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Report No. 2 of the Insolvency Working Group, on voidable transactions, Ponzi schemes and other corporate insolvency matters (the Report)

Introduction
Matters to be addressed:

- Voidable transactions.
- Secured creditors and reckless trading.
- Aspects of the 7th Schedule priorities.

Chapter 1: Voidable transactions
At paragraph 61 the Report asserts that it is detrimental for the voidable regime to discourage effective credit control which the elements of s296(3) of the Companies Act 1993 (the Act) tend to do. What is not said is that it discourages retrospective credit control – the collection of debt – rather than prospective credit control – not allowing the debt to arise in the first place. The second is self-evidently better than the first.

If the regime promotes advance credit assessment – and provided the wherewithal to do it effectively – then that should be the most desired outcome as the diligent credit controller would assist in preventing delinquency through insolvency in the first instance.

The truth of the matter is that the s296(3)(b) is a very low threshold test. It merely requires a suspicion of insolvency. It does not require the unfairly preferred creditor to know of solvency or otherwise. More clarity could be introduced as to the meaning – e.g. breach of credit terms is clear evidence of insolvency. Again, such a measure would promote effective prospective credit control.

It is certainly true that the various decisions made in *Allied Concrete* and *Timberworld*have emboldened creditors, or more particularly, their legal advisers to resist irrespective of the merits of their position[1]. The law with respect to spurious defence needs to be tightened to make it clear that failure will result in solicitor / client costs being paid.

The Report suggests that s296(3)(c) be amended to leave the 'altered position' defence as the sole principle albeit, it would seem, that the burden of proof would lie on the creditor. There are two problems with that proposal. First, any canny creditor would ensure that they had altered their position in anticipation. Second, it is frequently difficult to know what it might mean. For example, a sum of money reducing an overdraft is clearly altering a position. But what happens if that sum mitigated the need for an overdraft in the first place?

[1]Within the past year I have had a unfairly preferred creditor assert that they had no suspicion of insolvency even though they had issued statutory demand.

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Conclusion

I disagree with the repeal of the 'gave value' part of s296(3)(c) if it means the voidable period is reduced.

I recommend that there be some sort of provision to punish unfairly preferred creditors and their lawyers when they engage in the stratagems of inertia.

Chapter 2: other voidable matters

Part E suggests that the limitation period be truncated. I disagree for two reasons:

- Whilst the time period seems excessive it is the case that the unfairly preferred creditor has had the use of moneys he or should not have had for that extended period and thereby has the benefit of the time value of money.
- Through no fault of the liquidator inertia in the system can mean that there is extended delay.

Within the last five years I have had occasion to be appointed liquidator by a predecessor who had been appointed years before but could get no traction in the liquidation due to obstruction by the relevant director with respect to records. I had some records but by no means all. I attempted to use statutory discovery powers to augment the records only to be frustrated by the unfairly preferred creditors. In other words, the various discovery matters took years to resolve. Three years would have allowed those creditors who blocked to escape.

Part G: the continuing business relationship rule

I think the rule should be retained but clarified by making it clear that the start point is the peak indebtedness position as prevails in Australia.

Certainly, making the start point the point of insolvency will lead to endless debate as to when that happened. Though the Report does not say so I assume that would mean what is sometimes referred to the liquidity test as set out in s292 rather than the more definitive s4 test. If so, the liquidity test is extremely difficult to determine with complete accuracy and requires significant work by the liquidator, something the Report elsewhere seems to want to avoid.

Conclusion

I disagree with:

- The truncation of the voidable period to six months.
- Change in the limitation period.

I recommend that the 'peak indebtedness' rule is enshrined in statute.

Chapter 3: Procedural issues

Part A

The idea that the basis to a voidable claim should be standardised is to fail to take account of the fact that there are an infinite number of potential scenarios to which a standardised requirement would inevitably fail, at some point, to accommodate. Surely, liquidators who are poorly prepared will ultimately fail and that is sanction enough.

Part E

Statutory financial limits invariably become outdated and not remedied. They should be avoided. There is a natural limitation arising due to the effort necessary to prove the voidable claim. I rarely attempt voidable claim for sums under $10,000 and, with the difficulties arising from judicial decisions, I am wary of that threshold.

Part F
If voidable moneys are to be ring-fenced then everything else should be treated similarly (collections of debtors, realisations of physical assets etc.) leading to a monumentally and (likely) spurious accounting imposition on the liquidator.

Conclusion
I disagree that:

- There should be standardised forms for voidable claims.
- That there should be a *de minimis* rule given that it arises naturally.
- Voidable moneys should be ring fenced and, if it thought that a valid principle, it should be extended to all realisation.

Chapter 5: other issues
Recommendation R18
I couldn't understand why it is recommended that secured creditors be excluded from receiving the proceeds of a reckless trading claim.

I do appreciate that secured creditors might have the right to lay claim – in the manner of a cuckoo – to moneys they did not help generate. I would have thought the law of unjust enrichment would militate against their success. Leaving that aside, I foresee huge difficulty.

First, why has reckless trading been singled out and not the other potential directorial breach claims around s135 (breach of good faith, entering unfulfillable conditions etc.)? They are of a similar ilk and should be encompassed.

Second, it is within the discretion of a secured creditor to abandon its security (s305 of the Act). Either that simple device could be employed to participate or an injustice will arise..

Third, sums awarded for claims of the character of directorial breach are usually defined by the loss. It would seem inequitable to me that the loss would include sums subject to a general security but the person holding that security is denied compensation. Alternatively, the loss would not be included in which case the amendment would be very 'debtor friendly' (see 4th point).

Fourth, the definition of creditor at s240 of the Act allows a secured creditor for the unsecured portion (which could be a pepper-corn) to invoke s301 of the Act themselves which might result in strange anomaly. Besides, I have always understood that a secured creditor, or a receiver acting as their agent, can make claim in accordance with the common law which lies parallel to the statutory provisions.

Sixth, in virtue of s254 of the Act secured creditors and unsecured creditors can make common cause in such matters and the proposal seems to me to drive a wedge between them.

I think this recommendation needs to be rethought.

Preferential claims
I don't have any particular views on preferential status. However, if the matter is to be looked at there are two issues with respect to the interaction of the 7th Schedule and the Customs and Excise Act 1996 that might be usefully addressed.

First, I thought the preferential regime was to compensate the Crown for the case where it is an involuntary creditor. Customs is not always involuntary when it operates its deferred duty scheme. It probably ought not be a preferential creditor in such circumstances.

Second, duty is defined to include additional duty. Additional duty behaves much like penalties and interest under the Tax Administration Act 1994 which does not qualify. Consistency might suggest that additional duty is treated similarly to penalties and interest.

With respect to submissions on the first report, in accordance with the Official Information Act 1982 please provide a copy of the analysis of submissions if any such document exists. If no such document exists, please tell me.

Yours faithfully