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Dr Sean Turner
Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House, Canberra ACT 2600

Dear Dr Turner

Written questions on notice to Ashurst in relation to inquiry into corporate insolvency in Australia

We refer to your letter of 23 December 2022 seeking Ashurst's responses to questions attached to that letter, in addition to questions taken on notice at the public hearing on 14 December 2022.

Ashurst welcomes the opportunity to respond to your questions.

In the course of giving evidence to the Committee on 14 December, 2022, the Committee expressed an interest in hearing Ashurst's views on the submission presented by the Australian Restructuring Insolvency & Turnaround Association (**"ARITA"**).[1]

We address a number of themes which, as we read that Submission, emerge from a consideration of it.

Object of Insolvency Law

In section 1.2 of ARITA's Submission it proposes an objects clause for a unified insolvency law in these terms:

> "*(a) To provide a genuine opportunity for restructure of economically viable businesses, without providing incentive for inappropriate behaviour by debtors and creditors;*
>
> *(b) Where restructuring is not possible, to expeditiously and efficiently realise the value of the assets of the insolvent business at lowest reasonable cost;*
>
> *(c) To ensure directors and other relevant persons have acted in accordance with their duties, and where reasonable to do so identify any fraud or other malfeasance associated with the business;*

[1] Transcript at p.24.

(d) Where individuals become insolvent and have committed no offences, to discharge them from bankruptcy as soon as practicable;

(e) To ensure that where there is a public interest extending beyond the enforcement of the law and the interests of the creditors (for example, the maintenance of critical supply chains or aviation services), that this is made clear to, and is properly had regard to by, the relevant insolvency practitioner; and

(f) To support the development and best practice regulation of the insolvency profession."

Accepting that it is appropriate to consider the adoption of a unified insolvency law in Australia, we would commend a restatement of the principal objective of an insolvency law in or to the effect of the following terms:

"*The object of this Act is to provide for the financial affairs of individuals and companies who are insolvent or near insolvent to be administered in a way that:*

(a) maximises the chances of those affairs being rehabilitated or restructured; and

(b) only if that is not possible, results in a better return to the creditors of the individual or the company than would result from their immediate bankruptcy."[2]

If a unified insolvency law is not to be adopted, that object could be restated in terms which are appropriate for both the *Corporations Act* and the *Bankruptcy Act*.

In formulating the proposed objective of an insolvency law in this way, it is important for any insolvency law to recognise that it is just as important for individuals (in particular, consumer debtors) to be able to restructure their financial affairs as it is for a corporation irrespective of its size.

Beyond that, with one exception, the other elements of ARITA's proposed objectives for an Insolvency Law regime seem to us to involve ancillary considerations and we make no comment in relation to them.

The one exception concerns the suggestion that an objective of an insolvency law should be "*to ensure that where there is a public interest extending beyond the enforcement of the law and the interests of the creditors (for example, the maintenance of critical supply chains or aviation services), that this is made clear to, and is properly had regard to by, the relevant insolvency practitioner*".

It is understandable that, from the perspective of public policy, there will be occasions when a business is such an important contributor to the country's economy that it is desirable that efforts be made to maintain its continued operation. However, in our submission, the decision on the means by which the relevant goods and services continue to be supplied should be taken by government on a case-by-case basis. The ARITA proposal, if adopted, would result in the introduction into insolvency law of a degree of "moral hazard" to the extent that it may encourage those responsible for the management of some businesses to proceed on the premise that they are too important to fail. Beyond that, such a stipulation may operate as a statutory limitation on the options available to government as to how those goods or services should be supplied in the future.

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[2]: The term "bankruptcy" is used in this case to describe a formal insolvency administration for either an individual or a company.]

"A root and branch review"

We responded to a question during the course of giving evidence to the Committee on 14 December, 2022[3] by suggesting that the first issue to be addressed, when considering whether there needed to be a "*root and branch review*" of Australia's insolvency laws, was the identification of the policy objective of those laws. If, as both ARITA and Ashurst have proposed, the rehabilitation or restructuring of the affairs of companies and individuals in financial difficulties should be the primary objective of those laws, then we agree that such a review is necessary.

That said, at the outset of such a review, it should be recognised that the bulk of the components of a good and fit for purpose insolvency law can be found in the current legislation.

A significant challenge is that those provisions are organised in such a way that the law is not accessible. This position should be contrasted with the position in the United Kingdom which has enacted a separate *Insolvency Act* 1986 which regulates corporate insolvency.

The circumstance which has produced that outcome was recognised, at least implicitly, in the Harmer Report when it said (at para [52]):

> "*The Commission is also concerned that,……, the legislative approach to corporate insolvency in Australia is most conservative. There is very little emphasis upon or encouragement of a constructive approach to corporate insolvency by, for example, focusing on the possibility of saving a business (as distinct from the company itself) and preserving employment prospects*".

That observation reflected the law as it was then found in the *Companies Code* and the *Companies Act* 1961 (NSW) and the corresponding law in each of Australia's other states and territories as well as the corporations legislation which preceded that Act.

As the reforms proposed in the Harmer Report and subsequent reforms have been grafted onto a law with that approach, it has brought about the result that the structure of the insolvency provisions in the *Corporations Act* has become "*a thing of shreds and patches*" to quote the lawyer turned lyricist; WS Gilbert.

Accordingly, irrespective of whether Australia adopts a unified insolvency law, a root and branch review of our insolvency laws would be appropriate subject to the following qualifications:

(a) the legislation should be structured to reflect the policy which informs it;

(b) it should be recognised that many of the existing provisions in the *Corporations Act* and the *Bankruptcy Act* are fit for purpose and should be incorporated in their present terms in any revised legislation not least for the purpose of preserving the benefit of the case law which already exists which amplifies and explains their operation;

(c) to the extent that there are provisions which are common to more than one insolvency regime (such as liquidation and voluntary administration) it will be appropriate that they be incorporated in a schedule to the legislation subject to the relevant provisions in the schedule being clearly signposted in the provisions regulating each of the insolvency regimes;

(d) the review should be taken as an opportunity to address the legitimate concerns in respect of the need to reform some aspects of the existing law raised in Section 5 of the ARITA Submission with the possible exception of the suggestion made in relation to the law

[3] Transcript at p.25

concerning unfair preferences to the extent that it is not clear how the law can properly distinguish between effective credit management and the taking advantage of knowledge of the debtor's affairs which might not be generally known;

(e) those provisions in each of the *Corporations Act* and the *Bankruptcy Act* which correspond with each other, such as those concerned with recovering the benefit of unfair preferences and other antecedent transactions, should be harmonised if a unified insolvency law is not to be introduced into Australia; and

(f) if the review is to be undertaken within the Office of Parliamentary Counsel rather than by the Australian Law Reform Commission there would be merit in having a technical reference group comprised of members with relevant experience who are able to advise in relation to and comment upon draft legislation.

To amplify and exemplify our observation in (a) above, let us do so by reference to the current provisions in the *Corporations Act.*

Chapter 5 of that Act should be renamed something to the effect of "*Reorganisation and Liquidation*" to recognise that its provisions are not exclusively concerned with external administration. Then, at a very high level of generality, the various regimes for which it provides might then be ordered in or to the following effect:

(i) Object of the Chapter;

(ii) Safe Harbour;

(iii) Debtor in Possession Restructuring (as described in our submission to the Committee dated 30 November, 2022);

(iv) Schemes of Arrangement;

(v) Voluntary ;

(vi) Small Business Restructuring;

(vii) Winding up in Insolvency and on Other Grounds;

(A) Court Liquidation;

(B) Creditors' Voluntary Liquidation; and

(C) Members' Voluntary Liquidation.

The Receivership provisions might then be in either Chapter 5 or a new chapter; Chapter 5A.

A Unified Insolvency Law

We accept ARITA's submission that there is merit in consideration being given to the implementation in Australia of a unified insolvency law.

However, so far as it concerns the timing of such a reform, we wonder whether the observations made in each of the Harmer Report and the PC Review to which ARITA refers in its submission are still apposite.

In this regard, Chapter 5 of the *Corporations Act* is not nearly concerned with the circumstances of insolvent companies. So, the provisions dealing with schemes of arrangement, receivership and members' voluntary liquidation are relevant for the administration of the affairs of solvent companies.

Accordingly, attention would need to be given, in the context of any reform proposal, as to how these procedures are to be regulated.

Beyond that, the ARITA Submission calls in aid the circumstance of small businesses and the circumstance that the affairs of those businesses and the financial affairs of their owners or shareholders are often intertwined. That is undoubtedly the case. However, with respect, the Submission ignores a fundamental consideration which, in the ordinary course, informs the decision to incorporate a company to conduct the "family business"; limited liability. If the family business fails and the primary objective of insolvency law is to provide for a rehabilitation and restructuring, an insolvency professional who is acting on or advising about the possibility of the insolvency administration of both the family company and its shareholders is in a position of conflict when addressing the issue; to what extent, if at all, should the shareholders' assets be made available to satisfy the claims of the company's creditors?

Regulating the profession and a single insolvency regulator

The ARITA Submission properly draws attention to the conduct of unregulated insolvency practitioners and the corrosive effect which their activities and the advice they give may have on access by creditors and other stakeholders to their rights.

Notwithstanding our view in relation to the timeliness of the introduction of a unified insolvency law into Australia, we endorse ARITA's Submission which contends for the establishment of a single insolvency regulator and the reasons which support that submission.

A related reform would involve the regulation of insolvency practice rather than the law, as it does now, merely providing that, say, only registered liquidators were eligible to undertake designated positions. Such a reform would align the regulation of insolvency practice with the regulation of many other professional activities such as medicine and related health professions, veterinary practice, legal practice, architecture and engineering. The legislation which regulates those various professions provide models for, say, the *Restructuring and Insolvency Profession Act.* We accept that the challenge of the adoption of such a reform will be to define "restructuring and insolvency practice".

A question to be addressed when formulating that legislation involves a consideration of whether there should be different categories of Restructuring and Insolvency Practitioners. In this regard there used to be a distinction between Official Liquidators and Registered Liquidators. Only Official Liquidators were eligible for appointment to undertake liquidations ordered by the court. It may be the case, given the range of restructuring and insolvency regimes which are proposed, that there would be merit in having differing degrees of qualification which are required to assume responsibility for each of those regimes.

Public Interest Administration Fund

ARITA's Submission concerning the establishment of a Public Interest Administration Fund is supported. Indeed, it is submitted that the Committee should recommend the establishment of an Assetless Administration Fund as proposed in the Harmer Report.

The challenges identified in the Harmer Report still exist. Indeed, on one view, they have been compounded in relation to both:

(a) the funding of proper investigations into the affairs of companies being wound up by their liquidators; and

(b) the increasing reluctance of creditors (including, it would seem, the ATO) to apply to the courts for the liquidation of their corporate debtors.

As to the resourcing of the Fund, it is submitted that it should be supported by the corporate community, given that it is calculated to support the proper regulation of the conduct of members of that community. Moreover, such an impost reflects the circumstance that incorporation and the attendant benefit of limited liability is a privilege not a right.

If it would assist the Committee, we are happy to meet with it at its convenience to discuss this further submission.

Ashurst