ARITA Expert Series: Insolvency – Session 1

11 November 2021

THE CHANGING FACE OF LAW REFORM IN AUSTRALIA: COMMENTARY ON THE ALRC'S INQUIRY INTO INSOLVENCY, ITS CONTRIBUTION TO THE CURRENT LEGAL FRAMEWORK AND THE NEED FOR A NEW REVIEW GIVEN THE PASSAGE OF OVER 30 YEARS

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Introduction

1. Nearly 40 years ago, the ALRC was asked to consult on the law and practice relating to the insolvency of both individuals and body corporates in Australia. It was asked to consider the *Bankruptcy Act 1966* (Cth), in its application to both business and non-business debtors, and parts of the *Companies Act 1981* (Cth) so far as they related to insolvency of companies. In response, the ALRC undertook a five-year inquiry into insolvency and at the close, published ALRC Report No 45, the *General Insolvency Report*, more commonly known as the *Harmer Report*.

2. As the *Harmer Report* recognised, "[i]nsolvency law is a matter of considerable importance to the Australian community", yet at that time, "[t]he law of corporate insolvency ha[d] never been reviewed".[1] The ALRC also made the point that

> *…there has been an extraordinary increase in the use of credit. Inflation has become a fact of economic life. Interest rates fluctuate. There has been high unemployment. These factors have led to a large increase in the number of insolvencies. This increase has further indicated shortcomings in the present insolvency procedures.*[2]

3. The same could be said about the expansion of the financial services market in Australia since 1988. The size and diversity of Australia's financial markets has increased from $4.3 trillion in 2001 to $19.5 trillion in 2021.[3] Particular markets, such as those for derivatives and employee share schemes have exploded from $120 billion in 2001 to $727 billion in 2021.[4]

4. In light of changes to business and personal finances, it is crucial that the insolvency system is regularly reviewed to keep pace with modern commercial imperatives. As recognised in ARITA's 8-Point Plan, Australia's insolvency system 'is far from broken, but it can be

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[1] https://www.alrc.gov.au/wp-content/uploads/2019/08/alrc45_Summary.pdf p 1.
[2] https://www.alrc.gov.au/wp-content/uploads/2019/08/alrc45_Summary.pdf p 1.
[3] ABS, Key economic indicators.
[4] Ibid.

improved to be better suited to our 21st century economy'.[5] Given that the nature of financial markets has changed drastically since the *Harmer Report*, the ALRC is supportive of a call to Government to conduct a comprehensive review of Australia's insolvency laws to ensure they are 'simple, efficient and effective'.

5. The purpose of this presentation is to explain how the ALRC would undertake an inquiry into insolvency laws and how it might be guided by novel analysis methods developed by the ALRC during its current inquiry into the law on financial services and corporations. I will begin by noting some of the key recommendations of the Harmer Report and discuss how those recommendations have informed the present law. I will then comment on the opportunities that we have in the ALRC's current Inquiry, the Inquiry into financial services and corporations in Australia, to make recommendations which have the potential to make a similarly important mark on the Australian financial services market. Finally, I will step though how the ALRC might approach the task of reviewing insolvency laws in a comprehensive manner.

6. Through this speech this today, I hope to emphasise the importance of engagement and collaboration to the ALRC's reform process. There is a significant opportunity for the ALRC to apply its learnings from the *Financial Services Inquiry* to a review of insolvency laws to achieve greater simplicity and effectiveness in the law.

Recommendations of General Insolvency Inquiry and similarities to the FSI Inquiry

7. In the *Harmer Report*, the ALRC made recommendations in response to its finding that the existing regimes for dealing with the affairs of a company in financial difficulty were too rigid and did not encourage a constructive approach to corporate insolvency. The ALRC also noted the difficulties involved where corporate trading trusts faced insolvency, and recommended that the law be clarified to provide certainty.

8. The Harmer Report was particularly sophisticated in its appreciation of the principles underlining what was then described as the '[p]rinciples of contemporary insolvency law'. In summary, the principles were as follows:

    - the fundamental purpose of an insolvency law is to provide a fair and orderly process for dealing with the financial affairs of insolvent individuals and companies;
    - the insolvency law should provide mechanisms that enable both debtor and creditor to participate with the least delay and expense;

[5] Financial Recovery 2020 ARITA 8-Point Plan p 6.

- insolvency law should, as far as convenient and practical, support the commercial and economic processes of the community; and
- as far as is possible and practical, insolvency laws should not conflict with the general law.

9. These principles guided the ALRC in formulating its specific recommendations. Impressively, the principles endure, and capture the underlying approach of the ALRC to its current Inquiry into financial services and corporations. I will touch on a number of principles and ideas recognised in the *Harmer Report* which bear similarities to the ALRC's current thinking on financial services law reform.

10. First, like the drafters of the *Harmer Report*, the ALRC presently considers that the law should provide mechanisms to resolve disputes quickly and with the least expense possible. To this end, the ALRC has recently reviewed the conduct obligations in the *Corporations Act* and sought to simplify the regime by consolidating the obligations to make them simpler to navigate and apply. The ALRC believes that this reform will reduce the expense and time involved in enforcing conduct obligations under the current version of the *Corporations Act* – and as a corollary, will reduce compliance costs for businesses who are currently burdened by the requirement to comply with an overly prescriptive regime.

11. Second, in its recent work, the ALRC has recognised that competition in, and the stability of, the financial markets needs to be protected. Legislation should not be used to stifle economic innovation. Rather, it should support the natural evolution of the financial markets and bring the best economic outcomes to the community-at-large.

12. Third, the ALRC strongly supports the last of the Insolvency Report principles, which was that 'insolvency laws should not conflict with the general law' – in the present inquiry, we are equally concerned that financial services laws do not conflict with the general law. The ALRC has sought to comply with this principle by recommending that, where possible, terms used in the *Corporations Act* bear their ordinary meaning, or the meaning as they are used in other legislation. For example, the ALRC has recommended that the definitions of financial product and financial service be consistent between the *Corporations Act* and the *ASIC Act* and that the definition of financial product be simplified so that the ordinary meanings of currently defined limbs of the definition be relied upon, rather than being prescribed in legislation. This means removing nested definitions of 'makes a financial investment', 'manages a financial risk' and 'makes a non-cash payment'.

13. Lastly, one of the main issues underpinning the reference to the Commission on insolvency was whether the law relating to individual and corporate insolvency should be combined.[6] Ultimately, the Commission focused on the reform proposals rather than putting the two "very different aspects of insolvency into one Act".[7] The ALRC has recently been grappling with similar issues, such as whether to combine disclosure regimes in the *Corporations Act.* Recommendations of that complexity are best informed by input from stakeholders who use the legislation. It is for this reason that a number of the comments in the forthcoming financial services report are framed as questions to stakeholders for which the ALRC wishes to hear all perspectives.

***Corporations Act* and FSI Inquiry**

14. Whilst the ALRC's current Inquiry is not squarely on insolvency law, it is likely that some of the recommendation in its Interim Report on financial services law will be relevant to insolvency practitioners. I will explain some background on the Inquiry, including the philosophy that the ALRC has adopted to its reform task this year.

15. In its current Inquiry, the ALRC has been asked to inquire into the potential simplification of laws that regulate financial services in Australia. Unlike the General Insolvency Inquiry, the ALRC is not tasked in the current Inquiry with recommending policy changes regarding the content of obligations on financial service providers. Rather, the inquiry is more technical in nature, and seeks to facilitate a more adaptive, efficient and navigable framework of legislation within the context of existing policy settings. This is not dissimilar to the type of inquiry being sought by ARITA.

16. The ALRC is using Chapter 7 of the *Corporations Act* as the lens or primary focus to consider complexity in the *Corporations Act*. However, the ALRC does analyse other parts of the *Corporations Act* and therefore, its forthcoming recommendations will have implications for legislative design beyond Chapter 7.
17. As part of its Inquiry, the ALRC has undertaken extensive analysis, alongside wide-ranging consultations, which have revealed the following general problems with the law:

    - *problem one* – incomplete understanding of legislative complexity;

[6] https://www.hcourt.gov.au/assets/publications/speeches/current-justices/edelmanj/EdelmanJ14Jan2019.pdf p 592
[7] Harmer report, 14 [31].

- *problem two* – complex use of definitions;
- *problem three* – difficulties navigating definitions;
- *problem four* – overly prescriptive legislation;
- *problem five* – obscured policy goals and norms of conduct; and
- *problem six* – difficulties administering complex legislation.

In sum, the ALRC has found that stakeholders generally feel that the law is 'too complex' and in need of simplification.[8]

18. As in the *Harmer Report*, the ALRC will set out principles which it feels underpin the aims of the Inquiry. The principles are remarkably similar to those put forward by Harmer, which confirms that they are fundamental and enduring. The principles to be set out in the *FSI Interim Report A* are:

    - *principle one* – it is essential to the rule of law that the law should be clear, coherent, effective, and readily accessible.
    - *principle two* – legislation should identify what fundamental norms of behaviour are being pursued.
    - *principle three* – legislation should be designed in such a manner as to promote meaningful compliance with the substance and intent of the law.
    - *principle four* – legislation should provide an effective framework for conveying how the law applies.
    - *principle five* – the legislative framework should be sufficiently flexible to address atypical or unforeseen circumstances, and unintended consequences of regulatory arrangements.

19. These principles are just as applicable to other parts of the law as they are to financial services provisions. Let me now explain how these principles, along with the analytical methods employed by the ALRC, could be usefully applied to a review of insolvency laws.

What would an Insolvency Inquiry look like?

20. Many of the recommendations in the *Harmer Report* were implemented into law through the passage of the *Bankruptcy Legislation Amendment Act 1996* (Cth), the *Insolvency (Tax Priorities) Legislation Amendment Act 1993* (Cth) and the *Corporate Law Reform Act 1992* (Cth). For example, the *Corporations Law Reform Act 1992* (Cth) implemented most of the Commission's recommendations on corporate insolvency.

[8] https://www.alrc.gov.au/wp-content/uploads/2021/06/FSL1-Initial-Stakeholder-Views-1.pdf 1

21. We are therefore coming close to 20 years of jurisprudence and practical application of those laws, which might be thought a sufficient length of time to warrant another look. In addition, since the Harmer Report, the Australian Government has enacted the *UNCITRAL Model Law on Cross-Border Insolvency* (*Model Law*) by the *Cross-Border Insolvency Act 2008* (Cth).

22. The Preamble to the *Model Law* sets out the following objectives:

    (a) Cooperation between the courts and other competent authorities of this State and foreign States involved in cases of cross-border insolvency;
    (b) Greater legal certainty for trade and investment;
    (c) Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;
    (d) Protection and maximization of the value of the debtor's assets;
    (e) Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

    Again, these objectives are not very far removed from the principles identified in the *Harmer Report*.

23. A not insignificant body of jurisprudence is developing in relation to the *Cross-Border Insolvency Act*, particularly in relation to important concepts such as the temporal operation of the definitions, the identification of the centre of main interest, and the concept of 'habitual residence'. The extent to which the developing Australian jurisprudence accords with, or departs from, that of other parties to the *Model Law* has not yet, to my knowledge, been the subject of any law reform process. Such an analysis may be useful in the not too distant future.

24. In undertaking a comprehensive review of the insolvency laws, the ALRC would begin by processing and analysing the current state of the law. This process is done using a number of methods: primary legal analysis; engaging legal scholars; and, comparing the law to the law in other jurisdictions to highlight similarities and differences.

25. This year, the ALRC has developed techniques to quantitatively analyse the law using coding software. It plans to employ this technique to future inquiries and share its findings more broadly. The ALRC has generated an unprecedented volume of data on legislation and litigation in Australia using novel methods that have had little or no previous application in Australia. In particular, for every Commonwealth Act, the ALRC has been able to measure its: length; number of chapters, parts, divisions, sections; growth; use of linguistic features; use of complex

legislative elements, and location of obligations. In total, the ALRC has produced over 15 gigabytes of textual data from websites, and this data relates to over 13,000 Acts, 5,000 legislative instruments, and 100,000 court judgments.

26. The data has revealed a number of trends in the length and therefore complexity of the legislative regime. For example, the data shows that the *Corporations Act* has grown rapidly over the past 20 years, particularly since September 2016. The data has also shown that the use of definitions in legislation has increased.

27. This data can be used to identify how insolvency provisions both within the *Corporations Act* and outside the Act rank in terms of their 'complexity'. The data can also be used to identify hotspots of complexity within the insolvency provisions. This data can assist the ALRC to identify where simplification is needed.

28. A general finding from the data expedition undertaken this year is that legislation underpinning Australian corporate law, such as the *Corporations Act,* is regularly modified, amended and applied, and this contributes to the overall complexity of the system. There is also a large mass of 'secret' law, contained in legislative instruments made by bodies like ASIC, which unsophisticated users of the legislation struggle to find. This makes finding the law and applying it particularly burdensome for unsophisticated or less well-resourced users.

29. Notably, the *Harmer Report* emphasised the importance of collecting 'better statistical information' and making it public.[9] To this end, the ALRCs datasets relevant to legislative complexity in Commonwealth Acts, regulations and other legislative instruments will be made available on its website shortly.

30. The ALRC also undertakes an extensive consultation process where stakeholders can provide oral and written feedback on the law and any ideas proposed by the ALRC. The ALRC consulted with over 140 people or organisations during this year for the purpose of obtaining views on financial services law. The ALRC is committed to engaging with the views of stakeholders, and to that end, published a summary of initial stakeholder views on the *Financial Services Inquiry* in May this year. Like the process followed this year, the ALRC would hold public webinars, arrange targeted consultations, and attend industry and professional events all around the country to elicit as many views as possible to aid its reform process.

[9] https://www.alrc.gov.au/wp-content/uploads/2019/08/alrc45_Summary.pdf p 3

31. Interim Report A will be published on the 30th of this month. Interim Report A will call for stakeholder submissions on the proposals for reform relating to definitions, concepts and standards in financial services legislation – these submissions are crucial in assisting the ALRC to develop its recommendations.

32. To this end, the ALRC thanks ARITA for the 10 'key points' it has already provided which identify instances of definitional uncertainty and legislative complexity in the existing insolvency regulatory scheme, the supporting Regulations, and the *Insolvency Practice Rules.* In particular, the ALRC is on notice that ARITA considers that

    - there is inconsistency between the terminology used in the Act and ancillary legislation; and
    - the *Corporations Act* is structured in a problematic way.

33. The ALRC supports these key points and hopes that the Interim Report addresses some of ARITA's concerns in this regard.

Conclusion

34. As I mentioned earlier, Interim Report A on financial services legislation will be presented to the Commonwealth Attorney-General on the 30th of this month. At this point there will be a call for formal submissions which will guide some of the recommendations in the Second Interim Report, due on 30 September 2022. A Third Interim Report is due on 1 June 2023, with the final consolidated report due in two years from now.

35. The ALRC will continue to engage frequently with stakeholders and hopes to further develop its novel analysis techniques to strengthen the case for reforms to be made to financial services legislation. We hope that the momentum gained from this Inquiry can reopen the door for a comprehensive review of Australia's insolvency laws to be conducted in the near future.

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