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Business Law Section

Corporate Insolvency in Australia: Response to Questions on Notice

Parliamentary Joint Committee on Corporations and Financial Services

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Introduction

This document is a Response to Questions on Notice from the Parliamentary Joint Committee on Corporations and Financial Services (**PJC**) dated 23 December 2022. The Response has been prepared by the Insolvency and Restructuring Committee of the Business Law Section of the Law Council of Australia with additional input from the SME Business Law Committee and the Financial Services Committee.

The Section refers to its Initial Submission to the PJC dated 1 December 2022 which includes information about the Business Law Section, as well as material in respect of authorship and contributions.

Like the Section's Initial Submission, this Response deals with matters of complexity on which reasonable minds can differ. The views expressed in this Response do not necessarily reflect the views of particular individuals or their respective workplaces and organisations, but this Response is presented as reflecting the most widely held views among contributors.

The Section would be pleased to discuss any aspect of this Response. Any queries can be directed to the Chair of the Insolvency and Restructuring Committee, Chris Pearce

The Section appreciates the opportunity to provide this Response and commends the Response to the PJC for its consideration.

With compliments

Philip Argy
Chairman
Business Law Section

Glossary

In this Response, terms have the following meaning:

2015 PC Report	The Productivity Commission Inquiry Report into Business Set-up, Transfer and Closure, No 75 (2015)[1]
ALRC	The Australian Law Reform Commission
ARITA	The Australian Restructuring Insolvency & Turnaround Association
ARITA Code	The *Code of Professional Practice for Insolvency Practitioners* published by ARITA
ASBFEO	The Australian Small Business and Family Enterprise Ombudsman
ASBFEO Insolvency Practices Inquiry	The Insolvency Inquiry conducted by ASBFEO, and the report of that inquiry published in July 2020.
ASIC	The Australian Securities and Investments Commission
ATO	The Australian Taxation Office, though often used as a reference directly to the Commissioner, as the person entitled to be paid taxes and with relevant legislative powers
Bankruptcy Act	The *Bankruptcy Act 1966* (Cth)
BLS or **Section**	The Business Law Section of the Law Council of Australia
CCCD	Cross-class cram down, a mechanism to deal with uncooperative creditors who may be out of the money but are interfering with voting outcomes
Commissioner	The Commissioner of Taxation (unless otherwise specified)
Committee	The Insolvency and Restructuring Committee of the BLS
Corporations Act	The *Corporations Act 2001* (Cth)
Eggleston Reports	The seven interim reports of the Company Law Advisory Committee led by Richard Eggleston between 1969 and 1972
Harmer Inquiry	The General Insolvency Inquiry commissioned by the Commonwealth Attorney-General in 1983 operated by the ALRC

[1] Available here: https://www.pc.gov.au/inquiries/completed/business/report/business.pdf.

Harmer Report	The report of the Harmer Inquiry known as the Australian Law Reform Commission General Insolvency Inquiry Report No 45 (1988)[2]
Initial Submission	The initial submission by the BLS to the Inquiry dated 1 December 2022
Inquiry	The Inquiry into Corporate Insolvency in Australia by the PJC, in respect of which this Response is made
LCA	The Law Council of Australia
MSME	Micro, small and medium-sized enterprises
PJC	The Parliamentary Joint Committee on Corporations and Financial Services
PPSA	The *Personal Property Securities Act 2009* (Cth)
PPSR	The Personal Property Securities Register, established under the PPSA
Recommendation	A recommendation in the Initial Submission (except where explicitly identified as a recommendation of another inquiry or submission)
Response	This document, being a response to the Questions on Notice from the PJC
Safe Harbour Review	The statutory review of the insolvent trading safe harbour under s588HA of the Corporations Act, including its final report published on 24 March 2022[3]
Section or **BLS**	The Business Law Section of the Law Council of Australia
SBR	A small business restructuring effected under the SBR Regime
SBR Regime	The small business restructuring regime enacted in 2021 in Part 5.3B of the Corporations Act
SME	Small to medium-sized enterprise
Questions on Notice	The questions on notice to the BLS dated 23 December 2022, incorporating both questions directed specifically to the BLS or LCA, and others of a general nature
UNCCA	Working Group V (Insolvency) Expert Advisory Committee of the UNCITRAL National Coordination Committee for Australia

2 Available here: https://www.austlii.edu.au/au/other/lawreform/ALRC/1988/45.html.

3 Available here: https://treasury.gov.au/publication/p2022-p258663-final-report.

UNCITRAL	United Nations Commission on International Trade Law
UNCITRAL Principles	The Legislative Guide on Insolvency Law published by UNCITRAL
VA	Voluntary administration (under Part 5.3A of the Corporations Act) or, as appropriate, "voluntary administrator", being the insolvency practitioner in charge of the administration
Whittaker Review	Review of the Personal Property Securities Act 2009, conducted by Bruce Whittaker, the final report of which was delivered on 27 February 2015[4]

[4] Available here: https://www.ag.gov.au/legal-system/publications/review-personal-property-securities-act-2009-final-report.

Questions on notice directed specifically to us

1. Redesign of Australia's insolvency law

Question 1

If the insolvency system's legislative scheme is redesigned, as your submission's primary recommendation contends, what safeguards could or should be put in place to prevent the 'awkward blend of laws' being repeated?

1. This question makes reference to the terminology used in the Executive Summary of our Initial Submission. Underlying our reference to an "awkward blend of laws" are at least two categories of concern:

   (a) first, substantive amendments over a long period of time which focus on particular issues or areas to the exclusion of others, without necessarily any clear policy considerations on the effect on the insolvency regime as a whole; and

   (b) second, a piecemeal mishmash of legislative drafting techniques and policy, which have resulted in provisions scattered across various Acts, schedules, regulations, and regulatory instruments (as to which, see the analysis in our Initial Submission).[5]

2. Clearly enough, over time, legislative and regulatory changes may occur at the behest of particular governments with a particular focus, often responding to pressure from certain interest groups and without broad consultation. However, some of the recommendations in our Initial Submission might be considered useful in contributing some protection against the same mistakes occurring again:

   (a) Recommendations 1 and 33 in effect suggest that a broad review might be conducted by an organisation such as the ALRC (including in respect of matters outside the scope of the PJC Inquiry) and into the potential harmonisation of corporate and personal insolvency laws as part of the redesign of the corporate insolvency legislative regime.

   (b) Recommendation 29 suggests that consideration should be given to reallocating responsibility for corporate insolvency (and personal insolvency), including related matters such as the PPSA, to a single dedicated regulator under a single department.

   (c) Recommendation 12 is that the legislative scheme governing corporate insolvency (including relevant parts of the Corporations Act and the various schedules, regulations, rules, legislative instruments, and guidance that apply) should be redesigned to eliminate unnecessary and obsolete provisions, establish a single source of relevant law, and provide a more easily navigable system for stakeholders.

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5 Initial Submission, [82]-[88].

(d) Recommendation 18 contemplates that in this Inquiry, and in any broader review that may be recommended by the PJC and conducted by the ALRC or some other appropriate body, the consideration raised by the Safe Harbour Review in section 15 of its report should be taken into account (section 15 of that report makes suggestions about how holistic reform might be considered).

3. A harmonised regime covering all areas of insolvency under a single legislative instrument[6] with a single regulator would reduce the prospect of contradictory policy decisions and provide a single starting point under which future reforms should not need to stray into separate legislative areas.

4. The Committee acknowledges that some may argue there are downsides associated with reworking the entire legislative scheme. In some respects, we agree, care must be taken not to discard a valuable consolidated system of written laws and caselaw in the name of simplicity (particularly in insolvency, where complexity is a necessary evil).[7] But it may be that a reworking of the regime can be effected without disturbing the important key elements of the system. Ultimately, the PJC (or any subsequent review) must weigh up the benefits of a complete legislative redesign against its disadvantages.

2. Pre-pack administrations

Question 2

Can you elaborate on your explanation of how pre-pack administrations work?

5. As outlined in the Initial Submission,[8] pre-pack administrations are permissible in the United Kingdom.[9] Pre-packs effectively constitute a lawful "phoenix" transaction performed in consultation with an insolvency practitioner prior to his or her appointment. A "pre-pack" transaction refers to a process by which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of an administrator and the administrator effects the sale immediately on, or shortly after, appointment.[10]

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6 See, e.g., the *Insolvency Act 1986* (UK); the *Insolvency, Restructuring and Dissolution Act 2018* (Sing).

7 Initial Submission, [86].

8 Initial Submission, [132]-[134].

9 *Insolvency Act 1986* (UK) Sch 1; *Administration (Restrictions on Disposal etc to Connected Persons) Regulations 2021* (UK).Administrators in the United Kingdom, have an express power to sell company assets, and the courts have repeatedly upheld the power of administrators to do so without court approval prior to a creditors' meeting, see for example *Re T&D Industries* [2000] 1 BCLC 471 and *Re Transbus International* [2004] 2 BCLC 550.

10 Insolvency Practitioners Association, *Statement of Insolvency Practice 16: Pre-packaged Sales in Administrations*, 2009.

6. In essence, a pre-pack administration is a business or asset disposal "prepared and packaged, ready for completion upon the appointment of the administrator".[11] The defining characteristic is that it usually involves a pre-negotiated sale (negotiated with the assistance of an insolvency practitioner) which occurs outside of court and without formal creditor participation.[12] The process generally culminates in the formal appointment of the pre-insolvency advisor as administrator, who is thereafter responsible for consummating the pre-packaged transaction.

7. The primary benefits of pre-packs can be summarised as follows:

   (a) the expedited sale of all or part of a troubled company whilst ensuring assets are not sold below market value;[13] and

   (b) the preservation of employment, which is crucial to allowing the business to continue to trade.[14]

Question 2(a)

Could you explain to the committee why certain elements of the UK prepack structure would not be acceptable under Australian law?

8. In stark contrast, Australia's stringent independence requirements significantly impede the circumstances in which a pre-pack arrangement could ever be implemented.

9. The Corporations Act requires that an administrator declare any relevant relationships they have, or have had, within the preceding 24 months with, *inter alia*, the company and its associates.[15] At common law, the guiding principle is that an administrator must be, and be perceived to be, independent of the company, its directors and shareholders, and individual creditors.[16] This position is also reflected in the ARITA Code.

10. The ARITA Code states that a practitioner must not accept an appointment, or continue to act under an existing appointment, if there is a lack of independence or a perceived lack of independence.[17] A mere perception of bias is sufficient to breach this standard.[18] Unsurprisingly, issues giving rise to a perception of a lack of

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[11] Hugh Sims and Peter Cranston, 'Pre-Packs: Recent Law and Practice', 16 April 2007, 1.

[12] Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles* (2nd ed, Cambridge University Press, 2009) 453; Mark Wellard and Peter Walton, 'A Comparative Analysis of Anglo-Australian Pre-packs: Can the Means Be Made to Justify the Ends?' (2012) 21(3) *International Insolvency Review* 143, 144.

[13] Emanuel Poulos and Ayowande A McCunn, 'Pre-pack transactions in Australia' (2011) 19 *Insolvency Law Journal* 235, 236.

[14] *DKLL Solicitors v Revenue and Customs Commissioners* [2007] BCC 908.

[15] Corporations Act ss 60(1) and 436DA.

[16] *Commonwealth v Irving & NPC Manufacturing Pty Ltd* (1996) 65 FCR 291; *Bovis Lend Lease Pty Ltd v Wily* (2003) 45 ACSR 612 at [123]-[141] (Austin J).

[17] Australian Restructuring Insolvency & Turnaround Association. *Code of Professional Practice for Insolvency Practitioners* (4th ed, January 2020), 3.1.

[18] *ASIC v Franklin* [2014] FCAFC 85.

independence generally revolve around instances of prior contact between the administrator and the company.[19] The ARITA Code also provides that a professional relationship with the company within the previous two years is capable of preventing a practitioner from accepting appointment.[20]

11. There may be significant repercussions for any external administrator who falls foul of their obligation to observe independence requirements. For example, where ARITA's Professional Conduct Committee determines a breach of the standards is substantiated, penalties that may be imposed include:

    (a) termination or suspension of ARITA membership;

    (b) a reprimand recorded on the practitioner's disciplinary records;

    (c) limitations on the practitioner's professional practice;

    (d) the payment of compensation, damages, or reparations to any person; and

    (e) the imposition of a financial penalty.[21]

12. Additionally, ASIC or a creditor can apply to a Court for a judicial inquiry into the conduct of an external administrator, including in relation to allegations of lack of independence.[22]

13. It follows that the very premise of a pre-pack under Australian law as it stands can disqualify a practitioner from accepting an appointment as administrator.[23]

14. In *Re Korda, in the matter of Ten Network Holdings Ltd (Administrators Appointed) (Receivers and Managers Appointed),*[24] the Federal Court considered whether involvement in pre-administration planning would disqualify a potential administrator from accepting formal appointment.[25] The administrators had been retained for the purpose of preparing a contingency plan in case formal appointment became necessary. Apart from a matter which was able to be addressed, the Court found that the administrators did not lack independence. Notably, the court accepted that at no time did the administrators provide advice to the board, its directors or management, the creditors or any other stakeholders.[26] In its judgment, the Court acknowledged the impediments to adopting pre-packs in Australia and agreed that it would be difficult to imagine a situation where an Australian practitioner would be

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[19] Ibid.

[20] Australian Restructuring Insolvency & Turnaround Association, *Code of Professional Practice for Insolvency Practitioners* (4th ed, January 2020), 3.7.

[21] Australian Restructuring Insolvency & Turnaround Association, *ARITA Regulations 2022*, r 6.3.

[22] See for example *Australian Securities and Investments Commission v Wily and Hurst* [2019] NSWSC 521; 137 ACSR 1.

[23] Mark Wellard and Peter Walton, 'A Comparative Analysis of Anglo-Australian Pre-packs: Can the Means Be Made to Justify the Ends?' (2012) 21(3) *International Insolvency Review* 143, 163.

[24] [2017] FCA 914.

[25] *Re Korda,* [2017] FCA 914, [10]-[12].

[26] Ibid [20], [34]. This is precisely what would occur in any pre-pack engagement.

permitted to accept an appointment as an external administrator in situations similar to pre-packs.[27]

15. Consequently, absent amendment to the Corporations Act, external administrators cannot accept a later formal appointment to a distressed company if they have had previous involvement (in less than a minor way) with the board, directors, or the company. For those reasons, the use of pre-packs is not supported (and explicitly discouraged) under the law as it presently stands in Australia.

16. Notably, in our Initial Submission:

    (a) Recommendation 2 suggests that consideration should be given to relaxing independence requirements on voluntary administrators associated with pre-appointment work or providing more efficient mechanisms for managing those independence requirements (such as simplifying the appointment of special purpose investigators to report on pre-appointment matters); and

    (b) Recommendation 25 suggests consideration should be given to whether or not a better-regulated scheme for pre-pack administrations is required as part of the Australian restructuring regime.

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27 Ibid [23].

Questions on notice of a general nature

1. Root and branch review

Question 1(a)

Several submitters have suggested a root and branch review of Australia's insolvency laws in the style of the 1988 Australian Law Reform Commission (ALRC) Harmer Review. What is your view on whether there should be a root and branch review?

17. The Committee supports a root and branch review for the reasons enunciated in our Initial Submission, in particular at Recommendations 1, 12 and 33.[28]

Question 1(b)

Why would a root and branch review be required?

18. Our Initial Submission and our responses to these Questions on Notice (above at paragraphs 1–4) have already examined this issue in some detail. In summary, the legislative scheme is disparate and needs to be redesigned, and the opportunity should be taken to address substantive issues with the current legislative scheme that need to be addressed, many of which we have identified in the 33 recommendations in our Initial Submission, as well as in others' submissions to the Inquiry.

Question 1(c)

What organisation would be most appropriate to conduct the review?

19. In our Initial Submission, we identified the ALRC as a potential candidate for that role.[29] The ALRC conducted the Harmer Inquiry which was incredibly successful. It is notable that Justice Sarah Derrington, who until recently was the President of the ALRC, has called for such a review to be conducted.[30]

20. Other possible candidates include:

    (a) The Productivity Commission, which conducted the inquiry which led to the 2015 PC Report—noting that inquiry was into "Business Set-up, Transfer and Closure" and not specifically insolvency, although arguably many of its recommendations have formed the basis for some recent insolvency reforms

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28 Initial Submission, [20]-[24], [181]-[185].

29 Initial Submission, [24].

30 "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", The Hon Justice S C Derrington, 11 November 2021, https://www.alrc.gov.au/wp-content/uploads/2021/11/211111-ALRC-ARITA-Keynote-DerringtonJ.pdf. See also, Initial Submission, [12].

(for example, the safe harbour defence to insolvent trading, the moratorium on the operation of certain ipso facto provisions in administration, the SBR Regime and director identification numbers all arose from considerations raised in the 2015 PC Report).

(b) another appropriate body similar to the Corporations and Markets Advisory Committee (CAMAC) which was established in 1989 under the *Australian Securities and Investments Commission Act 2001* (Cth) to provide advice and recommendations to the Minister about matters relating to corporations and financial services law, administration and practice, but which was abolished by Schedule 7 of the *Statute Update (Smaller Government) Act 2018* (Cth), which commenced on 21 February 2018.

21. The advantages of the Productivity Commission or a CAMAC-like body are that they might be more specifically focussed on many of the behavioural economic issues that are key to complex insolvency processes than a law reform body. However, they may be equally lacking in other necessary skills such as law design.

22. It is probably sufficient for the ALRC or any other organisation tasked with a holistic review that it is well-enough resourced by appropriate consultants with a broad enough range of experience to perform the job properly.

Question 1(d)

Are there any other structural features you think a review should have—for example, its timing and consultation processes?

23. Notably, the terms of reference to the Harmer Inquiry were short and very broad:

> *… the law and practice relating to the insolvency of both individuals and bodies corporate, in particular—*
>
> *(i) the provisions of the Bankruptcy Act 1966, in its application to both business and non-business debtors;*
>
> *(ii) Parts VIII, X, XII of the Companies Act 1981 so far as they are related to or are concerned with the insolvency of companies;*
>
> *(iii) any related matter.*

24. The Committee appreciates there may be a need to be more specific in the scope of a reference in this day and age, but care should be taken not to box in any subsequent inquiry unnecessarily.

25. As to timing, it seems to us that any root and branch review resulting in settlement on a comprehensive set of reforms with legislation prepared and properly consulted on would involve a multi-year process. It was five years between the terms of reference being sent to the Harmer Inquiry and the handing down of the Harmer Report (and a further five years before reforms were introduced to enact the voluntary administration regime).

26. We do not suggest a proper process needs to take ten years[31] or even five. Notably, the issue was put directly to some stakeholders at the public hearing. Mr Winter (the CEO of ARITA) accepted it would be a multi-year process. Encouragingly, Dr Mundy (representing ARITA, but also the Chair of the 2015 PC Report) thought progress could be made in a year or two.[32]

27. So long as an inquiry is properly resourced, it may be appropriate to instruct any inquiry in its terms of reference not only to settle on particular proposed policy positions but to engage in the legislative drafting process so as to cut short any delay associated with a further consultation and review process.

Question 1(e)

In considering the structure, scope and approach of such a review, might Australia draw any insights from relatively recent reviews internationally (such as those undertaken in Singapore and the United States in the 2010s, for example)?

28. Recent international reviews and reforms have been quite successful. It is unnecessary to refer in detail to the substantive reforms that have taken place in other jurisdictions, but any Australian review should consider some international developments covered in our Initial Submission, such as the United Kingdom's (**UK's**) company voluntary arrangement and Part A1 moratorium regime (or indeed other automatic moratoria in schemes of arrangement),[33] broader debtor in possession models beyond the SME focus of the SBR Regime,[34] a CCCD regime in schemes or otherwise to allow a class of creditors to be bound notwithstanding a lack of favourable vote from that class,[35] reforms to security enforcement such as the potential abolition of circulating security receivership,[36] and a super-secured finance regime.[37]

29. As to the question whether Australia might draw on structural and scoping issues from other jurisdictions, we make the following observations:

    (a) Comparable international processes have taken some time to complete. The Commission to Study the Reform of Chapter 11 established by the American Bankruptcy Institute issued its final report in 2014 after a three-year review.[38] Singapore's Insolvency Law Review Committee was first tasked with

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31 Though note paragraph 29(a) below to the effect that the recent reforms in Singapore were indeed the culmination of a ten year process.

32 Commonwealth, Official Committee Hansard, Parliamentary Joint Committee on Corporations and Financial Services, 14 December 2022, p11 (Mr Winter; Dr Mundy).

33 Initial Submission, [113].

34 Initial Submission, [113].

35 Initial Submission, [113], [116]-[118].

36 Initial Submission, [114]-[115].

37 Initial Submission, [119]-[121].

38 Final Report and Recommendations, The Commission to Study the Reform of Chapter 11, 2012-2014, https://commission.abi.org/full-report.

undertaking a review in 2010 and reported in 2013.[39] After a subsequent review and report by the Ministry of Law's Committee to Strengthen Singapore as an International Centre for Debt Restructuring in 2016,[40] legislation was introduced in 2017[41] and 2018[42] which came into force in 2020—a full ten years after the initial review was commenced.

(b) It is notable that, as a policy matter, one of only four key goals in the terms of reference to Singapore's Insolvency Law Review Committee involved a key settled policy position of "[u]nifying the bankruptcy and corporate insolvency regimes in a single piece of legislation" (others were "modernizing" insolvency laws, making processes "user-friendly and accessible" and taking into account recommendations of a certain predecessor committee).[43]

(c) Several Australian practitioners and academics have participated in recent international reviews. Mr Richard Fisher, from whom this Inquiry has already heard at public hearings, was both a commissioner on the original Harmer Inquiry and a consultant to Singapore's recent Insolvency Law Review Committee.[44] Indeed, Australian private practice lawyers were recently tasked with effectively the entire design of Myanmar's new insolvency regime over a several year process concluding in 2020.[45] In any root and branch review of Australian insolvency law, it is important that any inquiry utilise the resource of the extensive experience of Australian practitioners and academics in these international processes.

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39 Final Report of the Insolvency Law Review Committee, 2013, https://app.mlaw.gov.sg/files/news/announcements/2013/10/ReportoftheInsolvencyLawReviewCommittee.pdf.

40 Report of the Committee to Strengthen Singapore as an International Centre for Debt Restructuring, 20 April 2016, https://www.mlaw.gov.sg/files/news/public-consultations/2016/04/Final%20DR%20Report.pdf.

41 *Companies (Amendment) Act 2017* (Sing).

42 *Insolvency, Restructuring and Dissolution Act 2018* (Sing).

43 Final Report of the ILRC, above n39.

44 Final Report of the ILRC, Ibid.

45 Scott Atkins and John Martin of Henry Davis York, later Norton Rose Fulbright Australia were engaged for the project following an international tender. Mr Atkins is a former president of ARITA and is now the president of INSOL International. https://www.nortonrosefulbright.com/en/knowledge/publications/672efb15/norton-rose-fulbright-advises-myanmar-on-new-insolvency-law.

Question 1(f)

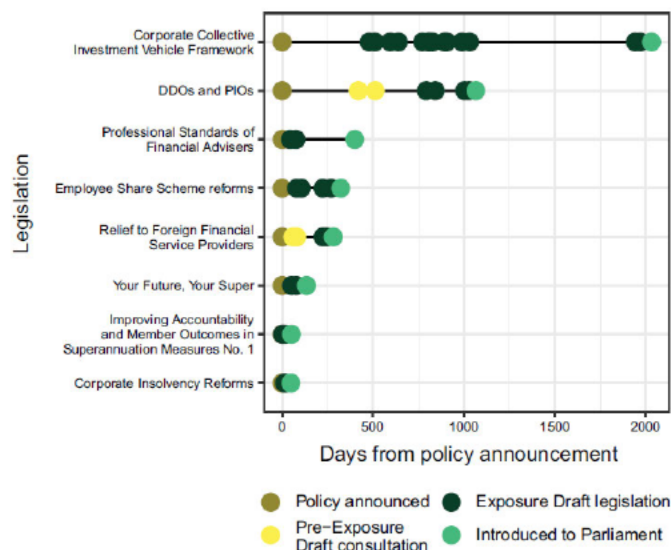
The ALRC is currently undertaking a review of the legislative framework for corporations and financial services regulation. Will that review address the complexity of insolvency law, or should the root and branch review take a similar approach?

30. The ALRC's current inquiry is focussed on Chapter 7 of the Corporations Act and so its relevance to insolvency matters (contained in Chapter 5) is limited. In late 2021, the then-President of the ALRC said of that inquiry:[46]

> *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.*

31. That Interim Report was released shortly after and made only a few minor references to insolvency law matters.[47] A subsequent Interim Report has since been released by the ALRC as part of the same review and, again, it has only passing relevance to insolvency matters.[48] Incidentally, the only direct reference in the report to insolvency is a comment to the effect that law design processes for corporate insolvency reforms have recently been far shorter than for any other topic:[49]

Figure 6.6: Timelines from announcement to Parliament



46 "The Changing Face of Law Reform in Australia", Derrington J, above n30.

47 'Financial Services Legislation: Interim Report A', ALRC Report 137, November 2021, https://www.alrc.gov.au/publication/fsl-report-137/.

48 'Financial Services Legislation: Interim Report B', ALRC Report 139, September 2022, https://www.alrc.gov.au/publication/fsl-report-139/.

49 'Interim Report B', Ibid, p182.

32. Again, the words of the ALRC's then-President are instructive:

> *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.*

33. Effectively, the ALRC's inquiry into financial services legislation is focussed on drafting and not on matters of policy. It is unclear to us whether the former President's reference to ARITA's position at the conclusion of that paragraph remains current. Whether any root and branch review into insolvency should address only technical drafting or matters of policy is the subject of the next Question on Notice and is addressed there.

Question 1(g)

Should the root and branch review address both the policy and legislative framework for insolvency?

34. In Recommendation 1 of our Initial Submission, the Committee suggested that, in respect of any of the issues raised in the Inquiry on which the PJC is not able to come to a final conclusion (in the time available or because it is outside the scope of the Inquiry's Terms of Reference), the PJC should recommend a further review by the ALRC or another appropriate body into those matters.

35. In our respectful submission, despite a material volume of well-considered submissions from a wide range of stakeholders and a dedicated team of committee members in the PJC, there will be some matters where, in the time and with the resources available, the PJC is not able to come to any final policy view. In some respects, given that, there may be other areas where the PJC might determine to leave ultimate policy recommendations to a broader inquiry. Decisions about the appropriate position policy to take on narrow issues such as preference recovery laws are best made with the benefit of comprehensive data and economic considerations that may take some time to compile.

36. Ultimately, the Committee recommends that any root and branch review address both:

    (a) policy matters, albeit potentially with some guidance from the PJC following its review; and

    (b) legislative framework matters (as to which see paragraph 27 above).

2. Purpose of Australia's insolvency laws

Question 2(a)

What are the goals and purposes of Australia's corporate insolvency laws?

37. Insofar as this question relates to the goals and purposes of Australia's current insolvency laws, in our Initial Submission, the Committee made reference to the summary provided by Derrington J of the key "[p]rinciples of contemporary insolvency law" enunciated in the Harmer Report:[50]

    1. *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;*

    2. *the insolvency law should provide mechanisms that enable both debtor and creditor to participate with the least delay and expense;*

    3. *insolvency law should, as far as convenient and practical, support the commercial and economic processes of the community; and*

    4. *as far as is possible and practical, insolvency laws should not conflict with the general law.*

Question 2(b)

Do you think those goals and purposes are clearly articulated at present? To the extent they are, are they in turn adequately realised in practice?

38. As we said in our Initial Submission, we consider Australia's corporate insolvency regime works generally well. There are opportunities for reform based on three key issues:

    (a) narrowly-focussed and piecemeal reforms over time which have resulted in a disparate and unnecessary complicated set of provisions;

    (b) a need for substantive reconsideration of the stakeholder balance in circumstances where there have been those piecemeal reforms which may not reflect general insolvency principles adequately; and

    (c) changes to the economy over time which have given rise to the need for consideration of potential reforms for SMEs as well as larger businesses (many of these specific areas of potential reform are identified in our Initial Submission).

[50] "The Changing Face of Law Reform in Australia", Derrington J, above n30. See also Initial Submission, [17].

39. To that end, consideration at least should be given to reforms to ensure the goals and purposes on which our regime is based remain appropriate and remain adequately reflected in the regime.

Question 2(c)

The Australian economy has changed considerably since the Harmer report was released in 1988. Have the goals and purposes of Australia's insolvency law changed with it?

40. In many respects, the Harmer Report principles are probably as applicable today as they were in 1988. There are other relevant compilations of criteria that might be consulted. The PJC itself assessed some of them in a previous report.[51] That report analysed the purposes of insolvency law enunciated in the Harmer Report, those in the Cork Report (which was in many ways the UK equivalent and was the foundation for the UK's *Insolvency Act 1986* (UK)), a then-recent review in New Zealand, and the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes (then recently released, but since revised—most recently in 2021).[52]

41. This Response does not seek to reproduce all of those lists, which are voluminous, but in coming to any final conclusions about the guiding principles of insolvency law, all of those documents should be consulted in detail.

42. In considering any foreign materials, it is necessary to consider the particular social, economic and political considerations specific to the Australian economy. For example, one of the key drivers behind the recent Singaporean reforms was a desire to attract international capital. Despite growth in globalisation since the Harmer Inquiry, international investment may not be as key or sole a focus for Australian reform as in other jurisdictions.

Question 2(d)

Is there an appropriate balance between the interests of stakeholders with the mixture of creditor and debtor-in-possession regimes that are currently in place?

43. As noted at paragraph 39 above, consideration should be given to some potential reforms. For example, the Committee identified in our Initial Submission the prospect that a broader debtor-in-possession model might be made available to the middle-market (to complement schemes of arrangement at the larger end and the SBR Regime for SME businesses).[53]

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[51] 'Corporate Insolvency Laws: A Stocktake', Parliamentary Joint Committee on Corporations and Financial Services, June 2004, https://www.aph.gov.au/~/media/wopapub/senate/committee/corporations_ctte/completed_inquiries/2002_04/ail/report/ail_pdf.ashx, see esp. [2.46]-[2.52] & Appendix 4.

[52] The World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes, 2021, https://openknowledge.worldbank.org/bitstream/handle/10986/35506/Principles-for-Effective-Insolvency-and-Creditor-and-Debtor-Regimes.pdf.

[53] Initial Submission, [128]-[131], Recommendation 24.

Question 2(e)

Are the goals and purposes themselves adequate and appropriate, or may they need reform?

44. Economic questions are front and centre in this analysis. As identified in paragraphs 40–42 above, it may be appropriate to consider the applicability of international developments to some extent, but with Australia's particular social, economic and political climate in mind.

3. Major reforms

Question 3(a)

What are the main gaps, discrepancies, or failings of Australia's current corporate insolvency laws?

45. The biggest major omission from Australia's current insolvency laws is a proper system for the management of trusts with insolvent trustees. We have dealt with that issue further at paragraphs 79–83 below.

46. There are other gaps and discrepancies, but none of them could be described as main or major. Our Initial Submission identified some potential areas for reform in respect of the voluntary administration (VA) regime, the SBR Regime, the simplified liquidation regime, the creditor-defeating disposition provisions, and the PPSA (as to which, see paragraphs 98–100 and 103–104 below).[54]

Question 3(b)

Are there major reforms that are required?

47. As already noted, there should be a proper system for regulating trusts with insolvent trustees.

48. Our Initial Submission also contemplates consideration of other reforms (beyond filling the gaps in the current system), particularly in light of international experiences (as to which, see paragraph 28 above).

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[54] Initial Submission, Recommendations 2-11.

Question 3(c)

Are any adjustments needed to preference claims and the use of litigation funding?

49. In our Initial Submission, we analyse some of the history of unfair preference laws and policy.[55] The upshot in our view was that care should be taken in recommending or implementing any reforms to the unfair preference regime that might have the effect of incentivising directors to dispose of company assets prior to appointments in a manner contrary to creditors' interests as a whole.[56] Notwithstanding that recommendation for caution, we note our comment on potentially streamlining the preference recovery system:

    97. That is not to say the preference recovery system cannot be streamlined and support given to creditor recipients to ensure they are properly represented and the system is able to operate effectively. There might, for example, be a better regime for determination of preference recovery amounts than the expenditure of material amounts of creditors' time and money on public examinations and subsequent court proceedings (coupled with the necessity for matching expenditure by recipients who, again, have done nothing wrong).

4. Public interest aspects of Australia's corporate insolvency laws

Question 4(a)

What aspects of the role of corporate insolvency practitioners are largely serving public purposes and are unfunded?

50. Corporate insolvency practitioners play at least the following conceptual roles under the current system:

    (a) one is tidying up the affairs of insolvent entities sufficiently for the commercial benefit of the stakeholders directly in that insolvency;

    (b) another is the investigation of misconduct or other matters that may or may not provide a commercial advantage to the direct stakeholder of the relevant entity but even if not are considered to be appropriate for other purposes.

51. An example of part of the role that may not directly benefit stakeholders in the relevant insolvency is the obligation to make reports under s 533 of the Corporations Act. The putative purpose of that sort of obligation goes beyond returns to stakeholders and extends to discouragement of poor corporate behaviour generally and the provision of assistance to the regulator.

52. Arguably, both parts of the insolvency practitioners' roles are in the public interest at least to some extent, though it is the second category that constitutes more of a public interest focus, because absent a statutory obligation, there would be no clear commercial imperative for an insolvency practitioner to do the work (and expend

[55] Initial Submission, [91]-[97].

[56] Initial Submission, Recommendation 13.

potential creditor returns on that work). Both categories of work are at least to some extent unfunded. More data is required to determine the extent of that issue.

Question 4(b)

To what extent is any unfunded work distorting the market where insolvency practitioners recover costs from unfunded work by charging higher rates on other matters?

53. The public hearings in this Inquiry have been the subject of some discussion on this point. The Committee's observations are as follows:

    (a) As an economic proposition, if a practitioner cannot recover fees for a material percentage of their work, the viability of their business model fails unless they can ensure a reasonable return on other work. That might not be a necessary conclusion where effectively *pro bono* work is not a material part of practitioners' activities, but suggestions before the Inquiry are that (to the contrary) substantial percentages of registered liquidator work is unfunded.

    (b) It is not a necessary consequence that the system involves material "cross-subsidisation" as has been put to the Inquiry in some submissions. Ultimately that is only the case if creditors of so-called 'profitable' insolvencies are being charged more than they should be charged (or perhaps would be charged if liquidators were fairly remunerated for other work or not required to perform unfunded work).

    (c) It is to be expected that creditors being paid a low cents-in-the-dollar return would scrutinise or feel aggrieved by a material portion of available funds being used to fund the work necessary to restructure or wind up the affairs of the company that owes them money. The public conversation about insolvency remuneration and consideration of stakeholder comments on those matters must be seen in that light.

    (d) It might be appropriate to compare the work done by and remuneration of insolvency practitioners to others who perform a similar role. Anecdotally, insolvency practitioner rates are often much lower than audit accountants, and the costs of insolvency processes are often comparable to or even less than the cost of an audit on a similar sized business, despite audit accountants performing a far less in-depth analysis of a company's affairs and having fewer direct obligations (and less personal liability) than insolvency practitioners.

Question 4(c)

Professor Jason Harris and Mr Michael Murray (submission 18) suggested 'a threshold financial and systems analysis of the regime, personal and corporate, be conducted, with a view to determining available funds and resources for necessary tasks. Depending on those findings, to then conduct a legal review to ascertain the private law and public law responsibilities in an insolvency.' Should such analysis be part of a root and branch review?

54. The Committee does not have a final and consensus view on some of the matters raised by Professor Harris and Mr Murray regarding these matters, in particular any potential introduction of a government liquidator.

55. However, it is undoubtedly appropriate for an analysis of the funding models, resource allocation and necessary tasks of insolvency practitioners to be the subject of any root and branch review.

Question 4(d)

What options are there to address unfunded public purposes of corporate insolvency work and what are the advantages and disadvantages of those options?

56. Three clear and distinct options for addressing these issues are:

    (a) legislative reform to remove or reduce the obligations on practitioners to perform unfunded work which is not considered to be adequately useful to justify the relevant expense;

    (b) the provision of government funding to practitioners to perform work which is presently required but unfunded; and

    (c) the introduction of a government-run (and funded) service (such as an official liquidator) to perform the work instead of requiring the private sector to do the work.

57. The disadvantage of removing the obligation to do the work is relatively obvious. Less investigation will lead to even less concern by bad actors about misconduct, and likely cause an increase in misconduct levels. The Committee is not convinced that because ASIC rarely takes enforcement action on misconduct reports, the misconduct reports should not be required. It may be that more enforcement activity is necessary. A comprehensive cost-benefit analysis must be conducted on any proposal to amend legislative obligations.

58. One obvious challenge presented by government funding to liquidators for any of that work is the simple cost to the taxpayer. That said, the Phoenix Taskforce estimates the economic impact of illegal phoenix activity on business, employees, and government to be between $2.85 billion and $5.13 billion annually.[57] If improved

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[57] https://www.ato.gov.au/General/The-fight-against-tax-crime/Our-focus/Illegal-phoenix-activity/The-economic-impact-of-illegal-phoenix-activity/.

funding of liquidators has a material effect on misconduct, the net positive effect on the taxpayer is likely to be substantial.

59. There is some support for a government or official liquidator, perhaps with a role similar to the Official Trustee in personal insolvency. Some jurisdictions have introduced a government liquidator or receiver (not necessarily by that name) for that sort of work. For example, the official receiver is the primary appointee on any court-appointed liquidation in the UK. The Committee is cautious about that approach. In Australia, there is no recent history of corporate liquidation activity inside government departments and its establishment would be a material task. Work may need to be subcontracted to the private sector in any event (as, anecdotally, often occurs in other jurisdictions) in which case the argument for a government appointee is weakened. Indeed, in some jurisdictions, there is recent movement away from a government-operated insolvency service.[58]

5. International best practice

Question 5(a)

To what extent do Australia's corporate insolvency laws align with the United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency Law?

60. Given the nature of this question, the Committee sought the input of the Working Group V (Insolvency) Expert Advisory Committee (**WCV EAC**) of UNCCA. A number of members of WCV EAC are also members of the BLS Committee, including Mr Scott Butler who is its chair.

61. The UNCCA has analysed the extent to which Australia's insolvency laws align with each of the 377 recommendations contained in UNCITRAL's Legislative Guide on Insolvency Law. Although the question only refers to corporate insolvency law, for completeness, the analysis also considers Australia's personal insolvency laws. The UNCCA's analysis is attached to this Response as Annexure A.UNCITRAL's Legislative Guide on Insolvency Law has five parts. Parts One and Two which deal with insolvency laws generally were adopted in 2004. Part Three, which deals with the treatment of enterprise groups in insolvency was adopted in 2010. Part Four, which deals with directors' obligations in the period approaching insolvency (including in enterprise groups) was adopted in 2013, and a second edition adopted 2019. Part Five, which deals with Insolvency law for micro and small enterprises was adopted in 2021.

58 See, e.g., Singapore, where the *Insolvency, Restructuring and Dissolution (Amendment) Act* was passed in January of this year and mandates all personal bankruptcies be administered by private trustees in bankruptcy except those which the Official Assignee (the relevant government service) decides to administer for public interest reasons.

62. The analysis undertaken reveals as follows:

(a) Australia's corporate (and personal) insolvency laws generally align with UNCITRAL's Legislative Guide.

(b) The key areas where Australia's laws do not align are as follows:

(i) c/f recommendation 26, in Australia, there is no restriction on commencement of insolvency proceedings for debtors whose assets and sources of revenue are insufficient to meet the costs of administering the insolvency proceedings;

(ii) c/f recommendation 53 and 63–68, there is no specific regime for the raising of finance during an insolvency proceeding which can have priority over existing secured creditors (as there is, for example, in the US and in Singapore);

(iii) c/f recommendations 69—82, there is no specific regime governing the acceptance or rejection of pre-appointment contracts;

(iv) c/f recommendations 83–84, there is no provisions allowing the assignment of contracts irrespective of terms in the contracts which restrict such assignment;

(v) c/f recommendation 125, - there is no special mechanism for insolvency representatives to be remunerated where the assets of the estate are insufficient to meet the costs of the administration. The result is that insolvency representatives must write off remuneration in excess of the available assets in the estate;

(vi) c/f the recommendations in Part 3 of the Guide, Australia has not legislated any specific provisions in its insolvency laws which deal with the treatment of Enterprise Groups in insolvency and accordingly, many of the recommendations are not reflected in Australia's insolvency laws. However, it is not uncommon for there to be an insolvency of an Enterprise Group and, in practice, Australian insolvency laws are currently flexible enough to allow for that to occur;

(vii) Australia's laws relating to directors' obligations in the period approaching insolvency (either under statute or under the general law) generally reflect the recommendations contained in Part 4 of the Guide, however, our insolvent trading laws go further than the matters recommended. In particular, the insolvent trading laws are more stringent than recommendation 255, which is more aligned to the wrongful trading laws in the UK, where directors have a duty to take all necessary steps to minimise the losses to creditors from the point the directors knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation; and

(viii) the recommendations in Part 5 of the Guide presume, for the most part, that a simplified insolvency procedure will be implemented and controlled by a court or some other government body, which is not the case for the small business restructuring (**SBR**) procedure in Part 5.3B of the Corporations Act, nor the simplified liquidation procedure in

Subdivision B or Division 3 of Part 5.5 of the Corporations Act. That aside, the SBR Regime and the Debt Agreement process under Part IX of the Bankruptcy Act are generally consistent with most of the recommendations. One glaring difference, however, is that contrary to recommendation 283, the SBR process does not reduce formalities for all procedural steps, including for submission of claims, for obtaining approvals and for giving notices and notifications. The SBR Regime is a complex process, making it more expensive than it should be, and the laws which apply to it are generally almost as complex as in a voluntary administration (and often mirror the same provisions which apply to voluntary administration).

Question 5(b)

Are there aspects of the UNCITRAL legislative guide that Australia should follow?

63. In the Committee's view, Australia should consider following:

(a) recommendations 53 and 63–68—there should be a specific regime for the raising of finance during an insolvency proceeding which can have priority over existing secured creditors (this is a matter that was raised in our Initial Submission under the heading 'Super-secured finance');[59]

(b) recommendations 83–84—there should be a mechanism to allow the assignment of contracts irrespective of terms in the contracts which restrict such assignment;

(c) recommendation 125—there should be a mechanism for insolvency representatives to be remunerated where the assets of the estate are insufficient to meet the costs of the administration;

(d) recommendation 255—our insolvent trading laws are more stringent than recommendation 255, which are more aligned to the wrongful trading laws in the UK where directors have a duty to take all necessary steps to minimise the losses to creditors from the point the directors knew, or should have known, that the company was insolvent; and

(e) recommendation 283—the SBR process should be re-examined to consider how it could be simplified and made more efficient and cheaper.

[59] Initial Submission, [119]-[121], Recommendation 22.

6. Data and research

Question 6(a)

Submitters to this inquiry and many previous inquiries and reviews have recommended that better data, statistics, and research is needed on corporate insolvency. Are those recommendations difficult to progress, and if so, why?

64. There are several categories of data that would be useful for the conduct of a proper review of the insolvency regime. Some statistics are easily enough obtained. There are barriers to the collection of other data. A non-exhaustive list of reasons might be:

    (a) poor historical record-keeping (for example, the introduction of the Director ID regime is intended at least in part to address issues with record keeping regarding directors who are appointed to multiple companies with slightly different names, addresses, etc.);

    (b) privacy or regulatory concern (for example, it may not be in the public interest to collate and make publicly available statistics on enforcement policies or the like which might assist untrustworthy advisors in devising systems to avoid detection); and

    (c) cost (the sheer volume of work in collecting, collating, and analysing data on some matters is enormous).

65. On that last point, Professor Jason Harris, who is a member of this Committee and has also appeared in a private capacity before the Inquiry, recently published a PhD thesis examining some relevant data on voluntary administrations. The fact that the amount of work involved constituted a material part of a doctoral submission is illustrative of the task at hand.[60]

Question 6(b)

To assist insolvency reform in a root and branch review, what are the research questions for which better data is needed?

66. It is not possible in this Response to provide an all-encompassing list of the sorts of data that might be relevant to a root and branch review. Arguably, the ALRC (or other appropriate body tasked with a review) might be left to consider that matter itself. The ALRC has done an admirable job of considering and compiling relevant data as part of its Review of the Legislative Framework for Corporations and Financial Services Regulation.

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[60] 'Promoting an Optimal Corporate Rescue Culture in Australia: The Role and Efficacy of the Voluntary Administration Regime', PhD submission, Adelaide Law School, Jason Harris, April 2022.

67. Some matters that might be relevant are:

(a) quantitative data on formal appointment numbers across industries and time periods (this is generally already readily available);

(b) quantitative data on creditor returns (there is already some publicly available data on these matters);

(c) quantitative data on practitioner fees and recovery;

(d) quantitative and qualitative data on regulatory enforcement (there is some available, but it is not necessarily sufficient);

(e) quantitative data on creditor attendance and voting in formal insolvency processes;

(f) qualitative data on matters such as stakeholder interest in insolvency processes of various types;

(g) qualitative data on how issues arising (that might be addressed by reform) have affected insolvency processes, continuation of business, creditor return and other matters; and

(h) quantitative and qualitative data from foreign jurisdictions on the success (or otherwise) of insolvency processes with minor or major differences to the Australian system which may prove useful in considering potential reforms.

Question 6(c)

Are there sources of data that exist, but are not publicly available?

68. Undoubtedly some regulators hold data which either cannot or at least is not publicly released for one reason or another. There may be good reasons why a regulator is reluctant to release certain information publicly. For example, during public hearings in this Inquiry, ASIC was asked whether it might reveal its algorithm for determining when misconduct reports might be further investigated, and responded:[61]

> *Mr Day: I think the answer is that we should always explain the types of things we're taking into consideration when we make our regulatory decisions. I think that's just part of the way we go about it. We try to be as transparent as we can as a regulator. <u>I'd be loath to say we'd open up all the inner workings of the 'black box', as I think you're describing it, mainly because we've seen a bit of gaming of it in other spaces.</u>* (emphasis added)

69. Later in questioning, ASIC accepted it had large volumes of data that might be considered further and released where possible.[62]

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[61] Commonwealth, Official Committee Hansard, Parliamentary Joint Committee on Corporations and Financial Services, 14 December 2022, p69 (Mr Day).

[62] Ibid, p72 (Mr Day).

Question 6(d)

Have the COVID-19 emergency measures had a distortionary effect on available data from the past three years and broader trends over the past decade?

70. Absolutely. Appointment numbers (particularly in respect of some types of appointments) are down materially, anecdotally as a result of decreased enforcement activity (by the Commissioner amongst others), stimulus packages such as JobKeeper, and temporary legislative changes such as extended periods to respond to statutory demands and insolvent trading moratoria.

71. Those changes will distort not just appointment numbers but other matters which may not be as self-evidently affected (for example, average creditor returns may have changes during that period).

Question 6(d)(i)

If yes, are there any steps required to mitigate this other than just waiting?

72. Data can be examined from pre-pandemic periods as well as the last three years. It may also be possible in some circumstances either to correct for these changes in respect of some data, or at least qualitatively to take note of those matters when considering the data.

7. Harmonisation of corporate, personal, trust, & partnership insolvency law

Question 7(a)

Why does Australia have separate Acts for personal and corporate insolvency?

73. Ultimately the short answer to that question is that it was considered too hard to do properly. There is a long a drawn-out history to Australia's federal companies legislation, which played out at about the same time as the Harmer Inquiry and consequent regulatory changes were introduced to the insolvency regime.

74. The regulation of companies has its origins in the *Joint Stock Companies Act 1844* (UK). In Australia, companies were originally governed at the state level. In the 1960s, each state introduced uniform legislation in an effort to remove difficulties caused by differing legislation between states.[63] In the 1970s, the Eggleston Reports led to the establishment of a National Companies and Securities Commission (the precursor to ASIC).[64] During the 1980s, legislation was developed for a unified

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[63] *Companies Act 1961* (Vic); *Companies Act 1961* (NSW); *Companies Act 1961* (WA); *Companies Act 1961*; (Qld); *Companies Act 1962* (Tas); *Companies Act 1962* (SA); *Companies Ordinance 1962* (ACT); *Companies Ordinance 1963* (NT).

[64] *National Companies and Securities Commission Act 1979* (Cth), later repealed by the *Corporations Legislation Amendment Act 1991* (Cth).

Corporations Law under Commonwealth law.[65] That legislation was amended in 1990 to change the constitutional basis for the referral of power,[66] though the referral was still found by the High Court to be unconstitutional in 1999.[67] Ultimately that issue was resolved in 2001 with the introduction of the current Corporations Act.

75. It is possible in Australia that the constitutional issues surrounding the introduction of the Commonwealth companies legislation have clouded issues relating to the federal regulation of insolvency. Ultimately, there can be no issue with unified federal insolvency legislation, given that "bankruptcy and insolvency" are explicitly within the powers of the Commonwealth.[68]

76. In any event, alongside those corporate developments, there was debate over the proper regulatory home for both company law generally and insolvency provisions generally. During parliamentary debate on the current Corporations Act, then-Senator Barney Cooney said:[69]

> *The concept of where company law has gone is interesting. It has been taken out of the Attorney-General's Department, which really deals with human relationships. It deals with the wide thrust of the law, which is really about putting into rules those standards that we should abide by as a decent community. This government has taken company law out of the Attorney-General's Department and put it across to Treasury, whose purpose is to see that the economy runs well and that the wealth of the nation increases.*

77. Separately, debate about whether there should be a separate "insolvency act" is not new. The 1982 Cork Report in the UK resulted in the introduction of the *Insolvency Act 1986* (UK). The Harmer Inquiry considered the same path but determined to focus on reform proposals at the expense of the difficult task of combining personal and corporate insolvency:[70]

> *31.* ***Not a major issue.*** *While the Commission accepts that there are advantages in unified insolvency legislation it <u>does not regard the goal of unity to be one of major significance. It is more important to concentrate on the particular reform proposals put forward in this Report</u> than to be overly concerned with attempting to put the two very different aspects of insolvency law into one Act. However, as far as possible and necessary, the Commission has sought in the Report to promote the uniformity of the substance of the provisions relating to individual and corporate insolvency. Moreover, to the extent that future reforms proposed for the law relating to either individual or corporate insolvency touch matters which are common to both (particularly where those reforms affect procedural matters), it is the Commission's view that corresponding reform should be made to both sets of laws.* (emphasis added)

78. More recently, the Singaporean review examined the history of consolidation moves in various jurisdictions. After mentioning the move to a harmonised insolvency Act in the UK, the review noted that common law jurisdictions like Australia remained separated. The report proceeded to assess the benefits of harmonisation and the

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65 *Corporations Act 1989* (Cth), later repealed by the *Corporations Act 2001* (Cth).

66 *Corporations Legislation Amendment Act 1990* (Cth).

67 *Re Wakim; Ex parte McNally* (1999) 198 CLR 511. See also *R v Hughes* (2000) 202 CLR 535.

68 Australian Constitution, s51(xvii).

69 Commonwealth, Parliamentary Debates, Senate, 18 June 2001, p24474 (Barney Cooney).

70 Harmer Report, p14.

reasons why a determination had been made to consolidate the separate regimes. Whilst the bases cited are in some respect specific to Singapore, the reasoning is informative and so is reproduced in full below:[71]

> 2. *At the outset, the Committee notes that, in its report issued in October 2002, the Company Legislative and Regulatory Framework Committee ("CLRFC"), recommended the enactment of an omnibus Insolvency Act, modeled after the UK Insolvency Act and its subsidiary legislation, that will be applicable to both companies and individuals, in order to set out the common principles and procedures, as well as consolidate and update the core areas, of Singapore's insolvency regime. The Government accepted this recommendation.*
>
> 3. *The Committee observes that, although more than a decade has passed since the CLRFC issued its recommendations, a number of major common law jurisdictions continue to house their corporate insolvency and personal bankruptcy regimes in separate pieces of legislation. For instance, the corporate insolvency and personal bankruptcy regimes for Australia are found in their Corporations Act 2001 ("Australia Corporations Act") and Bankruptcy Act 1966 ("Australia Bankruptcy Act") respectively.*
>
> 4. *Nevertheless, the Committee is of the view that the CLRFC's recommendation should be implemented. There are several objectives to be achieved by enacting omnibus insolvency legislation and, as far as the Committee is aware, there are no disadvantages in doing so.*
>
> 5. *First, insolvency law has developed and is considered as a discrete area of commercial law that is underpinned by a set of concepts, principles, and policies. For instance, much of the judicial management regime bears a closer relationship with the bankruptcy and liquidation regimes than general company law. This reflects the reality that, when individuals and companies are in financial distress, substantially different concerns, tensions, and stakeholder interests and objectives emerge, which have to be addressed outside general commercial and corporate law.*
>
> 6. *Second, having our insolvency statutory law untidily dispersed in fragmented and disparate pieces of legislation is not in keeping with Singapore's goal of establishing itself as a main commercial, financial and legal hub within the region. The consolidation of our various insolvency regimes into a single piece of legislation enhances clarity and access to our laws by members of the commercial sector. It also assists insolvency practitioners who currently have to navigate the mass of primary and subsidiary legislation in order to advise their clients and carry out their functions.*
>
> 7. *Third, consolidation will help to address the inconsistencies and uncertainties that invariably arise from having to cross-refer to concepts from various pieces of insolvency legislation; especially where there are differences between legislation relating to nomenclature, timeframes, analogous procedures and appointment holders. One such example would be the broad importation mechanism in section 227X(b) of the Companies Act that empowers the court to order that any other section in Part X of the Act (which relates to winding up) shall apply to a company under judicial management as if it applied in a winding up by the court. In practice, questions have often arisen as to how, and under what circumstances, section 227X(b) of the Companies Act ought to operate. Another instance would be the CABAR, the difficulties of which have even been judicially noted.*

[71] Final Report of the ILRC, above n39, p9-11.

8. *Fourth, consolidation will ensure that there is proper statutory provision to support the transition, relationship and coordination between the different insolvency regimes. For instance, the New Insolvency Act should provide for the smooth transition of legal proceedings from one insolvency regime (such as judicial management) into another (such as liquidation); hence addressing the anomalies in our current law whereby the importation of the avoidance provisions from the Bankruptcy Act into the judicial management regime have effectively prevented liquidators from maintaining an action for avoidance if the action was first commenced when the company was in judicial management.*

Question 7(b)

What are the differences in insolvency law for trusts?

79. Unlike a company incorporated under the Corporations Act (whose origins, as already noted, lie in the *Joint Stock Companies Act 1844* (UK) and *Joint Stock Companies Winding-Up Act 1844* (UK)), trusts did not originate as vehicles for business and commerce. Their use as unincorporated business associations in Australia is a relatively recent phenomenon, dating back to the emergence of trading trusts in the 1970s/1980s. Because historically they did not trade, trusts rarely became insolvent and so there was no pressure on Parliament to develop an "insolvency law" specifically applicable to trusts. Instead, they were left to be dealt with as part of the insolvent administration of the trustee. If the trustee was a natural person, the Bankruptcy Act would be applied. If it was a company, the relevant provisions of the Corporations Act (and its predecessors) would be applied.

80. The problem with this is that both Acts are, and always have been, almost entirely silent when it comes to trusts. A trust (or, more correctly, a trustee in that capacity) will have assets, liabilities and stakeholders that are separate and distinct from those of the person or company in their own right (and of any other trust of which they are trustee). The Acts do not expressly acknowledge this. Trust assets, liabilities and stakeholders are left to be dealt with as part of the bankrupt person's or insolvent company's estate, by statutory provisions that are manifestly ill-suited to the task. There is no legislative guidance as to how trust assets, liabilities and stakeholders should be dealt with separately from the bankrupt/insolvent trustee's own personal assets, liabilities, and stakeholders. Some practitioners suggest that this may be an especially significant issue for tax-related liabilities between trustee companies and the Commissioner as a significant (if not sole) unrelated creditor, with the Commissioner potentially indemnifying liquidators of that trustee company to pursue such claims against the trust's assets (via any new replacement trustee).

81. As a result, insolvency practitioners have had to apply trust law principles to work out stakeholders' rights. Those principles are mostly case law rather than statutory, and are quite ancient, developed at a time when trusts did not engage in commerce as they do today. Moreover, they are complex, arcane, and opaque. This has led to copious litigation and forced the courts to develop over time a "common law of insolvency" for trusts in piecemeal fashion—a project that has only been (and can only ever be) partially successful, leaving the market in a state of ongoing confusion and uncertainty.

82. Although the issues have become more apparent with each wave of bankruptcies and insolvencies, they are not new. They were identified in the Harmer Report. As

noted in our Initial Submission, in the relatively recent *Carter Holt* decision, the High Court has lamented the lack of reform despite those recommendations:[72]

> *In 1988, the Australian Law Reform Commission observed that although the trading trust had been used extensively for more than a decade, "the companies legislation makes little or no provision for corporate trustees which become insolvent". That observation remains true today. The issue that arises on this appeal, which was foreseen nearly four decades ago, essentially concerns whether creditors who would be priority creditors of an insolvent company are priority creditors when that company trades as the trustee of a trading trust."* (references omitted)

83. The former Chief Justice of New South Wales also summarised the issue succinctly when he observed extrajudicially as follows:[73]

> *A battleground being forged between creditors, debtors and … beneficiaries, is how to deal with insolvent trusts, particularly of late, insolvent managed investment schemes. Despite the issue being noted in the Harmer Report and subsequently, there is still no legislative scheme covering these entities in the event of insolvency. Instead this is probably one of the last outposts in insolvency law which has been left to the ingenuity of the Courts and the general law to solve.*

Question 7(c)

What are the differences in insolvency law for partnerships?

84. In Australia, general partnerships are regulated primarily under state-based legislation. Provisions that apply on dissolution of the partnerships are similar but not identical in the various different states. In the main, those provisions provide for the use of partnership assets to pay partnership debts on effectively a *pari passu* basis, or possibly as otherwise determined in the relevant partnership deed, as distinct from under the priorities regime under the Corporations Act which gives priority to certain classes of claim, such as employee entitlements and costs of an external administration.

85. Over the years, there have been conflicting decisions in the case law about whether the Corporations Act regime applies to the winding up of partnerships between corporate partners. For example, in 1981, the Supreme Court of NSW found that the waterfall priorities regime in the NSW predecessor to the Corporations Act did apply.[74] Subsequently, decisions in the Supreme Court of NSW and Western Australia have found that the Corporations Act priorities regime do not apply,[75] whereas cases in the Victorian Supreme Court and the Federal Court of Australia have found (on different grounds) that one party as effectively manager of the relevant trading business was a trustee of the relevant partnership assets and

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72 *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth* [2019] HCA 20, per Kiefel CJ, Keane and Edelman JJ at [1].

73 The Hon T F Bathurst, 'The Historical Development of Insolvency Law' (2014) 39 Australian Bar Review 113.

74 *Anmi Pty Ltd v Williams* [1981] 2 NSWLR 138.

75 *Woods & White v Hopkins* [2016] WASC 16; *Re O'Keeffe Heneghan Pty Ltd (in liq)* [2018] NSWSC 1885.

therefore the Corporations Act priorities regime did apply.[76] In the most recent relevant decision, the WA Supreme Court suggested that where there is a partnership of more than five members it could be wound up under the Corporations Act regime but not otherwise.[77]

86. The current state of the law as to the winding up or dissolution of partnerships is unacceptable for at least two reasons:

    (a) First the inconsistency between the existing set of first instance decisions causes an undesirable lack of clarity.

    (b) Second, as is the case with trusts, it is undesirable in a policy sense to allow for business to be operated and dissolved without a proper regulatory system in place for dealing with insolvency. As it stands, a financier could advise borrowers to operate businesses through a trading partnership as a way of ensuring better security for financiers and avoiding the prospect that employees might obtain the priority afforded to them under the usual insolvency regime.

87. Whilst partnerships generally are regulated by state laws, there could not be a constitutional criticism of an attempt under any all-encompassing insolvency regime to govern the dissolution of insolvent trusts, given the express insolvency power in the Constitution (as to which, see paragraph 78 above).

Question 7(d)

What might harmonisation of all forms of insolvency law look like?

88. Reforms in Singapore involved the adoption of a harmonised act based primarily on the *Insolvency Act 1986* (UK). In the Committee's view, whilst structurally there is a distinct advantage in drawing from the international experiences, some caution should be exercised in leaning heavily on the international legislative language too closely. While Australian insolvency laws arose out of a UK base, the legislative scheme and the common law in this country have both developed in different directions.

89. Whilst in particular areas of potential reform, consideration should be given to the amendment of relevant provisions and the introduction of new provisions, we recommend that much of the existing legislative language in the Corporations Act and Bankruptcy Act (along with each of their associated regulations and other instruments) could be retained, and with it the extensive body of case law that has developed over the years.

90. We do consider there should be an assessment of the distinction between relevant matching concepts in bankruptcy and corporate insolvency (such as in relation to voidable transaction) with an attempt to align the regimes where appropriate.

[76] *Re Victoria Station Corporations Pty Ltd (Administrators Appointed)* [2018] VSC 163; *Michell, In the matter of Petromech Pty Ltd (in liq)* [2021] FCA 1378.

[77] *Woodhouse v Francis [No 2]* [2022] WASC 318, see esp. [95].

91. A reworking of the regulatory landscape will also be appropriate if it is determined that a harmonised legislative scheme will also be administered under a single department by a single regulator. As will a separation between the commercial and regulatory roles of various government departments and organisations (such as the ATO or Commissioner as a commercial creditor as distinct from a regulator).

Question 7(e)

What barriers are there to creating a single insolvency act?

92. Key challenges associated with establishing a harmonised "Insolvency Act" include:

    (a) the costs of a review process and a redesign of the legislative regime combining personal and corporate insolvency;

    (b) the separation of relevant legislative parts of companies law *per se* from corporate insolvency; and

    (c) the associated combinations and separations necessary in respect of the regulatory regime and possibly the establishment of a new or expanded regulator.

Question 7(f)

What would the advantages and disadvantages be of a single insolvency act?

93. Aside from the challenges associated with implementation of the regime (dealt with at paragraph 92 above), the key disadvantage of a harmonised insolvency regime might be considered to be the perceived establishment of new fractures between presently-combined regimes. It might be said, for example, that the regulation of companies is presently all dealt with primarily under the Corporations Act, and that removing sections of the regulatory regime for companies is an unwelcome division.

94. That sort of issue should be considered as part of any broader review, though the Committee suspects that on a cost-benefit analysis, the advantages of a harmonised regime (as enunciated in our Initial Submission and also in some respects above in this Response) are likely to outweigh any disadvantages.

8. COVID-19 emergency reforms

Question 8(a)

Were there any temporary measures or reforms introduced as a result of COVID-19 that went too far or not far enough?

95. It is difficult to comment at this stage about the effectiveness or otherwise of some of the temporary measures put in place to protect the economy. There is no doubt that some measures adopted for a macro-economic benefit has some awkward consequences for specific stakeholders in specific situations. Some might argue that

some of the issues currently facing the construction industry resulted from inappropriate or inappropriately timed stimulus packages during the early stages of the pandemic.

96. Some general comments might be made about the reforms introduced during 2020 and 2021 insofar as lessons might be learnt from the experiences:

(a) In hindsight, the temporary changes to the insolvent trading prohibitions were a little loosely drafted in a way that gave rise to uncertainty and debate.[78] There remains some concern about assessment of historical debts through periods where safe harbour did, then did not, then perhaps did apply again.

(b) Government reacted quickly and efficiently, effecting changes to law in a timeframe that members of this Committee had not previously seen. Those timeframes necessarily created challenges, including extremely short consultation periods. Care should be taken to avoid a permanent change in this regard.[79]

Question 8(b)

Are there areas requiring normalization or reform that have been identified from the COVID-19 emergency measures?

97. Whilst many of the reforms were temporary, some of the legislative reforms enacted in a short timeframe are permanent (such as the simplified liquidation process and SBR Regime discussed in answer to other questions below). Whilst no criticism is made of those who worked hard to achieve reform in those circumstances, there are opportunities to examine and tidy up deficiencies in the legislative drafting now.

9. Recent reviews

Question 9(a)

The following reviews are complete, but the recommendations are yet to be implemented by government:

- Whittaker Statutory review of the Personal Property Securities Act 2009;
- The ABSFEO [sic] Insolvency Practices inquiry; and
- The Insolvent Trading Safe Harbour statutory review.

Are there any barriers to implementing those recommendations?

98. The Whittaker Review was conducted some time ago. The key barrier to implementation of the recommendations of the Whittaker Review is probably the sheer number of recommendations. Leaving aside those recommendations which are not to make any changes (that is, some recommendations did not require any

[78] See Initial Submission, [32].

[79] Ibid. Also, see paragraph 31 of this Response above.

implementation), there are probably about 240 recommendations for the amendment of the PPSA or of the functionality of the PPSR.

99. Another barrier to implementation of the Whittaker Review recommendations may be that some of the recommendations relating to the functionality of the PPSR (which are the most useful from a practical perspective) may involve changes to the software and systems underpinning the PPSR. Those changes may be costly and time-consuming for government, and costly and time consuming for users of the PPSR who would have to adapt their own systems as a consequence of these changes being implemented.

100. While all of the Review's recommendations are well considered, it might be possible to identify perhaps two dozen recommendations that would provide the most benefit. Implementing these key recommendations would be a lot easier than trying to deal with all 240, many of which will likely have little relative practical impact. Without seeking to identify an exhaustive list of key recommendations, they might include (as examples only):

    (a) Recommendation 15—that the definition of 'chattel paper' in s10 be deleted and all references to chattel paper be removed from the PPSA;

    (b) Recommendation 20—that the definition of PPS lease in s 13 be amended to remove all references to 'bailment'; and

    (c) Recommendation 92—that item 4(c) in the table in s 153(1) and the functionality of the PPSR be amended to enable a registration to be made against a number of collateral classes at the same time using a common free text field.

101. The ASBFEO Insolvency Practices Inquiry, by contrast, only made 10 recommendations, at least some of which have been subsequently implemented (such as updates to the statutory demand threshold and implementation of a simplified liquidation regime, at least in name). We are not aware of any specific barrier to implementation of some of the unimplemented recommendations, but we note our caution below in respect of some policy positions of the former ombudsman.

102. Finally, in respect of the Safe Harbour Review, again some of the recommendations were not to reform anything. Recommendation 14 was a holistic inquiry (effectively the mooted root and branch review currently being contemplated by the PJC).

Question 9(b)

Are there any of those recommendations that should not be implemented?

103. The Whittaker Review contemplates the abolition of s 588FL of the Corporations Act and the relocation of the concept of "circulating assets" from the PPSA to the Corporations Act. Given those reforms require amendments to the Corporations Act, it may be that consideration is given to the reworking of those provisions as part of broader considerations into harmonising insolvency legislation.

104. Further, there are some recommendations in the Whittaker Review relating to uncertainties in law which may no longer require amendments following case law

clarifying the position since the publication of the Whittaker Review. One example is the Review's recommendation 238 - that the PPSA be amended to clarify that references in sections 62 and 63 to the grantor obtaining possession of personal property are references to the grantor obtaining possession in its capacity as a grantor. This specific issue has, in our view, been sufficiently clarified by a subsequent superior court decision[80] which, not surprisingly, adopted the same approach as a long line of Canadian cases.

105. Separately from the Whittaker Review, there are recommendations for amendments to the PPSA in other submissions to this Inquiry that warrant consideration. ARITA's submission to the effect that secured parties' registrations should be deemed abandoned if they do not respond to notices within 15 business days[81] would solve many problems but might also be considered heavy-handed, given it involves effectively taking away people's property rights.

106. Turning to the ASBFEO Insolvency Practices Inquiry, we note that the inquiry report makes recommendations in respect of insolvency policy that in some respects target certain stakeholders or sectors of the economy (including at times insolvency practitioners, big business and landlords) in favour of certain other stakeholders (such as farmers and other small business operators). The Committee has cautioned in our Initial Submission and again in this Response against narrowly focussed reform without a broad view to the goals and purposes of the insolvency regime. It may be that some aspects of the ASBFEO Insolvency Practices Inquiry need reconsideration in that light.

10. Small business restructuring and simplified liquidation reforms

Question 10(a)

In January 2021, the following reforms commenced:

- a new small business restructuring regime to enable simpler restructuring of small businesses; and
- a simplified liquidation process to streamline creditors' voluntary winding up for companies that have liabilities less than $1 million.

How well are the reforms working and, in particular, the debtor in-possession aspects of the small business restructuring regime?

107. Anecdotal evidence from SBR practitioners is that the reforms are working reasonably for the limited SMEs which meet the entry criteria. While there are many insolvency practitioners who have not undertaken SBRs, it does appear that negative industry sentiment and perhaps a delay in investments in systems and processes to implement SBR practices are factors in the relatively low take-up of SBRs to date.

80 *Samwise Holdings Pty Ltd v Allied Distribution Finance Pty Ltd* [2018] SASCFC 95.

81 ARITA, Submission 36 to the Parliamentary Joint Committee on Corporations and Financial Services, 30 November 2022, p53.

108. With reforms to further simplify the process and expand the eligibility criteria (as referred to in the Initial Submission, as well as other submissions to the PJC on the issue), the policy aim of providing an efficient, cost-effective restructuring process for MSME businesses is achievable. For example, restructuring plans should be able to treat related party creditors differently to arm's length creditors.

Question 10(b)

Are any adjustments required?

109. In the Initial Submission, the Committee made recommendations that consideration should be given to the loosening of employee entitlements and taxation filing criteria, as well as the potential lifting of the debt cap (Recommendations 5, 6 and 7).

110. There is material support for some of those propositions in other published submissions to the PJC. Notably though, that support is not universal. We understand that ARITA, for example, consider that the purpose of the SBR Regime was to provide a simplified solution for only very small businesses and so they advocate for the reduction of complexity, but not an extension of the debt cap.[82]

111. SBR practitioners require guidance on questions such as:

    (a) further clarity regarding SBR eligibility– including quantification of contingent claims, such as worker's compensation or under leases; and

    (b) when the restructuring practitioner is required to pay a priority dividend.

    Consultation and improved guidance from the relevant regulator (or necessary amendments to the legislation) will assist SBR practitioners by providing certainty and accordingly reducing costs and take-up of the regime.

112. The availability of insurance in industries such as construction affects SBR take-up. SBR practitioners have reported instances where SBR is simply not possible because the insurance market will not insure a SME subject to SBR or will cancel the existing policy and issue a new policy at a prohibitive cost. Further conflict arises for industry-based insurance schemes, such as the construction industry's insurance through the Victorian Managed Insurance Authority. This insurance scheme is incompatible with the SBR regime where and SBR appointment triggers builder's warranty insurance and new builds will not be covered. Presently, construction accounts for just 20% of the overall usage of SBR,[83] approximately 15% below the rate at which construction is represented in insolvency figures overall.[84]

113. Anecdotally, the debtor-in-possession model works relatively well in practice. However, clarity is needed regarding when a transaction can be said to be entered into outside the 'ordinary course of business'.

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82 ARITA Submission, Ibid, pp 43-46.

83 https://asic.gov.au/media/31okxjmd/rep756-published-17-january-2023.pdf p8.

84 https://www.mbav.com.au/news-information/media-release/victoria-accounts-third-building-and-construction-insolvencies-2021?policy#:~:text=There%20were%20a%20total%20of,(16.5%20per%20cent)%20third.

114. SBR practitioners are not required by the legislative regime to conduct an analysis of the putative return to creditors in the SBR as compared with a liquidation, however, anecdotally the ATO do require this analysis (noting that the Commissioner is a substantial creditor in most SBRs). Accordingly, a substantial report becomes necessary to be generated, resulting in heavily caveated comments and arguably more work than should be necessary for an effective SME restructuring regime. An agreed standard for reporting requirements under the SBR Regime would assist SBR practitioners, reduce costs, provide certainty and likely improve take-up of SBR.

Second Question 10(a)

Table 2.1 in Treasury's submission (submission 34, page 11) demonstrates an increase in the number of companies entering small business restructuring over the past three quarters, from 9 in first quarter to 83 in the September quarter. What, if anything, does this trend say about take-up of the regime?

115. The Committee analysed this issue in the Initial Submission[85] where we referred to the same statistics used in the Treasury Submission. The incidence of SBR has almost tripled from FY21 to FY22 and, while still only representing a small fraction of the overall restructuring/insolvency statistics, the rate at which it is being utilised is promising, overall. Some practitioners suggest that the take-up could be further increased if the debt limitations on eligibility are increased from $1 million (e.g. to $3 million or $5 million), though it is noted at paragraph 110 above that there is not universal support for that change.

116. It appears that those insolvency practitioners who have invested in creating processes and precedents are successfully implementing SBR –of the small number of practitioners taking these appointments, many of these practitioners have multiple appointments. Anecdotally, it is the lack of awareness among 'High Street' accountants and business advisers (so-called 'referrers') regarding SBR appointments and who to refer their clients to, which hinders take-up of this regime. SBR practitioners who have targeted referrers are reporting increasing levels of inquiry—translating to increased appointments.

117. A more material government publicity campaign might assist in take-up of SBR appointments (it appears the fact sheets on the ASIC website are not driving enquiries from SMEs).

Second Question 10(b)

Is there enough data yet to properly evaluate the efficacy of the regime?

118. There is insufficient data yet available to evaluate the take-up of the SBR regime. While the Committee are not statisticians, we are inclined to think it might be preferable to have at least a further 24 months' data before declaring the SBR

[85] See Initial Submission, [53ff] in respect of the SBR Regime and [62ff] regarding simplified liquidations.

regime a success or otherwise. Having said that, the positive trend in take-up of SBR is noted.[86]

119. The story is different in respect of simplified liquidations with only 59 simplified liquidations between March 2021 and September 2022.[87] While for consistency, a further 24 months' data could be compiled (and likely will given the government's busy legislative agenda makes it unlikely the reforms would be reversed in the next 24 months), it appears that the insolvency profession has determined that the simplified liquidation process is too cumbersome and costly to implement. In this regard, we refer to Recommendation 9 of our Initial Submission.

Question 10(c)

What factors may have influenced this increase?

120. Anecdotally, the increase in the take-up of the SBR Regime correlates with SBR practitioners directly approaching referrers to educate them about the process. Once one referrer's SME client successfully completes a restructuring plan, the referrer invariably will have the SBR Regime front of mind and recommends SBR to its other SME clients. As noted at paragraph 107 above (and in our Initial Submission), it might be that some inevitable delay in investment in templates, systems and processes for implementation of SBRs were factors in the low early take-up that are now being addressed.

11. Regulation of pre-insolvency advisors

Question 11(a)

What data and research are available on the impacts of the unregulated environment for pre-insolvency advisors?

121. Regrettably, there is very little data on pre-insolvency advice, because its very nature is that it is outside formal appointment and thereby not measurable. Increasingly, legitimate actors in that space can be counted and identified. Many are members of organisations such as the TMA (Turnaround Management Association).

122. Public hearings in this Inquiry have already focussed on the terminology surrounding "pre-insolvency advisors" and the manner in which that term can be used in a pejorative sense. The true focus of this question is presumably on identifying improper behaviour by some untrustworthy advisors. In that regard, it is important to have regard to the work of the ATO's Phoenix Taskforce, established in 2014. The Phoenix Taskforce have done a lot of work to identify improper behaviour in this space and may be in a position to provide more detail to the Inquiry. A 2018 Report commissioned by the Phoenix Taskforce contains a material amount of data on

86 ASIC, Report 756, Review of small business restructuring process, January 2023, p5; The Treasury, Corporate Insolvency in Australia, PJC Submission 34, 5 December 2022, p 13, table 2.1.

87 The Treasury, Ibid, table 2.2.

phoenix activity.[88] According to its website,[89] in the period to 31 December 2022, the Phoenix Taskforce has resulted in the ATO raising more than $1.89 billion in liabilities from audits and reviews of illegal phoenix activities, and returned more than $901 million to the community.

Question 11(b)

What would be the benefits and disadvantages of regulating pre-insolvency advisors?

123. It is important to recognise that in at least some respects, pre-insolvency advisors are likely to be regulated already. That regulation may be an obligation arising out of a professional admission, membership of a group or society or the nature of the advice provided. For example:

(a) any pre-insolvency advisors who are admitted lawyers will be subject to legal profession conduct rules in relevant states;

(b) professional accountants are required to comply with the APESB Code of Ethics—which oblige individuals to act with integrity, objectivity, professional competence and due care, and according to standards of professional behaviour;

(c) professional insolvency and restructuring organisations such as ARITA and even organisations focussed on more informal restructuring work such as the TMA (Turnaround Management Association) or the ABRT (Association for Business Restructuring & Turnaround) have codes of ethics to which members are required to abide; and

(d) a person giving advice about taxation matters may be subject to registration obligations as tax agents or BAS agents under the *Tax Agent Services Act 2009* (and consequent regulatory requirements, including under the Code of Professional Conduct).

124. A difficulty arises that despite all these requirements and existing regulatory structures, there are anecdotally still bad actors in this space. Arguably:

(a) there is a dearth of available good advice in the pre-insolvency space because, amongst other things, many professionals avoid pre-insolvency advice on the basis it may affect their independence when taking formal appointments;

(b) because of the informal nature of the work, there is a difficulty identifying bad actors as the very nature of the work allows the advisor to avoid any formal recognition of their role;

(c) at times, there may be perceived personal advantages to the individuals engaging bad actors, because individual debtors (or directors of corporate

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88 https://www.ato.gov.au/uploadedFiles/Content/ITX/downloads/The_economic_impacts_of_potential_illegal_Phoenix_activity.pdf

89 https://www.ato.gov.au/general/the-fight-against-tax-crime/our-focus/illegal-phoenix-activity/phoenix-taskforce/.

debtors) can avoid scrutiny and retain assets, despite the fact their affairs are not properly managed in a formal bankruptcy, liquidation or other restructure, and creditors miss out on access to potential distributions.

(d) more regulation might have little effect—those who comply with regulatory obligations are not the problem, and those who are prepared to be involved in illegal phoenix activity and other illicit asset protection or similar activities are likely to avoid regulatory rules in any event.

125. It is equally arguable that corporate phoenixing might be better eliminated if companies who avoided liquidation by simply deregistering nor companies the subject of formal appointments were better scrutinised by the regulator. The public hearings in this Inquiry have already focussed on some of the issues associated with that regulation—a lack of funding of ASIC, and a lack of available funding for liquidators. Our Initial Submission noted some of the issues arising from the lack of use of the new creditor-defeating disposition regime.[90] If neither the private appointee nor the regulator is properly resourced to address illegal phoenix activity, then a focus on lack of regulation of pre-insolvency advisors may be the wrong approach.

126. There is one specific matter the Committee has previously raised in respect of potential regulation of pre-insolvency advisors that may bear repeating. In recent consultation by the Attorney-General's Department on proposed requirements to provide and collect information about pre-insolvency advisors and advice (for example, by an obligation when filing bankruptcy petitions or statements of affairs to list details of pre-insolvency advisors that have been used), the Committee said the following:[91]

> *36. The Committee observes that, despite near universal support conceptually for cracking down on problematic pre-insolvency advisors, there is no consensus on (indeed no real suggestion of) a set of defined characteristics of "untrustworthy advisors."*
>
> *37. Any attempt to create a regulatory environment without a clear definition of its target must be considered with caution.*
>
> *38. The Committee recognises that a means to track referrals gives enormous power, particularly with modern data analytics providing the ability to target individuals suspected of irregular behaviour. However, such profiling is prone to misinterpretation and the drawing of improper (and possibly plain wrong) inferences.*
>
> *39. Parties should not be required to have to disclose their professional advisers for several reasons:*
>
> *(a) First, advisers are already highly regulated. For instance, a specialist bankruptcy lawyer or restructuring advisor may well be expected to attract common inquiries from insolvent debtors. One might expect that that advisor's name would appears frequently in statements of affairs. It is*

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[90] Initial Submission, [64]-[71].

[91] 'Bankruptcy System Options Paper', Submission to the Attorney-General's Department, Law Council of Australia BLS, 25 February 2022, https://www.lawcouncil.asn.au/publicassets/bd32cb09-739f-ec11-944b-005056be13b5/4179%20-%20Bankruptcy%20system%20Options%20Paper%20January%202022.pdf

not appropriate for those advisors to have their work called into question simply because they are commonly involved in this important work.

(b) Secondly, it is fundamental to the administration of justice that insolvent or potentially insolvent debtors (like all people) have access to professional advice in assessing and structuring their affairs. The very fact that a person has taken advice may well be privileged, and legislation requiring the disclosure of that fact (let alone the substance of the advice) is an unwelcome attack on the rule of law.

40. Issues of confidentiality, privacy and privilege have not been addressed by this proposal.

Question 11(c)

What approaches are taken overseas or in the UNCITRAL principles to the regulation of pre-insolvency advisors?

127. The UNCITRAL Principles do not directly address the regulation of pre-insolvency advisors. Phoenix activity is a recognised phenomenon in other jurisdictions,[92] but the focus on illegal phoenixing and on untrustworthy advisors appears to be less severe. There may be a number of reasons for that. Anecdotally:

(a) it is possible the stronger independence obligations on those taking formal appointments in Australia contribute to a lack of good quality advisors in the pre-insolvency space;

(b) it may be that better enforcement in the event of formal insolvencies prevent the voluminous occurrence of improper pre-insolvency behaviour that has been observed here; and

(c) other social, economic and political factors may play a part in the higher occurrence of (and concern regarding) illegal phoenix activity in Australia.

12. Recommendations in submissions and timing of reforms

Question 12(a)

The committee has received many recommendations for reforms in written submissions. For example, the Business Law Section of the Law Council of Australia (submission 30) made 33 recommendations. Do you wish to comment on recommendations made thus far by any other inquiry participant, either in a written submission or in a hearing?

128. We are, of course, the entity referred to in the question. During public hearings, we tabled an "aide memoire" summarising in very brief form, by category, all the submissions of all the stakeholders whose submissions had at that stage been

92 See, e.g., this publication by the Insolvency Service in the UK: https://www.gov.uk/government/publications/phoenix-companies-and-the-role-of-the-insolvency-service/phoenix-companies-and-the-role-of-the-insolvency-service.

made public. We note that another 20 or so submissions have been made public since.

129. Whilst we do not propose to comment on other submissions from a policy perspective, the Committee would be pleased to update its so-called aide-memoire based on other submissions if the PJC would find it helpful. It may be that this Questions on Notice process obviates the need for that aide memoire, in that provided a sufficient number of responses are received, it will clarify on a category-by-category basis the position of the various stakeholders.

Question 12(b)

Noting the suggestions for a root and branch review of Australia's insolvency laws, the committee would welcome your views on whether there are areas of reform that should progress now, and which areas of reform are more appropriately dealt with in a root and branch review.

130. There are some broad areas of agreement amongst submissions to date on matters which may not require too much legislative work. Other matters might not be the subject of universal agreement, but the PJC may determine the question as an appropriate policy recommendation in any event. In the Committee's view, some potential areas of quick reform include:

(a) the introduction at least of *ipso facto* prohibitions on the ejection of corporate trustees upon insolvency appointments (even if broader trust reform will take time)—see Recommendation 16 in our Initial Submission;

(b) the addition of an administrative option or default approval process (e.g. absent any objection) for the extension of s439A convening period extensions—see Recommendation 3 in our Initial Submission;

(c) the addition of an administrative option or default approval process (e.g. absent any objection) for the limiting of administrators' personal liability (particularly for moneys borrowed where the lender consents)—see Recommendation 4 in our Initial Submission;

(d) the loosening of criteria for access to the SBR Regime (including one or more of payment of employee entitlements, filing of taxation returns and satisfying the debt cap)—see Recommendations 6 and 7 in our Initial Submission;

(e) the abolition of the Commissioner's statutory indemnity under section 588FGA of the Corporations Act—see Recommendation 14 in our Initial Submission;

(f) the introduction of some key recommendations of the Whittaker Review (as to which, see paragraphs 98–100 and 103–104 above)—see Recommendation 11 in our Initial Submission.