purposes served by the Omnibus Repealer are praise worthy and beneficient. We are calling the Act to the attention of the commissioners on uniform laws, who may well be inclined to make similar model legislation available to all the States."

Some of his fellow judges were not similarly impressed with the reform inherent in repeal. John A Fogelman is reported to have said simply, "I dissent because I disagree".

**The Voluntary Administration of an Insolvent Company**

You have heard described the changes envisaged by the 36 odd sections. The regime envisaged bears a striking resemblance to the existing, and unproductive system of Official Management. The existing system of Official Management is remarkable if only for the fact it is almost completely unused. It is said it is unused because of the restrictions that there would be a reasonable probability that the company would be able to pay its debts (see section 347(3)).

Companies in financial difficulty in the main fall into two categories:

The vast majority are insolvent small businesses - husband and wife or a two man business and they are generally going to a richly deserved and well overdue end. In these cases winding up is a cheap and inevitable solution and to give them the opportunity, or to impose upon them this form of voluntary administration is going to do no more than divert their last few thousand from their creditors to the administrator who will make a report. Even in these companies - and I think I am correct in saying they would account for 80% or 90% of the companies presently being wound up - there is often no money to pay the liquidator so there is often likely to be insufficient money for

any scheme of rehabilitation to work, there must be a system for calling out these companies.

The second category of companies are those that carried on a larger operation and have given security to their bankers. Mr Fox has discussed the proposals in the legislation for dealing with secured creditors and it is sufficient I think for me to point out that the effect of the giving of a mortgage debenture - be it a fixed or a floating charge - is to assign in equity the title to the mortgaged property to the mortgagee. That is why a mortgagee in an insolvency situation does not need the leave of the court to realise his property even though it be after the commencement of the winding up and that is why the proposals as set out in proposed section VA30 are in my view doomed to the same ignominious neglect as the present Official Management provisions. The proposal is that the secured creditors' property is not bound by the scheme but the company may apply to the court if it believes that the secured creditors' intentions to take possession would "materially prejudice the purpose and object of the deed" and the court on the application after having regard to the conduct of the parties, the proposals by the company for the continued performance of the agreement (presumably payment in full) and "any prejudice likely to be suffered by the company and its creditors" can make an order that "in the circumstances are just".

Given the fact that the equitable title to the property the subject of a mortgage debenture belongs to the mortgagee, it is hardly realistic to expect a court to make an order that is "just" if it expropriates the mortgagee's property. Assuming for the moment the Commonwealth can make laws that achieve this expropriation in view of section 51(xxxi) (and if it cannot any Commonwealth effort would appear to be invalid) it is simply not realistic to expect a court in all but the most extreme cases will tell a secured creditor he cannot have his property until he allows the defaulting borrower time and indulgence.

One should not lose sight of the fact that the creditor's right if he proves insolvency is a right ex debito justitiae (Western & Canada Oil (1873) 17 EQ.1). That is a creditor has a right to have the affairs of the company wound up. The company's wish to survive, or be given time to restructure, must be equated with the creditor's right to have his contract fulfilled without interference.

Often the insolvency courts are painted as the slaughter house of young virile businessmen; all they need is 28 days moratorium and 28 days with a certified public accountant and all is cured. I would respectfully suggest that this is simply naive. 90% of those companies are heading for a richly deserved overdue demise and to impose a moratorium is just delaying the inevitable.

**Group Administration**

There is one area however amongst the mass of insolvencies where there is need for reform and that has been neglected - probably because it is impossible. We must take into account the changing face of insolvency. One of the consequences of deregulated banking is that most trading activities now have a number of banks. In days gone by a company had one credit supplier (be it a trustee for debenture holders or a bank or a finance house), and there was a straight head to head competition between the secured creditor and the unsecured multitudes. There is propensity for companies (particularly in their declining fortunes) to borrow from a variety of sources and therefore the matrix one confronts in an insolvency is often that of a great number of companies borrowing secured from a variety of lenders and with a bunch of unsecureds. The Bartlett Group of Companies is a case in point where there is said to be in excess of 100 companies, and in excess of $100 million owed to secured creditors whose number exceeds 15 or 20. There is a great need for an overall regime in these circumstances so that the whole of the assets can be dealt with in an orderly and logical way for the benefit of all of the combatants. In these types of situations each secured creditor can look only to his security and there is no co-operation between the various entities. Reform could well be directed in this area where there is a fertile field for saving those very few unfortunates who are both deserving and capable of rescue, resuscitation, rehabilitation or whatever other noble words you want to apply.

I would respectfully suggest that to impose the scheme on the masses for the benefit of the few is unproductive and unwieldy and unlikely to succeed. This form of court appointed receiver is much more likely to be productive and welcomed and less likely to be abused.

**Directors or Shareholders**

It is indicated the scheme of administration is initiated by the directors not the shareholders, and I question if that is intended. Generally the right to manage is with directors but the right to wind up and conclude a business is a right of the shareholders.

**Judge's Reform**

Quite often legislators misunderstand and under-estimate the ability of the courts to cope quite adequately with the changing position of public opinion. Legislators, and their advisors believe that the Parliament is the only source of change. That is simply not so. History shows the courts are far more successful in interpreting the law to represent public opinion than legislators and by far the better approach is to leave well enough alone unless the Parliament is proposing a significant change.

It is sometimes suggested that legislation should follow on after court interpretations (for example the article "The Meaning of Valuable Consideration" in 61 ALJ 105 following Barton v. The Official Receiver 60 ALJR 556). This is simply not necessary. The author of the article "The Meaning of Valuable Consideration" was probably the only person who did not know that in a commercial document the words were given a commercial meaning and the High Court in Barton's case was doing nothing remarkable let alone something sufficiently remarkable to justify the time of the Parliament.

The point is that judges are much better able and equipped to interpret and perceive the law than the Parliament will ever be.

**Effectiveness**

There remains one final observation and that is law reform is a waste of money and time if it is not effective. The proposals here in this voluntary administrator scheme do not appear to me likely to be accepted. One is reminded of the words of Mr Justice Higgins in Brett v. Barr-Smith (1919) 26 CLR 97 where he said:

> "The case of Elders v. Dennis ... (is) ... one of the many demonstrations that the man who needs money, even if aided by the parliamentary draftsman, is no match for the man who has money with his skilled conveyancer".

If the secured creditor cannot be appropriated without expense and fuss then the scheme is not going to work in any significant number of cases. If we cannot produce effective change we should leave well enough alone.