INQUIRY: CORPORATE INSOLVENCY IN AUSTRALIA

P Fishman submission

29 November 2022

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
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Dear Committee

Please accept this submission for the above-named inquiry.

What is "corporate insolvency" in Australia? An Australian company is insolvent if it is unable "to pay all [of its] … debts, as and when they become due and payable."[1] This means that the company cannot fully satisfy its creditors in a timely manner.

What can be done under existing corporate insolvency laws in Australia? An insolvent company can be wound up in insolvency.[2] But also, the insolvency can be resolved with the company continuing in existence. For example, this might be achieved by commencing administration and then executing a deed of company arrangement (DOCA),[3] or commencing restructuring and then making a restructuring plan.[4]

What should corporate insolvency laws seek to achieve? There are various schools of thought regarding the proper aims of bankruptcy and insolvency law. However, the leading economic theory seems to be the one pioneered by Professor Thomas H Jackson in the 1980s called the Creditors' Bargain Theory (CBT). Notably, the Productivity Commission relied on Jackson's seminal 1986 text[5] to explain "[t]he economic role of insolvency law" in a 2015 report.[6]

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1 *Corporations Act 2001* (Cth) s 95A.
2 Ibid Part 5.4.
3 Ibid Part 5.3A.
4 Ibid Part 5.3B.
5 Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press, 1986).
6 Productivity Commission, *Business Set-up, Transfer and Closure* (Inquiry Report No 75, 30 September 2015) 347 <https://www.pc.gov.au/inquiries/completed/business/report/business.pdf>.

The CBT broadly supports corporate insolvency laws which seek to maximise returns for the creditors of an insolvent company. This aim makes sense given that the problem facing such companies is that their debts cannot all be fully paid on time. If creditors will not receive what is due and payable to them, one might expect them to be paid *as much as possible* towards the satisfaction of their claims. Yet other aims that are sometimes associated with corporate insolvency law include (i) business rescue, and (ii) corporate rescue.

When does business rescue make economic sense? If an insolvent company's insolvency is resolved and its business continues as a going concern (in the hands of that company or a new owner), the business is *rescued*. Only viable businesses should be rescued: the ones that are "worth more … alive than dead."[7] In capitalist economies, markets promote efficient businesses and drive out inefficient ones. Accordingly, "insolvency … may provide a strong clue" that a business is not viable.[8] As competition increases, the chances that any given insolvent company is running a viable business will decline.[9]

The Terms of Reference for the present inquiry mention "protecting and maximising value". To achieve this, unviable businesses ought to close so that the assets involved may be put to better use.[10] Thus Jackson and Professor David A Skeel Jr argue in their 2013 paper that the law should *enable*, yet should not *require*, business rescue.[11] Applying this to Australia's corporate insolvency laws, business rescue ought not to be a constant aim—but merely a means by which to maximise value in those special cases where the insolvent company is operating a viable business.

When does corporate rescue make economic sense? If an insolvent company's insolvency is resolved and it continues in existence, the company is *rescued*. But companies are legal fictions: "works of the human imagination that exist only because the law says that they do."[12] Thus the UK's Cork Report states that "society has no interest in the preservation or rehabilitation of the

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7 Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press, 1986) 2.

8 Barry E Adler, 'The Creditors' Bargain Revisited' (2018) 166(7) *University of Pennsylvania Law Review* 1853, 1860-1861.

9 Tim Verdoes and Anthon Verweij, 'The (Implicit) Dogmas of Business Rescue Culture' (2018) 27(3) *International Insolvency Review* 398, 411.

10 Thomas H Jackson and David A Skeel Jr, 'Bankruptcy and Economic Recovery' (University of Pennsylvania Law School, Institute for Law and Economics, Research Paper No 13-27, 2013) 24 <http://ssrn.com/abstract=2306138>.

11 Ibid 24.

12 Patrick Anthony Keane, '"No body to be kicked or soul to be damned": The limits of a legal fiction' (Harold Ford Memorial Lecture 2022, Melbourne Law School, 17 May 2022) 2 <https://www.hcourt.gov.au/assets/publications/speeches/current-justices/keanej/KeaneJ_17%20May2022.pdf>.

company as such", unlike "in the preservation of the commercial enterprise."[13] Australia's Harmer Report likewise advocates for a greater focus "on the possibility of saving a business (as distinct from the company itself)".[14]

However, corporate rescue may sometimes be economically desirable when coupled with business rescue. The CBT would seem to support corporate rescue in circumstances where (a) the insolvent company is running a viable business, and (b) that business is worth more in its existing legal entity than it would be in the hands of a new owner.[15] Applying this to Australia's corporate insolvency laws, corporate rescue ought not to be a constant aim—but merely a means by which to maximise value in those special cases where the insolvent company is best placed to run its viable business.

What are the aims of the existing legislation? The Terms of Reference mention "the operation of the existing legislation". The regime governing administrations and DOCAs normally involves creditors voting on the company's fate.[16] Presumably they vote in their own best interests.[17] Yet the relevant regime expressly seeks, first, for "the company, or as much as possible of its business, [to continue] … in existence".[18] Its primary aim is therefore corporate rescue or business rescue. Secondly, the regime seeks "a better return for the company's creditors and members than would result from an immediate winding up"—but only when the primary aim "is not possible".[19]

The regime governing restructuring and restructuring plans normally involves companies proposing restructuring plans to their creditors.[20] A restructuring plan will be made if creditors accept the proposal.[21] Once again, presumably they make the decision in their own best interests. Yet the express object of the relevant regime does not refer to corporate rescue, business rescue, or a better return for creditors and members than in liquidation. The regime simply seeks for the company to develop and "enter into a restructuring plan with creditors",[22] seemingly irrespective of its economic effects.

How could the existing legislation be improved? The Terms of Reference mention "potential areas for reform". In light of the foregoing, it is submitted that ss 435A and 452A of the *Corporations Act 2001* (Cth) could be amended

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13 Insolvency Law Review Committee (UK), *Insolvency Law and Practice* (Cmnd 8558, 1982) 53 [193].
14 Law Reform Commission, *General Insolvency Inquiry* (Report No 45, 1988) 28 [52].
15 Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press, 1986) 210-212, 214. See further at 219-224.
16 *Corporations Act 2001* (Cth) s 439C. See further s 435C(1)(b) and (2).
17 See ibid s 438A and *Insolvency Practice Rules (Corporations) 2016* (Cth) r 75-225(3).
18 *Corporations Act 2001* (Cth) s 435A(a).
19 Ibid s 435A(b).
20 Ibid s 455A(1).
21 *Corporations Regulations 2001* (Cth) reg 5.3B.26(1). See further reg 5.3B.25.
22 *Corporations Act 2001* (Cth) s 452A.

to provide that the primary aim of each of the two regimes discussed above is to maximise returns for creditors. Such a primary aim would be consistent with the CBT and would align with how these regimes appear to operate already. It could be added that business rescue may be a means of maximising value, and that this might sometimes involve corporate rescue.

Please note that this submission is based on my longer submission for the *2021 Prize in International Insolvency Studies* (available here). That submission was awarded the Bronze Medal by the International Insolvency Institute.[23] It was subsequently discussed on a podcast episode[24] and a slightly modified version was published as an article.[25] These works all stem from my doctoral research, which is supported through the provision of an Australian Government Research Training Program Scholarship and a Zelling-Gray Supplementary Scholarship. The views expressed are my own.

Sincerely,

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[23] See International Insolvency Institute, *III Prize in International Insolvency Studies History* <https://www.iiiglobal.org/initiatives/iii-prize-in-insolvency/>.

[24] Akshaya Kamalnath, *The Creditors Bargain Podcast*, ep 1 ('The aims of corporate insolvency law') <https://open.spotify.com/episode/3L7GyHOLagcaaVytD1IWtc>.

[25] Paulina Fishman, 'Insolvency Law to the Rescue—And Zombies Arise' (2021) 30(5) *Norton Journal of Bankruptcy Law and Practice* 448.