INSOLVENCY LAW REFORM - MAJOR ISSUES

JUSTIFICATION FOR THE INTERFERENCE IN THE RIGHTS OF SECURED CREDITORS

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Thank you Robert and good afternoon ladies and gentlemen.

I appeared before you once before at Manly, as I recall in 1987. A number of things have occurred since that time. Two things that are relevant to what I am about this afternoon are first, that at that time the inquiry into the insolvency laws of this country was in its formative stage. Since then of course the Report has been completed. It was tabled in the Federal Parliament in December of last year. It has recently been the subject of attention of the select committee that was established to try and work out the Corporations Bill. In the Report of that select committee it has recommended that the recommendations contained in the Report receive early attention for their possible implementation into what it appears we are all going to have, namely a Commonwealth Corporations Act.

The second thing that I would observe going back to Manly in 1987 was that at that Conference I was for the first time in my life accused of being a socialist. It seems to me that that view of me has escalated somewhat in the subsequent passage of two years because I understand that I have now been unfavourably, or favourably, however you wish, compared with a former Prime Minister of this country, namely Ben Chifley, who was responsible largely for the introduction of the bank nationalisation in the 1940s. And I gather that some of you would wish that I might be deposited on a collective farm somewhere in or east of the Urals, and that I might spend the rest of my days there!

Collectivism is a major part or a major philosophy of insolvency law. It is the present traditional and contemporary role of insolvency law to provide a compulsory collective system. And I do not think there can be any argument - I have never heard a secured creditor argue - that all the unsecured creditors ought to be placed under that compulsory collective system. So they are not given the opportunity of creating wreck and havoc by each pursuing their individual remedies and rights and pulling apart what little property there might be available to seek to satisfy the debts that are due to them.

Now if you like to regard that as akin to socialism and communism let me remind you that that has been the traditional base of insolvency law for so many years now that it does not matter.

We are of course all aware that in the past that collective system has not, except in certain instances, intruded upon the rights of a person who holds a valid and subsisting security over the property of the insolvent. That person has been free to exercise default rights and move and do whatever he, she or it is entitled to do according to the contract of security. But insolvency law has come out, I believe, of its deep and dark recesses. It has come out into the light, at least in this country, in recent years and more recently in the past few months. And if you think of the type of collective wizardry that has been at work in such corporate collapses as Ariadne, International Harvester, Rothwells (and there are a few more in the boot of the car at the moment), you will appreciate that people have been actively pursuing, if possible, a policy of a collective approach to the problem. So that insolvency, given that it was for a long time akin to death with morticians and undertakers walking around in the stealth of the night, and people using whispered tones about petitions and receivers and things like that, (almost akin to being what the young child heard but never discovered that Auntie might have seen in the woodshed in the bottom of the garden), has come a long way over the last few years.

The view has emerged, in my opinion, that there is now a perceived more useful role for insolvency law to play. Putting it in its most basic form, it is that it can and it should seek to maximise the value of the pool of property for all the people who are affected by the lack of money to go around. And it is the submission of the Australian Law Reform Commission, (and I remind you of that, it is not just my submission - people talk about the Harmer Report - it is not my Report, it is the Report of the full Commission), that this is something that insolvency law not only can do, it is something that it should do.

If it is to attempt that role other than in a token sense, you have to have reform. You might say that this can occur by the voluntary will of many people, such as in the Ariadne collapse. There is no doubt that Ariadne was a tribute to the 32 banks that were involved in it - they all were caught because they did not have any security. And they all recognised, they all had the intelligence to recognise, that the only way of getting out of that mess was to agree amongst all of them that it would be "hands off" to see if there could be a work out of that failed company. Ariadne is going to work. It will be one of the best corporate rescues that this country has even known. It simply goes to show that it is not impossible for institutions such as banks to see and perceive an intelligent approach instead of each going their different way and tugging here and pulling there.

If you leave people unconstrained and you want to endeavour to maximise the pool of property, there will always be the maverick. The maverick may have to be settled down and constrained by appropriate legislation. And that is why the Commission says that a reform in the law is necessary and that its fundamental purpose ought to be to provide, for a short period of time, a compulsory moratorium on all people having an interest in that pool of property.

Now that is controversial. I would not be here unless it was otherwise. It is controversial and therefore I perfectly accept that the banking community may have a fear as to what the result of that will be. But before you start pronouncing that fear I would strongly suggest that you read the Report and in particular the legislative proposals (which are designed to encourage the government, if they are to implement, to the appropriate form of the legislation) and try and understand the way in which we have bent our back to providing secured creditors with adequate protection.

Professor O'Donovan in his paper has outlined the nature of the restraints and the exceptions to them. It is not a case of the Commission saying to the government - look, put all of these people under a curtain or a hold for 28 days or whatever it might be, and do not let them do anything. If you want a comparison - and comparisons are sometimes odious - there is legislation fresh out of our Tasman neighbour, New Zealand. I am glad that I have it here because I think the person who accused me of being a socialist at the Manly Conference came from that country. I want to refer to what they have done just recently in their Act dealing with the appointment of a statutory manager.

The Securities Commission, which I suppose is the equivalent of that body of ours known as the NCSC, can recommend that any corporation be placed under statutory management and appoint a person to be the statutory manager. Of course it is glossed over. You go through the Minister and the Minister goes to the Governor-General and so forth. But the person who makes the recommendation and who has the carriage of it is the regulatory authority. And one of the bases upon which that can be done is because it is in the opinion of the Securities Commission that it is desirable - they are the words in the statute - because it will enable the affairs of the corporation to be dealt with in a more orderly or expeditious way. So far we do not have a great deal of quarrel between some of our recommendations and that concept, but let me go to s.42. The effect of this appointment is that it is forbidden of any person to foreclose, enter into possession, sell, appoint a receiver of the property of that corporation; it is forbidden for anybody to claim pursuant to any retention of title clause, hire purchase agreement, mortgage, lease, security, any property in the possession of the corporation; it is forbidden to determine or forfeit any tenancy and so forth, or indeed to exercise any right against that corporation.

There are no exceptions to that type of prohibition. None whatsoever. And that is why I say read the proposed legislation and look at the exceptions that we have provided. We have provided that if a receiver is first appointed then, except in exceptional circumstances that will have to be determined by a court and not by some government regulatory authority, that appointment will stay in place. We have provided exceptions so that, for example, when a company is placed under administration and the moratorium takes effect nonetheless there can in a number of circumstances still be sale of property subject to a security. I could go on with those but as I say they are pointed out in Professor O'Donovan's paper.

Then we go on to the powers of the statutory manager under this statute that has come out of New Zealand - s.51. The statutory manager is entitled to sell any property notwithstanding the existence of any security over it. We have not provided for that except, again, in exceptional circumstances where application must be made to a court. So again we are being protective of the rights of those creditors. We do not permit the administrator to go straight off and sell property.

And now we come to the "pearl". This is in s.61 of the New Zealand legislation. So if you are apprehensive of what we are proposing, just understand this by way of a possible alternative. It is, that when a corporation has had a statutory manager appointed to it and it is already in receivership, the receivership shall cease and the person appointed as receiver shall be discharged! As I say comparisons are not always the most valuable way of determining the absolute quality of anything but it may help I think for you to appreciate that our recommendations by comparison are positively mild. In fact when I read that I thought we really had not been strong enough.

The other point I think you need to understand is that there is nothing in the recommendations of the Commission which transposes rights of distribution or takes away essential rights and property. We do not re-write what is the position vis-a-vis various people in terms of their security. We keep intact, in the main, all of those rights. But if you respected each and every right, including the right to exercise full rights on default, then you might as well give up the attempt to bring about a situation where in a given case there can be a maximisation of the pool of property for the benefit of all concerned.

Now Professor O'Donovan, I think it is almost in the last sentence of his paper, takes the pessimistic view. He says, well look, it is all very well to have these wonderful principles and these grand ideals, but in the end all that you will probably do is to delay the process whereby the employees get paid, there is a handout to the Commissioner of Taxation, and the rest goes to the secured creditor. Well that might be the case in many instances, but on the other hand it might be the reverse in a

number of other instances. Because you have to understand that within the same context we are trying to encourage the corporate managers that we are saddled with in this country to wake up to some of their responsibilities and as soon as they realise that their particular vehicle is headed for a big drop over a cliff, to try and do something about it. It is for that reason that we have deliberately attempted to avoid putting too much in the way of that being effected. We want those people to be able to exercise their power to put a company in the hands of an independent administrator. We want to, in part, encourage them to do that in the knowledge that over a short period of time that administrator will be able in a period of relative calm and peace to try and work out what is best for that corporation. If it has got to be put over the cliff, then the secured creditors are not going to be affected thereafter. But if there is a prospect that if everybody stays together, if the pool of property is kept together that it can be realised at a greater value in that state than otherwise, then I really do not understand the concern that there is.

Of course there are some particular provisions which are going to affect the holder of a security over property of the company. Those are in part dealt with in the latter part of my paper. Professor O'Donovan has touched upon them more considerably in his. I have been told to stop, and I will.