Chapter 12

Additional proposed reforms

12.1 In light of the scale and incidence of the problem of insolvency in the construction industry, it is unsurprising that a number of submissions and witnesses identified additional areas of reform. These ideas are the culmination of sustained and engaged thinking by participants within the industry and are worthy of consideration. This chapter will examine five areas for reform:

- whether a legal obligation should be placed on individuals or organisations to warn the regulators of impending insolvency events;
- measures to enhance transparency surrounding the identity of beneficial owners and directors;
- the pressing problem of unscrupulous pre-insolvency advice;
- whether debt assignments should be valued in a different manner for the purpose of voting in creditors meetings; and
- whether the Federal Circuit Court of Australia should have jurisdiction over corporate insolvencies.

Legal obligation to warn of impending insolvency

12.2 Chapters 3 and 4 explored the terrible effects—both economic and social—that insolvency has on participants within the industry, their families and the broader community. Preventing these devastating consequences from affecting more Australians is the driving force behind this inquiry.

12.3 Chapter 6 illustrated that some businesses connected to Walton Constructions may have been aware of the perilous state of the Walton companies before their sudden collapse. Companies with either inside knowledge or strong suspicion of Walton's situation then acted to limit their exposure to Walton. Unfortunately, evidence presented before the committee suggests that this is an all too common occurrence. Associate Professor Michelle Walsh explained that the research team from Melbourne and Monash universities 'suspect that…it is going on across a whole lot of different scales'.[1]

12.4 Some witnesses discussed one potential legislative reform that seeks to combine these two strands of thought. At present there is no legal obligation on any person that knows or suspects that a company is almost insolvent to advise the regulator. Rather, as Mr John Winter, ARITA, explained, banks and other commercial parties are presently 'limited in what they can disclose, outside of having to report a criminal act'.[2] The creation of such an obligation will improve the regulators' ability to detect insolvency in real time and thus better protect unsecured creditors. The question

1 *Official Committee Hansard*, 29 September 2015, p. 11.

2 *Proof Committee Hansard*, 28 September 2015, p. 14.

raised before this inquiry is, therefore: should a legal obligation to warn of impending insolvency be placed on individuals or organisations?

12.5 Economists recognise that information asymmetry—where one person in a market knows more than another person, i.e. a person selling a car knows more about the car than a buyer—leads to incomplete and inefficient markets. Joseph Stiglitz has drawn on this fact to explain that within a market economy certain government intervention—through appropriately designed regulations—can lead to more efficient outcomes.[3]

12.6 While regulation generally focuses on preventing harmful behaviour, it can also be used to promote constructive behaviour. In this case, an obligation on financial institutions to inform the regulator that a business is in financial distress, may lead to a more efficient allocation of capital. That is, a struggling company may enter administration earlier, undergo a restructure, and emerge in a more efficient form, or the business' expedient closure will allow for redeployment of capital and employees to more productive uses.

12.7 Asymmetries of information naturally create power imbalances. Removing the asymmetry by imposing a duty on those with more information to inform other participants in the market will reduce power imbalances and lead to a more effective market overall.

12.8 As noted in chapter 6, without endorsing the proposal, Mr Michael Chesterman, QBCC, acknowledged that information is critical and any information 'which raises issues about whether or not a licensee meets the financial requirements for licensing is gold'.[4]

12.9 Making a similar point, Mr Michael Cranston, ATO, noted that without commenting on legislation or policy, the ATO encourages people 'as good citizens' to bring any relevant information 'to the Tax Office'.[5]

12.10 Nevertheless, despite the attraction of this proposal, the committee is concerned that it may not be workable.

12.11 In particular, blurring the distinction between financial difficulty and insolvency runs the risk of critically damaging companies that may otherwise trade themselves out of trouble. In this regard Mr Matthew Strassberg, Veda, noted, a company in financial difficulty is in a very different position from one trading while insolvent: 'obviously some companies will work their way back out of a period of difficulty; that is a somewhat different proposition from a company that is trading whilst bankrupt'.[6]

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3 See, for example, Joseph Stiglitz, 'Regulation and Failure' in David Moss and John Cisternino (eds), *New Perspectives on Regulation* (2009), pp. 11–23.

4 *Official Committee Hansard*, 31 August 2015, p. 38.

5 *Proof Committee Hansard*, 28 September 2015, p. 19.

6 *Proof Committee Hansard*, 28 September 2015, p. 6.

12.12 The act of informing the regulators that a company may be close to insolvency is likely to spread throughout the industry and drain confidence in that company, thereby speeding its descent into insolvency. Paradoxically, this would make the situation worse for the company's creditors, as it ensures that the company will not be able to turn around. Mr Price, ASIC, explained:

> In some circumstances possibly initiatives like that may help. They may also, however, result in companies entering into administration at the first sign of any possible problem.[7]

12.13 Mr Price posed the question:

> …if you were to provide that level of information, generally, in the market, might it have an unintended consequence of a greater level of business failure and impact on economic development and employment and all those sorts of issues?[8]

12.14 Noting this, Mr Winter considered that a more beneficial approach would be to promote 'a far more positive connotation to restructuring turnaround in Australia'. Mr Winter explained his position:

> That is that if directors sought expert advice early on and did not get their businesses into this level of distress, and there was a framework for them to work through that period to achieve the protection of jobs and to achieve as great a protection of creditors as possible, that would be one of the most significant reforms that could be undertaken to the Australian insolvency regime.[9]

Committee's views

12.15 The committee believes that information is critical in inhibiting illegal phoenix activity and in preventing small-scale insolvencies turning into larger collapses. The committee recognises that government intervention through appropriate regulation can remove information asymmetries, leading to more efficient operation of the market. Thus, the committee is supportive, in principle, of requiring banks to warn respective regulators if they have reasonable grounds to suspect that a business is in financial distress and may be about to trade insolvent. However, the committee accepts that imposing a legal obligation on banks would be largely counterproductive and may force companies that otherwise could survive into insolvency. The committee suggests that participants in the industry who provide goods or services on credit should seek as much information about the financial situation of the trading partner as early as possible, in order to protect their own interests.

Increasing transparency and verifying company directors

12.16 To register a company, a person must lodge an application with ASIC. Under section 117(2) of the Corporations Act, the application must include the name and

7 *Proof Committee Hansard*, 28 September 2015, p. 31.

8 *Proof Committee Hansard*, 28 September 2015, pp. 31–32.

9 *Proof Committee Hansard*, 28 September 2015, p. 13.

address of each director of the company.[10] However, little is done to verify that information and consequently there is a lack of transparency surrounding the identity of company directors. Several submissions and witnesses identified this failing as a contributing factor to the scale and incidence of illegal phoenix activity and the misuse of corporate vehicles more generally. Two complementary solutions were proposed: a beneficial owners' register; and, a director identification number.

Beneficial owners' register

12.17 Veda considered that a beneficial owners' register may be effective in reducing the incidence of illegal phoenix activity. In Veda's view, the inability of regulators and participants in the building and construction industry to identify and track individuals suspected of illegal activity was a significant cause of the scale and incidence of the problem. A lack of transparency around company directors has the consequence that regulators are slower in clamping down on illegal phoenix operators and therefore those at the acute end of the information asymmetry become tangled in schemes, suffering significant economic and social effects.

12.18 Veda explained the advantages of a beneficial owners' register. In its view, such a register:

> …would enable the ability to distinguish between the legal owner and the actual beneficial or controlling owner. Such a register, coupled with a requirement for companies to hold information on their beneficial owners, will reveal who owns and controls an entity, making money laundering, tax evasion and the creation of phoenix entities more difficult.[11]

12.19 At the Sydney hearing, Mr Jonathon Newton, Veda, explained why a beneficial owners' register would assist regulators:

> With regard to phoenix companies, you need to determine who the beneficial owners are before you can start making links to other companies that may have folded previously or who is related within those companies…[12]

12.20 Mr Strassberg, Veda, continued, noting that a beneficial owners' register would save a significant amount of time for regulators trying to draw links between companies.[13]

12.21 Such a register would also have significant benefits for participants within the industry. Mr Newton noted that the current system lacks transparency and weakens participants' ability to identify if companies they are planning to contract with are involved in suspected illegal activity:

> …we are finding that the market is really struggling to wade through the information that is available. They do not trust the information that is available on the ASIC register. They have reservations as to how people are

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10 *Corporations Act 2001* (Cth), s 117(2)(d), (f).

11 Veda, *Submission 14*, p. 4.

12 *Proof Committee Hansard*, 28 September 2015, p. 2.

13 *Proof Committee Hansard*, 28 September 2015, p. 3.

> registering with ASIC before they can really trust the information that is presented to them when opening accounts and performing financial transactions.[14]

12.22 However, witnesses noted that a beneficial owners' register may be difficult to implement for two major reasons. First, a register is unlikely to be comprehensive; and second, all information it contains would have to be verified, potentially at significant cost to the party seeking verification.

12.23 For a register to be effective it must be comprehensive, containing all information about individuals and business structures. However, in practice this would be difficult to ensure. As Mr Newton explained the register would have to 'span across federal and state registries' and encompass the full gamut of legal persons, some of whom are not centrally registered at present:

> A 'legal person' can take the form of a propriety company, a trust, an incorporated entity or a partnership. They all have various ways of registering. Some, such as trusts, have no central registry. You have to rely on the trustee. That trust may have a corporate trustee. [15]

12.24 Even domestic proprietary companies can have complex ownership structures. Mr Strassberg provided statistics on proprietary companies in Australia that engage with the banking industry:

> …around 70 to 80 per cent of domestic proprietary companies are what we would deem to be simple companies, a company owned by natural persons—a mum and dad or something like that. The remaining 20 to 30 per cent that they are facing are complex entities, companies that are owned by non-individuals. They are owned by other companies. They are owned by trusts. They might be owned by sole traders. They might be owned by people who declare that they do not beneficially own the shares—so we have the issue of bearer shares and so forth, where there is no public register of who those shares actually belong to. That level of complexity can really blow out. We have seen instances of companies that have up to 21 non-individual owners listed in their ownership structure, in their corporate structure.[16]

12.25 Additionally, a beneficial owners' register would only be useful and effective if the names entered on the register are accurate and up-to-date. As Mr Strassberg explained, there would need to be some form of independent verification; there 'must be checks and balances as to people submitting names, putting their hands up and saying they are a beneficial owner; they would need to prove that as well'.[17]

12.26 Unfortunately, as Mr John Price, ASIC, explained, at present 'there is no independent identity-checking mechanism that is required in Australia when you

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14 *Proof Committee Hansard*, 28 September 2015, p. 2.

15 *Proof Committee Hansard*, 28 September 2015, p. 2.

16 *Proof Committee Hansard*, 28 September 2015, pp. 3–4.

17 *Proof Committee Hansard*, 28 September 2015, pp. 3–4.

become a company director'.[18] Mr Strassberg considered that ASIC, as the collector of company information, should be required to verify the information:

> …if you are going to put information on ASIC, what are the obligations on the collector of the register to check? Also, what are the obligations on the discloser if you do not have any statements that you have to sign, if you can simply lodge these things without taking any steps?[19]

12.27 Mr Strassberg argued that any verification system would not be difficult, costly or timely to implement, naming the 'Document Verification Service' (DVS) as a useful model.[20] A creation of COAG, this service is managed by the Attorney-General's Department on behalf of all jurisdictions. The DVS is not a database and it does not store any information; rather, information is verified against data held by relevant state or territory agencies. The design and operation of the DVS has been informed by a rigorous, independent Privacy Information Assessment, and it has led to increased confidence and efficiency in making identity-related decisions.[21]

Director identification number

12.28 A complementary reform designed to ensure greater transparency, endorsed by a number of witnesses, was the use of director identification numbers. Witnesses explained that a director identification number could assist in maintaining an accurate and complete database of all company directors, including tracking individuals' involvement with companies no longer trading. Implementing this would require a straightforward amendment to section 117(2) of the Corporations Act. Mr Strassberg explained how it might operate:

> …at your first directorship…there would be an obligation to provide identity…as well as to self-attest that you have read material, that is, as I understand it, appended to any lodgement form, on the obligations of a director. At that point some basics would be covered and your director identification number would attach to you, and that would then be used any other time you become a director of a company.[22]

12.29 Associate Professor Michelle Welsh noted that this would enable ASIC to track people who are directors of multiple companies.[23]

12.30 Mr John Winter, ARITA, strongly supported the introduction of a director identification number regime. Mr Winter stated that ARITA considered this a 'critical reform' in addressing illegal phoenix activity, stating that 'we cannot emphasise enough how important we think the director identity number is'.[24]

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18 *Proof Committee Hansard*, 28 September 2015, p. 30.

19 *Proof Committee Hansard*, 28 September 2015, p. 4.

20 *Proof Committee Hansard*, 28 September 2015, p. 4.

21 'Document Verification Service', https://www.ag.gov.au/RightsAndProtections/IdentitySecurity/Pages/DocumentVerificationService.aspx (accessed 1 December 2015).

22 *Proof Committee Hansard*, 28 September 2015, p. 2.

23 *Official Committee Hansard*, 29 September 2015, p. 2.

24 *Proof Committee Hansard*, 28 September 2015, p. 9.

12.31 Indeed, evidence before the committee suggested that it was very simple for individuals to register several companies in multiple names. Mr Frank Nadinic acknowledged registering between 32–33 companies, under 'Frank' Nadinic, 'Frane' Nadinic and Frank 'Nadimic'.[25] In particular, when registering 'Royal Como Pty Ltd' in August 1995 he provided ASIC with all 3 names. Mr Nadinic emphasised, and the committee accepts, that he did not make these registrations with any improper intent. However, that might not always be the case. Associate Professor Welsh explained further that she could register a business in the name of 'Michelle Welsh' and another as 'Michelle A Welsh' and it was unlikely that that 'it would ever be put together that it was the same'.[26]

12.32 The committee notes that the draft report of the Productivity Commission into *Business Set-up, Transfer and Closure*, recommended the introduction of Director Identity Numbers. The Productivity Commission explained that 'this would ensure that directors of companies that enter external administration can be clearly identified; and would assist in investigations of a director's involvement in what may be repeated unlawful phoenix activity'.[27] The Commission considered that a 100 point identity proof test should be adopted to verify a person's identity.[28]

12.33 However, introducing a director identification number may not entirely ameliorate the issue. Mr Price explained that unscrupulous individuals may simply appoint shadow directors—people appointed as directors but not actually performing the role—to disguise their involvement.[29]

Committee's views

12.34 The committee considers that any measure to increase transparency of company directors is beneficial in preventing illegal phoenix activity. The committee is very supportive of measures to introduce a beneficial owners' register and Director Identification Numbers. Further, the committee notes that the introduction of Direction Identification Numbers accords with the recommendation of the Productivity Commission in its draft report into *Business Set-up, Transfer and Closure*. The committee considers that an analysis of the potential advantages and disadvantages of a beneficial owners' register should be conducted by the Legislative and Governance Forum for Corporations, the body with oversight of corporate and financial services regulation.

12.35 The committee appreciates, however, that both a beneficial owners' register and a Director Identification Number will only be effective if there is an independent verification system to ensure that information provided to ASIC when an individual

25 *Official Committee Hansard*, 29 September 2015, p. 15.

26 *Official Committee Hansard*, 29 September 2015, p. 6.

27 Productivity Commission, *Draft Report: Business Set-up, Transfer and Closure* (May 2015), p. 382.

28 Productivity Commission, *Draft Report: Business Set-up, Transfer and Closure* (May 2015), pp. 382–383.

29 *Proof Committee Hansard*, 28 September 2015, p. 30.

becomes a company director is accurate. As the collector of company information, the committee believes that ASIC should be required to verify it.

12.36 The committee notes further that while some ASIC information about registered businesses is publically available, the information which shows company dealings—some of which could indicate the financial health of a company—is only available for a fee and is generally obtained through an information broker. If all ASIC and Australian Financial Security Authority company records were available free of charge, small business operators would be able to do their own due diligence and might be better placed to avoid companies which have unlawfully phoenixed or which are going through financial difficulties or whose directors have a history of bankruptcy.

Recommendation 35

12.37 The committee recommends that the government, through the work of the Legislative and Governance Forum for Corporations establish a beneficial owners' register.

Recommendation 36

12.38 The committee recommends that section 117 of the *Corporations Act 2001* (Cth) be amended to require that, at the time of company registration, directors must also provide a Director Identification Number.

Recommendation 37

12.39 The committee recommends that a Director Identification Number should be obtained from ASIC after an individual proves their identity in line with the National Identity Proofing Guidelines.

Recommendation 38

12.40 The committee recommends that the *Australian Securities and Investment Commission Act 2001* (Cth) be amended to require ASIC to verify company information.

Recommendation 39

12.41 The committee recommends that ASIC and Australian Financial Security Authority company records be available online without payment of a fee.

Problem of pre-insolvency advice

12.42 The committee heard that many corporate advisory firms engage in pre-insolvency advice about how companies in financial stress can restructure. This is legal and can be beneficial in ensuring that a business remains an ongoing concern. However, the committee also heard evidence from contractors,[30] liquidators,[31]

30 Subcontractors Alliance, *Submission 18*, p. 5.

31 Mr Glenn Franklin, PKF Lawler, *Official Committee Hansard*, 29 September 2015, p. 40.

academics,[32] and the regulator that some of these firms may advise companies 'how to phoenix', or how to avoid paying their debts.

12.43 ASIC informed the committee that unscrupulous liquidators and businesses advisors 'can and do facilitate illegal phoenix activity'. They can do so by:

- advising directors or officeholders on how to remove assets fraudulently from one company to another;
- advising the directors or officeholders on how to structure companies to avoid paying their liabilities; or
- registered liquidators not meeting their statutory duty to investigate a failed company's affairs properly, adequately record their external administration and report offences to ASIC.[33]

12.44 Mr John Price, ASIC, explained that ASIC has taken action against people who have facilitated illegal phoenix activity in the past. These persons are not limited to insolvency practitioners or liquidators:

> There was a fellow called Mr Somerville, a lawyer, who was providing advice on effectively structuring things as phoenix transactions. We took action against him, banning him from being a director for a number of years. There have also been a number of insolvency practitioners in recent times who are playing that role. Mr Andrew Dunner is one such person. Mr Pino Fiorentino is another such person.[34]

12.45 Mr Price explained further that pre-insolvency advice is 'not a specifically regulated activity at the moment', which accentuates the difficulties faced by ASIC in clamping down on unscrupulous advisors. Mr Price continued:

> In fact, there are a number of insolvency professionals who have been removed from registration by ASIC for disciplinary reasons who are currently playing that pre-insolvency role. In playing that role, they often frustrate the actions of honest and hardworking insolvency practitioners who are subsequently appointed to the companies and need to clean up the mess.[35]

12.46 Associate Professor Welsh agreed that dishonest pre-insolvency advisors are an 'emerging business model'.[36] With reference to the phoenix typology,[37] she explained that they are 'becoming a real problem' in relation to illegal type 1 and illegal type 2 phoenix operations.[38] Associate Professor Welsh stated further:

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32 Associate Professor Michelle Welsh, *Official Committee Hansard*, 29 September 2015, p. 5.

33 ASIC, *Submission 11*, p. 27.

34 *Proof Committee Hansard*, 28 September 2015, p. 30. Mr Price is referring to *ASIC v Somerville* [2009] NSWSC 934 (8 September 2009); *ASIC v Dunner* [2013] FCA 872 (30 August 2013); *ASIC v Fiorentino* (CALDB, Matter No: 03/NSW13), 24 June 2014.

35 *Proof Committee Hansard*, 28 September 2015, p. 29.

36 *Official Committee Hansard*, 29 September 2015, p. 10.

37 See paragraph 5.6.

38 *Official Committee Hansard*, 29 September 2015, p. 4.

> What we are saying is that if that person goes to one of these turnaround specialists for advice and has never thought about this before, and then it is presented to them as an idea, that is an issue. But it is also an issue at number 4 if people are doing this as a business model and with the assistance of someone.[39]

12.47 Mr Glenn Franklin, PKF Lawler, noted that pre-insolvency advice is an issue that ASIC and ARITA has 'struggled with'. In Mr Franklin's opinion, this is because 'they are not really regulated. They are not caught by the legislation', even though corporate restructuring impacts into insolvency.[40]

12.48 The absence of regulation was reiterated by many witnesses and seen as the fundamental issue. Associate Professor Welsh considered that the 'problem is that…these turnaround specialists are not regulated in any way'.[41] Mr John Winter, ARITA, agreed, explaining that pre-insolvency advisors constitute a 'large and growing market' who are 'completely unregulated'. Mr Winter continued:

> They give advice to people in distressed businesses on how to strip assets out. Their recommendation, by and large, could be summed up as saying, 'If you strip all the assets out, ASIC won't do anything.' Because there is nothing left, they will not be able to pursue it, and ASIC has a track record of not following those things up.[42]

12.49 Mr Winter restated his position that the solution is greater enforcement action against directors and individuals engaged in illegal practices. Certainly, advice that aids and abets a breach of the directors' duties is against the law:[43]

> …in stark contrast, in New Zealand or in the UK, every day there are announcements of substantial actions against directors that send a market signal that says that the regulator will pursue people who undertake this illegal activity. We do not get that market signal here in Australia.[44]

12.50 Associate Professor Welsh agreed that lack of enforcement was part of the problem, but considered that education is also part of the solution. Associate Professor Welsh noted that 'there are probably a lot of people out there who do not realise that what they are doing could be a breach of the director's duties'. When a turnaround specialist says "I can fix your problem for you", it is likely that they will follow that advice.[45]

Committee's views

12.51 The committee is concerned with the growing trend of corporate advisory firms advising companies on how to restructure their business prior to the company

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39 *Official Committee Hansard*, 29 September 2015, p. 5.

40 *Official Committee Hansard*, 29 September 2015, p. 40.

41 *Official Committee Hansard*, 29 September 2015, p. 5.

42 *Proof Committee Hansard*, 28 September 2015, p. 10.

43 *Corporations Act 2001* (Cth), s 79.

44 *Proof Committee Hansard*, 28 September 2015, p. 10.

45 *Official Committee Hansard*, 29 September 2015, p. 6.

entering administration with the result that, in the event the company or related companies enter administration, creditors—especially unsecured creditors—are left in worse position than they would have otherwise been. While corporate restructuring is often a necessary and beneficial strategy to either ensure the ongoing viability of a business or to provide the greatest value to creditors, it appears that unscrupulous advisors are, in some cases, facilitating illegal phoenix activity. The committee appreciates that pre-insolvency advisors are largely unregulated and considers that greater enforcement action by ASIC is the best prospect to deter such pre-insolvency advice.

Recommendation 36

12.52 The committee recommends that ASIC focus enforcement action on business advisors specialising in pre-insolvency advice who advise firms to restructure in order to avoid paying their debts and obligations.

Recommendation 37

12.53 The committee recommends that ASIC publish a regulatory guide in relation to the nature and scope of pre-appointment advice given or taken by companies.

Valuing debt assignments fairly

12.54 The question of debt assignments was raised in relation to Walton Constructions. As chapter 6 noted, QHT Investments (QHT) bought $18.5 million of Walton's debt for $30,000. As also noted in chapter 6, QHT was owned by a member of the Mawson Group, the firm recommended by NAB and engaged by Craig Walton to provide turnaround advice to Mr Walton. Mr Green, NAB, explained that there are two reasons why a person would buy a debt:

> One would be to move the voting outcome in a creditors' meeting that is decided on the value of debts; the other would be somebody saying to themselves, 'that is a bargain; I believe that it will be worth more than that'.[46]

12.55 In this case, QHT bought Walton's debt to influence the voting outcome. At a creditor's meeting QHT's vote was worth $18.5 million, not the $30,000 QHT had paid for it. Evidence strongly suggested that this value was used to ensure that PKF Lawler remained the liquidators of Walton Constructions—though the purchase of this debt was apparently not necessary for that outcome.[47]

12.56 Mr Franklin, PKF Lawler, considered that there is a 'disconnect' between the Corporations Act and the Bankruptcy Act over the value of debt assignments. Mr Franklin explained that, under section 64ZB(8) of the *Bankruptcy Act 1966*, if you undertake a debt assignment you can only vote for the amount that you have assigned for it, not the original value of the debt. In relation to Walton Constructions, this approach would mean that the value of QHT's vote at the creditor's meeting would

46 *Proof Committee Hansard*, 4 November 2015, p. 31.

47 *Official Committee Hansard*, 29 September 2015, p. 32.

only be $30,000 and not $18.5 million—significantly reducing the value of QHT's vote.

12.57 Mr Franklin argued that 'there needs to be an alignment between the Bankruptcy Act and the Corporations Act' on this point.[48] Mr Green agreed, calling the situation under the Corporations Act 'an anomaly'.[49]

12.58 Indeed, it appears that the situation under the Corporations Act is incongruous. As early as 1999, the Federal Court considered the intention of s 64ZB(8) of the Bankruptcy Act:

> The explanatory memorandum explains the mischief that ss 64D(aa) and 64ZB(8) were designed to deal with, namely, the activities of persons favourably disposed towards a bankrupt in procuring, for only a fraction of their value, the assignment to them of debts due by the bankrupt to creditors and thereby obtaining control over voting at meetings of creditor…The stated object of these provisions is to ensure that a creditor claiming assignee of a debt due by the bankrupt can vote at a meeting of creditors only for the amount of the consideration that he gave to the assigning creditor.[50]

12.59 Aligning the approach under the Corporations Act with the Bankruptcy Act would mean that a person could still gamble in terms of buying debt cheap and hoping that it increases in value, but would no longer be able to shift the outcome of voting.

Committee's views

12.60 The committee believes that there is no cogent reason for debt assignments to be valued differently for the purposes of the Corporations Act and Bankruptcy Act. This anomaly should be rectified.

Recommendation 38

12.61 The committee recommends that the *Corporations Act 2001* be amended to align with section 64ZB(8) of the *Bankruptcy Act 1966*.

Recommendation 39

12.62 The committee recommends that firms who provide business advice be prohibited by way of an amendment to the Corporations Act from buying into the companies they are advising via debt acquisitions.

Transfer of jurisdiction of insolvency matters

12.63 The Law Council of Australia recommended that the jurisdiction of the Federal Circuit Court of Australia (FCCA) be expanded to include corporate insolvency matters. In the Council's view, the proposed expansion would enable a range of Corporations Law matters to be determined 'more quickly and cost

48 *Official Committee Hansard*, 29 September 2015, p. 33.

49 *Proof Committee Hansard*, 4 November 2015, p. 31.

50 *Bechrose Pty Ltd v Jefferson (Trustee)* [1999] FCA 1153, [54].

effectively than is currently the case', as well as 'improve the efficiency and effectiveness of the allocation of federal court funding'.[51]

12.64 The FCCA was established in 1999 as the Federal Magistrates Court. The Court is intended to relieve the workload of superior federal courts by resolving less complex disputes. It has a substantial jurisdiction in personal bankruptcy, and comprises a significant proportion of the Court's workload. The Law Council of Australia cited the FCCA's 2013–14 Annual Report:

> The 2013–14 Annual Report for the FCCA notes that the Court received filings in 4285 bankruptcy matters that financial year, and finalised 4010, up from 3984 filings and 4105 finalisations in 2012–13. The total number of filings in the Court was 8665, and finalisations 7508 in 2013–14. Bankruptcy applications comprised 49.5% of the FCCA's general federal law applications, and 5% of its total workload in 2013–14.[52]

12.65 The FCCA does not, however, have jurisdiction in corporate insolvency matters under the Corporations Act. This is a discrepancy identified by the Court itself. In its 2013–14 Annual Report, it noted: 'the conferral of some insolvency corporations law jurisdiction is seen as desirable to complement the significant personal bankruptcy jurisdiction exercised by the court'.[53] As the Law Council noted, the FCCA made similar comments in its 2011–12 and 2012–13 Annual Reports.[54]

12.66 Furthermore, the FCCA fee structure is substantially less than that of the Federal Court of Australia. Transfer of jurisdiction to the FCCA, therefore, offers a significant cost advantage and may potentially improve access to justice for litigants—particularly for routine matters, such as appointment of receivers and applications for the winding up of companies.

Committee's views

12.67 The committee received only one submission on this issue but notes its appeal. The committee considers that reasonably strong arguments can be made for the extension of the jurisdiction of the Federal Circuit Court of Australia's to include corporate insolvency matters under the Corporations Law. The committee believes that further consideration on this point could be conducted by the Legislative and Governance Forum for Corporations, the body with oversight of corporate and financial services regulation.

Recommendation 40

12.68 The committee recommends that the government, through the work of the Legislative and Governance Forum for Corporations, give serious consideration to extending the jurisdiction of the Federal Circuit Court of Australia to include corporate insolvencies under the Corporations Act.

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51 Law Council of Australia, *Submission 10*, pp. 3, 4.

52 Law Council of Australia, *Submission 10*, p. 5.

53 Federal Circuit Court of Australia, *Annual Report 2013–14*, p. 53.

54 Law Council of Australia, *Submission 10*, p. 5.

Senator Chris Ketter
Chair