



ASIC

Australian Securities & Investments Commission

ASIC'S perspective of current insolvencies and the role of the insolvency practitioner

An address by Professor Berna Collier, Commissioner, ASIC to the Insolvency Practitioners Association of Australia (WA Division), 20 March 2002

Thank you for inviting me to speak today.

The topic of my presentation today is "ASIC's perspective of current insolvencies and the role of the insolvency practitioner." There are many issues I would like to address in this context. In view of time limitations however I will limit this presentation to the following topics:

1. A quick briefing on key insolvency-related cases in which we are currently involved;
2. Complaints;
3. The powers which we might use in an investigation;
4. Insolvency issues we anticipate arising for ASIC in the next twelve months;
and
5. Our interaction with the insolvency profession.

Current insolvency matters

ASIC investigates a large number of complaints, not only in relation to insolvency, but other matters which fall within our jurisdiction. I will turn shortly to complaints as

an issue. In the meantime I will mention a number of the major insolvency related matters we are currently monitoring.

HIH

As you are all aware, HIH, then Australia's second largest insurer, went into liquidation on 15 March 2001 with a deficiency of up to \$5.3 billion. A Royal Commission was established by letters patent on 29 August 2001 to inquire into the reasons for and the circumstances surrounding the failure of HIH.

ASIC has separate investigations into the collapse of HIH. On 14 March Santow J handed down his decision in ASIC's civil penalty action against former HIH Insurance Limited director Mr Rodney Adler, former HIH Chief Executive Officer Mr Ray Williams and former HIH Chief Financial Officer Mr Dominic Fodera. Santow J found that the three former directors had breached their duties as directors in relation to a payment of \$10 million by an HIH subsidiary (HIH Casualty and General Insurance Ltd) to Pacific Eagle Equities Pty Ltd, a trustee company of which Mr Adler was a director. ASIC has claimed banning orders, compensation and penalties against the defendants. The matter is next listed for mention on Thursday 21 March 2002.

In the meantime we are continuing to closely monitor the hearings of the Royal Commission and matters emerging from the hearings. Our investigations are continuing.

Harris Scarfe

The Adelaide-based retailing group Harris Scarfe (including Harris Scarfe Holdings Ltd and Harris Scarfe Ltd) entered voluntary administration on 3 April 2001. A major secured creditor, ANZ Bank, subsequently appointed Bruce Carter and John Spark of Ferrier Hodgson as receivers under its charge. The retailing business was sold and Michael Dwyer was appointed liquidator of the group on 3rd January 2002.

Charges have been laid against Alan Hodgson, the former Chief Financial Officer of Harris Scarfe Holdings Ltd and a director of Harris Scarfe Ltd. Mr Hodgson appeared

for the first time in the Adelaide Magistrates Court on 18 January 2002 on charges arising from our investigation. The charges relate to failing to act honestly as an officer, acting dishonestly as an employee and dissemination of false information to the ASX.

Our investigation of the group is continuing.

One.Tel

ASIC commenced a formal investigation of One.Tel on 30 May 2001, following the referral of certain matters from the Australian Stock Exchange, and the announcement by the Board of One.Tel that they had appointed administrators to the company. The company is now in liquidation under the administration of Mr Peter Walker of Ferrier Hodgson.

Three officers of One.Tel – former joint managing directors Messrs Jodee Rich and Bradley Keeling and former finance director Mr Mark Silbermann – and Mrs Maxine Rich, have provided consent undertakings in relation to disposal of assets, which remain in force until 17 June 2002 when the matter is next listed before the court.

On 12 December 2001, ASIC announced civil proceedings against Messrs Rich, Keeling and Silbermann, and former chairman Mr John Greaves. ASIC is seeking declarations of contraventions, bannings, and damages of between \$30 million and \$50 million in compensation for the reduction in One.Tel's value over an eight-week period from 30 March 2001 to 29 May 2001. This period reflects the period during which One.Tel continued to trade because of the alleged failure of the defendants to properly discharge their responsibilities.

Any compensation recoverable will be made available to the liquidator for payment to the creditors.

Air New Zealand / Ansett

There is no question that the collapse of Ansett has had serious repercussions in the Australia community – for the travelling public, employees, creditors and many other groups.

We have had an investigation into the collapse of Ansett since September last year. We are now looking at disclosures made by Air New Zealand in the dying days of Ansett.

We have established a special task force to look at issues including the identity of persons who suffered damage as a result of any failure by AIZ to keep the market informed.

Over the next month we will be advertising for people who have suffered loss during the last days of Ansett to come forward with information. We will be in a position by 31 May to decide whether we will take further action. Depending on the outcome of our inquiries, the public interest may be served by the commencement of a representative action for damages against AIZ in relation to the level of its financial disclosures. We are, however, reserving our rights in relation to any action we may take in this matter until all aspects of the investigation are concluded.

Farmer Furniture

This is an insolvent trading case involving a Western Australian company, Farmer Furniture Pty Ltd. The company was a private family company carrying on the business of manufacturing and retailing furniture in Western Australia. Farmer Furniture Pty Ltd ceased trading on 23 July 1997 when it went into voluntary administration. BankWest appointed a receiver and manager on 24 July 1997, and the company went into liquidation on 20 August 1997. In the liquidators, the unsecured creditors received nothing.

All directors of the company were committed to stand trial in the Supreme Court of Western Australia on charges of insolvent trading on 22 May 2001. The charges were laid after an investigation by ASIC and are being prosecuted by the Commonwealth DPP. ASIC alleged that the company traded while insolvent between 27 May and 7 July 1997. During that period Farmer Furniture incurred debts of more than one million dollars, including consumers who had paid deposits on furniture.

Complaints

Assessment

The amount of complaints ASIC receives, primarily relating to small to medium sized businesses, is steadily rising. Last year, the amount of complaints we received represented a 26% increase from the previous year. This meant 6,946 complaints in the 2000-2001 financial year. You can appreciate the significant impact this has on our workload and resources.

ASIC *assesses* every complaint it receives. However we cannot *investigate* every matter which is brought to our attention.

We have a dedicated unit – the National Complaints Program (“NCP”) – represented in each Regional Office which records and initially assesses each complaint. We aim to have each complaint assessed within 28 days of receipt, in order to determine whether the complaint identifies a contravention of a law for which ASIC has responsibility, and if it does, whether further action from us is justified. Last year we commenced 214 major investigations. We have sophisticated mechanisms to determine which matters are resourced, specifically key complaints assessment criteria against which we measure complaints. Even where, however, the ASIC officers judge that a matter does not satisfy the necessary criteria for enforcement action, the officers may nonetheless consider the matter warrants referral to another part of ASIC (for example, financial services or consumer protection) for further consideration.

Public Assistance

One of our strategies in dealing with complaints is public assistance. When we receive a complaint, options we have to resolve the matter expeditiously include a warning letter, contacting the offender with respect to compliance, providing information to complainants, and assisting aggrieved complainants in other ways to resolve small disputes. We have found that our assistance at an early stage of a complaint contributes to an effective regulatory outcome in more than 40% of cases.

Assistance to liquidators

We have had comments from insolvency practitioners concerning our approach to matters arising from the administration of an insolvency which they bring to our attention. First let me say that we treat all matters brought to our attention by practitioners seriously and as promptly as possible. For example – of the 366 matters brought to our attention by external administrators which were on our books in February, 80% were dealt with within 28 days.

ASIC had informed the profession that a review of our assistance to liquidators would be undertaken after June 2001. The review has been held up due to other work commitments but has now commenced under the supervision of NT Regional Commissioner Anthony Beven. We anticipate a report on this by mid-June 2002.

Finally in this context we are taking steps to improve our analysis of information supplied to us by external administrators as part of the EXAD project. I'll discuss this shortly in the context of our interaction with the insolvency profession.

The Powers we might use in an Investigation

In the course of discussing compulsive powers we might use in an investigation, I would like to consider three powers which are potentially of relevance in the course of an insolvency investigation, and also to mention circumstances where these powers can impact on the insolvency practitioner.

Section 30 notices to produce books

Section 30 *ASIC Act* provides

- (1) **[Body corporate]** ASIC may give to
- (a) a body corporate that is not an exempt public authority; or
 - (b) an eligible person in relation to such a body corporate ;
- a written notice requiring the production to a specified member or staff member, at a specified place and time, of specific books relating to affairs of the body.

Note : Failure to comply with a requirement made under this subsection is an offence (see section 63)

- (2) [**Registered scheme**] ASIC may give to :
- (a) the responsible entity of a registered scheme; or
 - (b) an eligible person in relation to the responsible entity;
- a written notice requiring the production to a specified member or staff member, at a specified place and time, of specific books relating to operation of the scheme.

Note : Failure to comply with a requirement made under this subsection is an offence (see section 63)

The primary rationale for using section 30 is that corporate crime often involves complex facts, and it is usually critical to a successful prosecution that we gain access to the books of the company (or scheme). An additional rationale is that in cases of corporate crime the usual victim is the company, and it is in both the corporate, as well as the public, interest for the regulator to gain access.

Anyone who conceals, destroys, mutilates or alters a book where ASIC is investigating or about to investigate a matter, commits an offence for which the penalty is 200 penalty units or 5 years imprisonment (or both) (section 67). Generally speaking, the power of ASIC to require production of books exists notwithstanding the general rules concerning self-incrimination, although information provided cannot be used in a criminal proceeding against the person or a proceeding to impose a penalty on the person (section 68). "Books" are defined by section 5 (1) *ASIC Act* to include a register, financial reports or records, a document, banker's books and any other record of information.

ASIC cannot require production of books without reason – we can only do so (section 28)

- for the purposes of the performance or exercise of any of our functions and powers under the corporations legislation; or
- for the purpose of ensuring compliance with the corporations legislation; or
- in relation to an alleged or suspected contravention of the corporations legislation or other Commonwealth law involving the management or affairs of a body corporate, or involving fraud or dishonesty in relation to a body corporate or financial product.

ASIC uses section 30 notices in around 90% of cases we investigate.

A positive spin-off for the insolvency practitioner is that when ASIC has taken possession of books under section 30, it may permit another person to inspect any of the books under section 37 (7). In the case of documents of a company, we can provide copies to the practitioner either electronically (if we have put the documents on to our litigation support system (LSS)) or in hard copy.

Warrants

The ability of ASIC to apply for a warrant to search premises for books and records can be found in a number of places.

So far as presently relevant, section 35 *ASIC Act* provides as follows :

(1) **[Procedure]** Where a member or staff member has reasonable grounds to suspect that there are, or may be within the next 3 days, on particular premises in Australia, books

- (a) whose production has been required under this Division; and
- (b) that have not been produced in compliance with that requirement;

he or she may:

- (c) lay before a magistrate an information on oath setting out those grounds; and
- (d) apply for the issue of a warrant to search the premises for those books.

A magistrate may issue a search warrant under section 36.

In essence, ASIC may apply for a warrant where there are reasonable grounds to suspect that a person has failed to comply with a notice to produce books (and has failed, therefore, to comply with section 30).

Alternatively, section 3E of the *Crimes Act 1914* (Cth) permits an issuing officer (a magistrate or a justice of the peace : section 3C) to issue a warrant to search premises if the officer is satisfied by information on oath that there are reasonable grounds for suspecting that there is, or there will be within the next 72 hours, any evidential material at the premises (section 3E (1)). ASIC may apply for a search warrant under the *Crimes Act* pursuant to our general power of investigation in section 13 *ASIC Act*.

Section 3L *Crimes Act* also permits evidential material on computer hard disks to be seized by the executing officer seizing the equipment or copying the material on to disks, tapes or other storage devices.

A well-known example in this context arose in our investigation into Pacific Eagle Equity Ltd, where search warrants were issued to seize documents from the homes of Messrs Ray Williams and Rodney Adler and the business premises of Mr Williams' accountant. ASIC's power to issue warrants to search for and seize documents in relation to possible criminal breaches of section 184 *Corporations Act* was upheld by the Federal Court in *Williams v Keelty* (2001) 19 ACLC 1,535 on 13 September 2001. This included obtaining evidentiary material from Mr Williams' accountant and stored on the accountant's computers.

Section 19 notices

The third power which may be of interest to practitioners is the power of ASIC to require a person to appear for examination. Section 19 provides:

(1) **[Application]** This section applies where ASIC, on reasonable grounds, suspects or believes that a person can give information relevant to a matter that it is investigating, or is to investigate, under Division 1.

(2) **[Reasonable assistance and appearance]** ASIC may, by written notice in the prescribed form given to the person, require the person :

- (a) to give to ASIC all reasonable assistance in connection with the investigation; and
- (b) to appear before a specified member or staff member for examination on oath and to answer questions.

Note : Failure to comply with a requirement made under this subsection is an offence (see section 63)

(3) **[Content]** A notice given under subsection (2) must :

- (a) state the general nature of the matter referred to in subsection (1); and
- (b) set out the effect of subsection 23 (1) and section 68.

Examinations must take place in private (section 22) although the examinee's lawyer may attend (section 23). The person conducting the examination (the "inspector") may cause a record to be made of the examination, and must do so if the examinee requests (section 24). An examinee is not entitled to refuse to give information on the basis that doing so might incriminate the examinee, although this information may not

be used in a criminal prosecution, or proceeding to impose a penalty (section 68); nor is ASIC required to tell the examinee in advance the questions he or she will be asked.

When ASIC examines a person under section 19, ASIC has power to release the transcript of the examination to the lawyer of another person, if the lawyer satisfies ASIC that the person is carrying on, or is contemplating in good faith, a proceeding in respect of a matter to which the examination related (section 25). We have a Policy Statement on this issue (Policy Statement 103 *Confidentiality and Release of Information*). This may be of assistance to insolvency practitioners who are contemplating actions against persons we examine under section 19.

Insolvency issues we anticipate arising for ASIC in the next twelve months

I would like to briefly mention insolvency issues we anticipate arising over the next twelve months.

We have a number of important insolvency-related cases coming to a head during 2002. All of the cases I outlined earlier will be in court, plus our investigations into major matters will be continuing and more proceedings may be commenced. Further, we will be closely monitoring the HIH Royal Commission, which may have significant ramifications.

It is also likely that the Federal Government will be scoping CLERP 8 sooner rather than later. It is anticipated that CLERP 8 will be the insolvency reforms, and there are a large number of issues which could be included depending on the approach taken. ASIC will be taking a leading role in this debate, including consultation and formulating our own submission. In addition to this, the government last Friday 15 March closed off public submissions in relation to the Ramsay Report into auditor independence, and is expected to respond during this year with its approach to this controversial issue.

Taking into account our own other activities in the insolvency area, we expect to be busy over for the remainder of this year in monitoring developments in relation to insolvency practice, law, and law reform.

Our interaction with the insolvency profession

In conclusion I would like to give some consideration to ASIC's interaction with the insolvency profession. In doing so I would like to concentrate on two broad areas.

They are

- a. the ways in which we collect information from the insolvency practitioner; and
- b. our expectations of the insolvency profession.

Collecting information: EXAD and RASS

We are taking steps to facilitate lodgment of information by external administrators and evaluation of that information. At the moment, all insolvency forms are lodged manually. To date, forms lodged in external administrations are docimaged, but, as a general rule, not otherwise stored. Information in, for example, section 533 reports, which is potentially useful to the regulator, the profession in general, and law reform agencies could be more efficiently captured. Further, electronic lodgment of information is arguably more convenient for practitioners.

The EXAD (ie external administration) project has been scoped and developed to provide capability for all external administration forms and reports to be lodged electronically. The plan is to ensure secure lodgment of data by, for example, use of PIN numbers. We will be doing a mail-out to insolvency practitioners allocating them a PIN number allowing them access to EXAD.

We anticipate reports notifiable under Schedule B to Practice Note 50 – that is reports under sections 422, 438D and 533 – being available for electronic lodgment via ASIC's web-site by mid-year. We are currently conducting a pilot programme trialling the system, with the helpful assistance of a number of accounting firms. Our aim is that within two years of service 60% of forms are lodged electronically, and that it is adopted by major insolvency firms within one year of implementation. The system will use ASIC developed application software for user interactive web interface, customer authentication, and a web server.

Further, we are in the process of automating a scoring system in order to assess complaints. RASS – Risk Assessment Scoring Scheme – is a software programme in

the final stages of completion in ASIC. It will be linked with the Complaints Management System and the data collected by EXAD for tracking and identification of problems in insolvency matters, both in particular files and potentially systemically in business generally. Reports received by external administrators under sections 422, 438D, and 533 are processed through RASS.

Collecting information: Form 524X

As you may know, as part of CLERP 7 ASIC is in the process of obtaining Treasury's authority for us to be responsible for the design and update of all forms issued under the *Corporations Act*. In particular, we have been engaged in a process of removing the current Form 524 *Presentation of Accounts and Statement by Liquidator* and Form 508 *Presentation of Accounts by Scheme Administrator/Controller/Administrator of Deed of Company Arrangement*, to replace them with a new proposed form 524X. This is in conjunction with our EXAD project.

The new form will be capable of electronic lodgment, be one form for all types of insolvency appointments, permit creditors and other stakeholders to better obtain information from ASIC on the potential of dividends, and permit us to track deficiencies on assetless administrations.

We have been consulting with all practitioners on our email listings and have received detailed constructive feedback. In light of that feedback we will modify the form again to simplify it, and go back to practitioners with a revised draft.

Our expectations of the insolvency profession

Insolvency practitioners are required to lodge reports under sections 422, 438D and 533, informing ASIC of situations where, for example, directors of the insolvent company have committed an offence or breach of duty or trust. ASIC's ability to act depends to a significant extent on the quality of the report we receive from the practitioner. First and foremost, if you believe that an officer of a company has contravened the law, we need from you in the report a clear statement of what contraventions you suspect and what evidence there exists to support your suspicions.

While this may seem self-evident, not all reports we receive contain this type of statement where appropriate.

We would like you to keep in mind however that in cases of criminal fraud or dishonesty, a very high standard of proof is required to establish an offence. Not only do we need to be satisfied, but once we have completed our investigation we will refer the matter off to the DPP , who makes the decision whether to prosecute on the basis of the Prosecution Policy of the Commonwealth. What I am saying therefore is that there will be a rigorous process before any prosecution is commenced, and it limits the number of matters which will proceed to prosecution to those where the evidence is very strong.

Secondly, if in the course of an administration you suspect serious misconduct we would like you to contact us immediately and tell us rather than waiting to put it into a report. The sooner we are informed, the more likely it is that we will be in a position to resource the matter for investigation, as it is more likely that the evidence is fresh and there will still be funds around to compensate investors. ASIC Practice Note 50 urges practitioner to contact the Manager, Complaints in the nearest state or territory office of ASIC and verbally report any suspected contraventions of an Australian law that may require urgent ASIC consideration. The Practice Note currently refers to telephoning – we are also quite happy to accept faxes or emails in relation to urgent matters.

Finally – and this is more of a comment than an expectation – we value our interaction and liaison with the insolvency profession as stakeholders. We appreciate the time and effort insolvency practitioners put into consultation with us, and look forward to that continuing through our individual consultations, Regional Liaison Committee meetings, Liquidators Liaison committee meetings, and stakeholder work with peak professional organisations like the IPAA.