CLEANING UP AFTER THE CORPORATE CRASH

by

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The Australian community is attempting to meet the legal problems thrown up by the unprecedented corporate collapses of the 1990's with a system that is out of date. No proper use is made of technological tools. We are not adapting our legal system to the problems that we are confronting.

As to technology one example will suffice. In Britain, in criminal trials of serious fraud offences, specially designed courts are used. With computer screens in the jury box, the Bench, Bar table, the dock and the witness box everybody can see at a glance the text of the document being discussed instead of a laborious and time consuming search in the voluminous material that accompanies complex commercial fraud. However technology is not what I want to talk about. My primary concern is whether the responses that legislatures and the courts have put in place to deal with the consequences of the financial collapse of corporations are working satisfactorily. I happen to believe that judges who can see the difficulties in practice have a duty to call attention to them. One can not adequately discuss possible solutions in a judgment.

That we are in a period of unprecedented corporate upheaval cannot be denied. It is not necessarily that there are more corporate failures than ever before, or even that, adjusting for the fall in the value of money, the amounts involved are greater than ever before. The new features are first, the number, the complexity and geographical spread of the

transactions which require to be examined. Second, many of the transactions involve a failed company A having used apparently as a banker another company B which also failed. In other words the web of transactions means that the liquidator of Company A has to become familiar not only with the affairs of that company and its related companies but also with the affairs of other companies outside the group which have also failed and have different liquidators. To give an illustration from actual experience, in an action by the liquidator of Company A, seeking to recover a loan to Company B, the defendant's claim is that the loan was made simply for the purpose of "on lending" monies to the employees of Company A who were not required to repay it to B and therefore Company B was not liable to Company A.

Consider the numerous civil actions that are likely to follow the recent corporate collapses. There are likely to be actions against company officers, auditors, guarantors, for the recovery of preferential payments all of which will have to tread over much of the same ground relating to the financial affairs of the particular company or group of companies. How many times will a court, differently constituted, look at the same financial picture? As well each of the actions, in particular against officers and auditors, will be long and complex. Quite frankly,I do not think that the Australian court system has the number of judges to cope with the threatening avalanche. Increasing the delay in the hearing of personal injuries claims is hardly acceptable. At a time of

financial stringency the country is confronting, will Parliament make further resources available? What will it do to our already battered reputation overseas if creditors will have to wait for years for the actions to be heard?

It is inappropriate that I should choose any identifiable current corporate difficulty as a primary means of illustration. Instead, I can reach back to the events which followed the collapse of Cambridge Credit Corporation Ltd some fifteen years ago. Investigators were appointed after the company went into liquidation. They had a monumental task. Their report took some years. That is not a criticism of the investigators. Whilst the investigations proceeded, nothing was done to further any civil or criminal proceedings. In a sense, it was appropriate that the facts uncovered by the investigators should be utilised to found the appropriate actions both civil and criminal.

The civil actions were commenced, so to speak, at the death knock just prior to the expiration of the period of six years provided by the Statute of Limitations. No criminal charges were laid for many years afterwards. When charges were eventually laid, the proceedings were stayed on the ground that the charges were so stale as to make it unfair to put up anyone to answer them. Necessarily justice was denied to the community.

If the criminal charges had been laid at, or about, the time of commencement of the civil actions, then different problems would have surfaced. For various reasons, which it is

unnecessary to discuss, in NSW even complex civil actions can be brought to trial much more quickly than criminal proceedings founded on the same facts. Until recently, it had been thought that the so-called tort felony rule prevented any real progress in the preparation of civil cases which had criminal counterparts. That has been shown to be a fallacy. But the fact remains that the so-called right to silence, or the right not to incriminate oneself, has made it very difficult to satisfactorily prepare civil cases for trial using the methods customarily utilised, where the criminal proceedings complication does not exist, and which secure an effective and expeditious hearing. The ultimate difficulty has been that, with one or two exceptions, judges have not forced civil proceedings to go to trial ahead of criminal trials. The consequence has been that, for years, creditors of failed companies have been denied the remedy of a civil hearing, and perhaps their money, whilst-so-ever the criminal justice system endeavoured to accommodate the requirements of a long, complex trial. In Cambridge Credit the amount claimed by the plaintiffs was $102million and interest. If the plaintiffs were entitled to succeed, hundreds of secured creditors of the company were kept out of their money for almost a decade. On the other hand, if the defendants succeeded their reputation remained unfairly under a cloud for that period not to mention the personal anguish and anxiety suffered by them. Eventually the claim was settled for many millions of dollars.

To me, what is sad is that the improvements in the justice system, both legislative and curial, since that time, are so marginal as to be unnoticeable and ineffective. I must admit at once that the regret I have just expressed does carry an element of personal complaint. In an Appendix to a judgment I delivered in 1983 I suggested that measures of correction were urgently needed.

In my view the ordinary demands of fairness and the imperatives of the proper administration of justice required reforms. I referred to the suggestion by Lord Lane, Lord Chief Justice of England, that charges associated with commercial crime be heard by a Judge sitting with assessors as a possible way to reform. Such a tribunal could at the same time conduct an investigation, and hear any civil and criminal charges that may arise.

I forwarded copies of what I had said to those in a position to do something about it. There was no acknowledgement of receipt of the document, much less any action taken. Perhaps as we go through another cycle of company collapses, there may be a greater readiness for action.

Today, in every State of Australia, there are batteries of lawyers occupied in examination of scores of people who have been involved in the affairs of failed corporations. As a hangover from another age the transcript of the evidence is unavailable to third parties. This means that the same information has to be searched for and obtained in a

multiplicity of actions. Simply the cost of this is beyond belief. It is also unnecessary. Nonetheless care must be taken with measures to overcome such problems. The obvious step would be to make the transcript of the examination available to third parties. On the other hand, why should the liquidator have to expend the creditors' money on the costs of the examination and give a free ride to others? Then again, how could the costs of the examination be fairly apportioned when it is unknown how many persons will seek the transcript. What is being done to examine these questions?

Costs pose great problems and act as a very unhealthy deterrent to the enforcement of creditors' rights. Lord Devlin said:

> "The trouble at the root of our legal system is that we have allowed it to grow up in an atmosphere in which, where justice is concerned, money is hardly an object. But money must always be an object for those who believe in justice for, if the system is too expensive, it will not be used and so injustice will go without redress."

One of the major changes to the shield of limited liability has been the enactment of s556 of the Companies Code. In essence the section permits a creditor to sue for the debt of a corporation an officer who has been responsible for incurring the debt at a time when the company was not in a position to pay it. Unfortunately the cost of establishing that the

corporation was not in a position to pay is usually too high for individual creditors to essay the task. In the result unscrupulous directors do not have to face the music.

In the new Commonwealth legislation there are major new provisions for recovery of damages from wrongdoers. In a paper in March 1990, enunciating the proposed approach of the Australian Securities Commission to enforcement of the provisions of the new National Companies Scheme Mr Hartnell indicated the willingness of the Commission to make full use of these provisions. Of course now the legislation is under a cloud.

For a long time, legislation has attempted to compel compliance with appropriate behaviour by corporations and their officers by imposing both civil and criminal sanctions. In more recent times, provision has been made for investigators with draconian powers to be appointed to identify the reasons for the corporate collapse, and pinpoint any offences that may have been committed leading to such collapse. By any standard the resources committed to investigation of company collapses has been high, but the fruits have been meagre. Why is this so, and what can be done to improve our methods of procedure? In a recent article by Mr Peter Wood,of the NSW Bar in the March 1990 issue of the Journal of the Commercial Law Association of Australia he suggested the insertion in the legislation of a

scheme of statutory immunity which would prevent the use, in the criminal proceedings, of any evidence given by an accused in the earlier related civil proceedings. The article concluded:

> "The introduction of general use immunity provisions in the corporate regulatory environment would, indeed, serve to confirm the truth of the statement of Cardozo J. in Palko v Connecticut; 'justice, however, would not perish if the accused was subject to duty to respond to orderly inquiry'."

A nice illustration of the slow implementation of change can be seen in the fact that in 1983 in Research Paper No.16 the Australian Law Reform Commission, in Part B par 46, discussed a possible certification procedure and in 1985 made its recommendation (par 852 et seq). So far no Parliament has had legislation put before it.

The suggestions I offered in the Appendix to my 1983 judgment were perhaps unorthodox and I dare say, productive of many problems. As a variant to my 1983 suggestions a judge could hear the criminal charges with a jury. At the conclusion of the trial, using the same evidence, supplemented as may be necessary, the judge could proceed to deal with all the civil claims arising from the corporate collapse. Again, it is not difficult to find practical problems that would arise.

I do not for a moment suggest that the suggestions are necessarily apt solutions to what are very difficult problems. The fact remains that the problems are there and cry out for public discussion so that from the crucible of public debate a solution may emerge which meets the legitimate demands of the community.