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Parliamentary Joint Committee on Corporations and Financial Services
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Inquiry into Corporate Insolvency - Answers to questions on notice

We enclose our responses to the list of questions on notice enclosed with your 22 December 2022 letter.

1. Root and Branch review

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.

a. What is your view on whether there should be a root and branch review?

There should be a root and branch review but that term needs definition. What is needed is a staged review, based upon consultations held and decisions made about the principles, purposes and aims of the insolvency system. The review should ascertain what the appropriate goals and scope of a modern insolvency law for Australia should be. The chair expressed it well at our session on 13 December 2022, with respect.[1]

Consideration of the appropriate resourcing of the insolvency system and the allocation of responsibility between the public domain (government or government sponsored action) and the private sector (insolvency practitioners). For example, if there be a principle or aim that an insolvent debtor without assets be able to access the insolvency system, the system should be resourced such that the debtor has that access. That is the principle and the system in personal insolvency, that there should be free access to the insolvency system for insolvent debtors, through the government Official Trustee.[2] Also, if there is to remain an aim that all

[1] Page 39 "CHAIR: …. A root-and branch review is really right back to principles. What is the purpose of this? What principles underpin it? Why is it required? Does it deliver productivity and economic benefit to the country? Is the current historically inherited structure fit for purpose for a digital economy growing at a rapid pace in the 21st century?"

[2] This contrasts with the £680 fee in the UK payable by a debtor to go bankrupt. The lack of a fee in Australia has been questioned. In a Senate hearing in 2014, the then Inspector-General in Bankruptcy was questioned as to the fairness or sense of having such a fee. Among many responses, she said that the fee would address the 'anomaly that [Australia is] one of the only major common law jurisdictions, if not the only one, that does not charge a fee for applications for bankruptcy'. See Who should pay for the costs of the administration of an insolvency? – Murrays Legal

insolvent estates are to be investigated for breaches of the law, the resources by which that is to be achieved needs to be considered.

Any aims set should be measurable in some way. While some outcomes in insolvency are difficult to measure, insolvency processes should be subject to useful real time data collection and analysis where possible to ensure that the law and any changes are working as anticipated. We discuss this further in relation to the questions concerning data. We suggest that the aims be settled in consultation, and then the structure and resources by which those aims might be met should be decided.

Only then can there then be a root and branch review of the legal detail of the system that seeks to meet those aims – the processes leading to insolvency, the powers and duties of the insolvency practitioner, how the insolvency practitioner is resourced to exercise those powers through voidable transaction powers, what role creditors can play, what focus is given to the debtors, as to rehabilitation, and accountability.

This process has little to do with the fusion of personal and corporate insolvency laws important as that issue might separately be. However, a unitary system that incorporates both personal and corporate insolvency through a single Insolvency Act and a single insolvency regulator is standard in other common law countries, such as Canada, Singapore and the United States.[3]

If supportive: b. Why would a root and branch review be required?

The threshold root and branch approach is required because of at least three failings of the system we have identified:

- Lack of access by certain debtors to a system operated by the private sector – many companies and their directors cannot afford to put their company into insolvency, leaving behind unresolved creditor claims, unpaid employees and unattended business assets and other liabilities.
- Work is done on behalf of the state by the private sector and charged to private creditors; this distorts the system, reduces its financial outcomes and is unfair to creditors.
- Overall, there is a lack of a co-ordinated government role regulating both personal and corporate insolvency, and providing administration services for assetless companies, and services for the state in public interest matters.

[3] The UK has the Insolvency Act 1986, which covers both personal and corporate insolvency, but its regulatory framework involves several professional associations enlisted to regulate insolvency practitioners. That regime is, at the time of writing, under review.

Generally, these and other factors promote an unhealthy "expectation gap" as to what insolvency can achieve: see *Keay's Insolvency*,[4] chapter 1 as to the (arguably unfair) criticisms of insolvency for its low creditor returns and high costs.[5]

Organisation

c. What organisation would be most appropriate to conduct the review?

The nature of these failings in the present system is such that a financial, organisational and systems review is required, in conjunction with a legal review. If the ALRC can tap into other disciplines, including economics, finance, complex systems, IT and AI, then it would be suitable. Alternatively, the Productivity Commission may also be suitable given that an important aspect of any insolvency system is its efficiency and effectiveness in economic terms;[6] again though, as long as it can access other relevant disciplines.

Review Structure

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

We think that, given the broad scope of the task, a series of discussion papers should be issued to prompt and direct thoughts; roundtables would also assist. These are matters of detail that are best decided upon by the review body. We do think that views from a broader range of stakeholders should be sought than in past inquiries, and from disciplines beyond law and accounting.

Overseas experience

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)?

Given the generally universal nature of insolvency law principles, reviews undertaken in comparable jurisdictions are always valuable.

In 2013, the Law Reform Commission of Singapore released a detailed review of insolvency law. This recommended a unitary insolvency law statute covering personal and corporate insolvency. It also recommended improving restructuring through a scheme of arrangement by introducing a broad moratorium, super-priority financing and cross class cram down (so that dissenting classes are creditors can be bound by a court order), each of which has then been introduced into law and then consolidated into the *Insolvency, Restructuring and Dissolution Act* 2018. During the pandemic Singapore also introduced a streamlined

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[4] Thomson Reuters, 11th ed 2022, Murray & Harris.

[5] Further, see our article *Rebuilding the structure of the Australian insolvency system* (2022) 22 (1&2) INSLB 14 ("*Rebuilding the structure of the Australian insolvency system")*.

[6] See *The Use of Data in Assessing and Designing Insolvency Systems (*IMF.org) WP/19/27, prepared by José Garrido (dir.), Wolfgang Bergthaler, Chanda DeLong, Juliet Johnson, Amira Rasekh, Anjum Rosha, and Natalia Stetsenko, February 2019.

liquidation and streamlined restructuring for small businesses affected by COVID. The sunset provisions for those streamlined procedures have been extended to January 2024. Most recently, in 2023, Singapore has sought to reduce the level of government involvement in the administration of bankruptcies.

India undertook a wholesale insolvency law review in 2014 with the Bankruptcy Law Reform Committee. India had previously maintained several statutes that dealt with insolvency law for personal and for corporate insolvency, which created complexity and delays. The Committee issued its report in 2015, which resulted in the introduction of the Insolvency and Bankruptcy Code 2016. The Code provides both a specialist tribunal to handle insolvency disputes and provides considerable flexibility and control for creditors to determine the outcome of an insolvency or restructuring case. The regime was amended in 2021 to include a new small business pre-pack procedure to streamline restructuring for SMEs.

The American Bankruptcy Institute undertook a commission of review for the US Chapter 11 restructuring procedure that reported in 2014. One major theme of that review was the discussion concerning the cost and complexity of restructuring laws being too expensive for most small businesses. The ABI Commission recommended a new streamlined Chapter 11 procedure for SMEs and this recommendation was largely adopted into law in 2020 with a new Subchapter V of the US Bankruptcy Code 1978, which streamlines reporting obligations for debtors, provides assistance through a Subchapter V trustee (there usually being no trustee appointed in a Chapter 11 case and the Subchapter V procedure remaining a debtor in possession regime) and a standardised timetable for proposing restructuring plans.

Aside from broad reviews of insolvency law, it is also useful to note that other major jurisdictions have undertaken broad scale reforms of their insolvency laws, with the European Union issuing new directives on insolvency and on restructuring, which has caused several European Union member states to reform their laws, most notably the Netherlands which created a new scheme of arrangement procedure that offers both public and private (confidential) options.

The United Kingdom has also undertaken extensive law reform to facilitate debt restructuring and corporate rescue. In 2020, the *Corporate Insolvency and Governance Act* made significant changes to insolvency law by introducing a broad moratorium, a new restructuring plan with cross class cram down and new powers to stay ipso facto clauses in contracts.

ALRC's review of corporations and financial services regulation

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?

While we think that the ALRC's review of the legislative framework for corporations and financial services regulation might offers some precedent for insolvency law, there are more fundamental tasks required in any insolvency law reform. The drafting of the law to address what is said to be the "complexity" of insolvency law is secondary and is perhaps more apparent than real. We accept insolvency law is more legislatively complex than is required,

and it is internally inconsistent between corporate and personal insolvency law, and difficult to navigate. To some extent do we consider the ALRC approach is suitable for insolvency law, as to the re-drafting of the legislation generally with a view to its greater clarity and accessibility.

Review of both the policy and legislative framework for insolvency

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

Certainly, the root and branch review should address both the policy and legislative framework for insolvency. This should be clearly stated once settled and kept under review. The policy and legislative framework for insolvency in Australia was last reset with the Harmer Report in 1988. Australian business and society have changed significantly since that time, which requires a reconsideration of the policy and legislative framework for insolvency law in Australia to ensure that the law and policy meet community expectations and the economic needs of the country.

2. Purpose of Australia's insolvency laws

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

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?

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?

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?

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

a. The goals and purposes of insolvency law can be and are expressed in different ways depending on context. In *Keay's Insolvency*, we list the aims and purposes of insolvency law as including to:

- protect the debtor company from the consequences of its insolvency and release the debtor from its liabilities.
- align with and accommodate existing rights in other areas of law.
- protect those creditors who take valid security over the debtor's assets.
- ensure equal sharing between unsecured creditors.
- investigate the insolvency to the extent of providing some accountability.
- efficiently and effectively recycle the insolvent's assets to better economic use.
- assist in the restructuring of an insolvent business and otherwise rehabilitate the debtor.
- support the rule of law.

As we explain in *Keay's*,[7] overall, insolvency aims to be an open and independent process, whereby creditors are promptly informed of the fact of the insolvency so as to protect them from further dealings with the debtor and allow them to make other business arrangements and otherwise to factor in their potential losses. Ready information about the insolvency from an independent and registered practitioner gives an assurance to the creditors that their interests are being given attention and that an opportunity to assist with information is available. Insolvency also provides the debtor with protection from the demands of creditors, and the release from operating a failing business, but with necessary accountability obligations to assist, and in some cases remain involved in the process. The community benefits from the order and accountability imposed and the prevention of further financial harm. The economy and broader society benefit from the efficient and effective recycling of capital as well as through the ability to save businesses in financial distress and preserve enterprise value and personal dignity for the owners and managers of the business.

There are some particular purposes of personal insolvency necessarily relating to the bankrupt as an individual, in particular the protection against debt enforcement processes the rehabilitation and personal relief that comes from discharge in bankruptcy.

The efficiency (cost vs benefit) and effectiveness (aims achieved) of the regime is an overall focus. As an IMF paper - *The Use of Data in Assessing and Designing Insolvency Systems* - explains:

> "The definitions of effectiveness and efficiency in the insolvency context can be derived from the general systems theory. From a general point of view, effectiveness refers to the achievement of the objectives of the system, whereas efficiency is determined by the relationship between inputs and outputs. Effectiveness is a measure of the extent to which the insolvency system achieves its intended objectives. Efficiency is the measure of the extent to which the insolvency system achieves those objectives with the minimum use of resources".[8]

We also set out as annexed at A an extract from the *Guide on the Treatment of Insolvent Micro and Small Enterprises in Asia*,[9] of 2022 which well explains the purposes of insolvency more in economic terms.

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?

They are not clearly articulated at present but to a large extent they are met for those companies accessing the system, although the efficiency and effectiveness of the process is lacking. Furthermore, the lack of detailed data about the cost and outcomes in insolvency limits our ability to determine how effective or efficient the current system is.

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[7] Chapter 1.
[8] Referred to at footnote 6 of this response, see p 4.
[9] Issued by the International Insolvency Institute and the Asian Business Law Institute.

There would be merit in having such principles settled and legislated in some way, and measured where possible on an on-going basis as to whether they are and continue to be met.

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?

The goals and purposes are largely the same save that the priorities may have altered. In particular, while a return to creditors is an aim, it is not often achieved and that should be recognised in any law reform. Furthermore, the change in business assets (from fixed assets to intangibles), the widespread use of business leasing (as opposed to outright ownership of plant and equipment) and the increasing levels of secured debt (both personal property security and often multiple levels of security over real property) challenges traditional notions of dealing with a financially distressed business with heavy plant and equipment and unencumbered assets that will help pay for insolvency processes.

The increasing role of pre-insolvency advisors has also led to debtors (both personal and corporate) using pre-insolvency transactions to manage the assets available to creditors on a formal insolvency. Business restructuring procedures are less likely to involve freefall appointments that then go on to develop a plan to address the debtor's difficulties. Rather, pre-negotiated insolvency appointments involve the insolvency practitioner monitoring the business before the appointment so that they can "hit the ground running" and minimise disruption to the business.

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?

Insolvency involves a balance between many competing interests, for whom outcomes are often limited, and those outcomes can appear unsatisfactory to the participants. The reality is that a person who is insolvent simply cannot repay all their creditors and that has to be accepted. Accountability in verifying that insolvency is required but it is often confirmed as a reality. Debtor-in-possession (DIP) models accept that the debtor may not have been fully responsible for their insolvency – market forces, weather, economic conditions may have been beyond their control, or inexperience may have been a factor– and they should be allowed to learn and proceed further in business.

However there is, in our view, a cultural aversion in Australia to allowing the debtor of a failing company to remain in control, based upon a perceived connection between insolvency and wrongdoing, which is unhealthy if adopted as a universal approach. Australia's harsh approach is evident in its retention of a 3 year period of bankruptcy, handled by the Attorney-General's Department, despite a government decision in 2015 that it be reduced to one year.[10] The DIP scheme under Part 5.3B, under Treasury, represents some measure of rejection of that strict approach.

[10] National Innovation and Science Agenda report, 1 November 2015, National Innovation and Science Agenda report | Department of Industry, Science and Resources

Debtor in possession regimes are becoming increasingly popular around the world, particularly for restructuring efforts. The European Commission's Directive on Preventive restructuring recommends that all EU member states introduce a form of debtor-in-possession restructuring.[11] The new restructuring plan procedure under Part 26A of the Companies Act 2006 (UK) is also a debtor in possession regime. DIP regimes have long operated in Canada under the Companies' Creditors Arrangement Act 1985 (RSC) and in the US under Chapter 11 of the Bankruptcy Code 1978.

What is important in each of these DIP regimes is that creditors can have confidence in the transparency and legitimacy of the restructuring efforts. In some jurisdictions (such as the US), this role is performed by the specialist bankruptcy courts. In Canada, this role is performed by a court officer (the Monitor) who is an insolvency practitioner that does not manage the business but advises creditors and the court as an independent "eyes and ears" of the court during the restructuring efforts under the Companies' Creditors Arrangement Act 1985 (RSC). In the UK company voluntary arrangement (CVA) debt restructuring regime, this role is played by an insolvency practitioner who is selected as a nominee and who then becomes a supervisor under the CVA plan.

In the Part 5.3B small business restructuring in Australia, that role is played by a restructuring practitioner, who is an insolvency practitioner. Another important feature of DIP regimes around the world is the protection of secured creditor's collateral and the preservation of property owned by others (such as real property lessors) that is used by the debtor during the restructuring. Statutory provisions that require adequate protection of security and property rights are common, as well as the ability to lift the stay that usually applies during a restructuring effort.

Where Australian restructuring law could be improved in balancing the rights of different creditors is by introducing a "cross class cram down" rule for schemes of arrangement that would allow the court to approve a scheme that was approved by the majority of creditors even if one or more classes voted against the plan (as long as the plan is otherwise fair and reasonable). This is a feature of schemes in Singapore and the Netherlands and was also introduced into UK law with the new restructuring plan in Part 26A of the Companies Act in 2020. Cross class cram down is a prominent feature of Chapter 11 bankruptcy in the United States.

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

The goals and purposes could be reformed and stated either in the law or some practice guidance. We need to assess what is achieved presently, what can be achieved with some law reform, and then frame the goals and purposes accordingly. It is to no purpose to set goals that cannot be met in the majority of cases. This leads to what we say is an implementation

[11] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, Article 5.

and expectation gap which negates respect for and acceptance of insolvency law and its often unhappy outcomes.

One area where the goals could be said to be out of date is in relation to the facilitation of asset sales during insolvency and restructuring. The current law does not facilitate pre-pack sales negotiated prior to formal insolvency appointments. There is a tendency to expect a public sale campaign which may in some cases damage the value of a trading business. Asset sales have become the dominant outcome in restructuring procedures in many countries with restructuring plans then either not being used (and the company being transferred into a liquidation to distribute sale proceeds) or the plan being a distribution (or liquidating) plan. This is common in Canada under the Companies' Creditors Arrangement Act 1985 (RSC), in Chapter 11 bankruptcy and in Administration in the UK.

However, independence restrictions on pre-appointment work by insolvency practitioners and their reporting obligations to creditors are both seen as hindering fast track asset sales in restructuring cases in Australia.

3. Major reforms

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

Several PhD theses could be written on this question (and some already have been). However, we offer the following as a list of major areas for reform:

1) A government liquidator's office (such as the Official Receiver) to manage or fund assetless liquidations
2) Insolvent trust rules (or rather legislation to address insolvent trustees)
3) A cross class cram down mechanism for creditors' schemes of arrangement
4) Streamlined liquidation processes
5) Expedited sales processes in restructuring (such as a pre-pack regime)

In addition, the lack of detailed data about the nature and operation of insolvency processes (including the cost and outcomes of insolvency) significantly hinders a proper evaluation of the effectiveness and efficiency of the insolvency system.

b. Are there major reforms that are required?

Trust law would be an early priority. Otherwise, there are themes of law reform along the lines of reducing the need for court or creditor approval, ensuring consistency in time limits, and meeting rules, voidable transactions, etc could be harmonised.

Given the costs sensitivity and financial complexity often associated with insolvency, the use of artificial intelligence (AI) and information technology (IT) should assume a priority in any major reforms.[12]

[12] We note the "my.company" reforms suggested by the Association of Independent Insolvency Practitioners' submission for all companies. Related to that is the idea of an insolvency portal for all insolvencies: TIP – The Insolvency Portal – Murrays Legal

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

Preference laws don't seem to meet their intended purposes of deterring the 'race to the courthouse' and of restoring the pool of funds to their position had the preference not been made. That is, the cost of bringing proceedings may invariably outweigh the money recovered, and go, legitimately, not to creditors but to unmet remuneration of the insolvency practitioner. While ensuring the remuneration of the insolvency practitioner is valid, pursuit of preference proceedings for that purpose is not really appropriate and indicates, as we suggest, a lack of funds available to support the insolvency system. Apart from these issues, it may be preferrable to provide for automatic preferences that are recoverable within a limited timeframe prior to insolvency (such as 2 or 3 months), with a carve out available based on good faith and market value for the consideration provided for the transaction. This could be enforced by an administrative notice from the insolvency practitioner, or a notice being issued by ASIC, rather than needing to pursue litigation to obtain preference recoveries.

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

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

These are discussed in detail in our article *Rebuilding the structure of the Australian insolvency system.* It is initially important to acknowledge that insolvency needs to deal with both public and private interests. As we say in our article, the nature of those interests and who attends to them and who should bear responsibility for them must first be examined and balanced appropriately. We quote from a NZ insolvency law reform lawyer the proposition that

> "private functions should be performed by the private sector and paid out of funds otherwise available for distribution among creditors, while public functions should be performed by public officials and paid for out of public funds …".[13]

As we go on to say in our article, that is a useful division subject to the various overlaps of functions that inherently exist. For example, while investigation of misconduct may be seen as a public role, it may well also serve to recoup money for creditors. However, that overlap can also exist by default, because the separation between public and private functions has not been understood and applied in past law reform.

The need for public funding of various public functions of insolvency is relatively uncontentious in relation to the system of courts, a public register, and relevant laws.[14]

Beyond that, the problem is the allocation and delineation of responsibilities within the insolvency system that we suggest need rethinking and readjustment. It is not that there are

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[13] P Heath, *Insolvency Law Reform: The Role of the State* (1999) NZLRev 569 ["Heath, the Role of the State"]. See also New Zealand Law Commission Study Paper 11 *Insolvency law reform: promoting trust and confidence* - An advisory report to the Ministry of Economic Development, May 2001, Part II The Role of the State.

[14] Heath, The Role of the State.

insufficient resources to administer the system, with both an experienced private insolvency profession in Australia and a government staff with varied experience in insolvency matters.

In particular response to your question, it is the investigations into misconduct that are purely public tasks and which are not separately funded as a matter of course. They may be funded through the AA Fund, or by creditors. Attending to assetless insolvent companies is another task that is inherently unfunded, unless the insolvency practitioner can secure or recoup assets to fund the work required.

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?

This is discussed in Mr Murray's recent article - *Rethinking Insolvency Practitioner Remuneration,*[15] in particular as to the lawful means whereby insolvency practitioners seek to recoup remuneration on unfunded estates.

We are not qualified to say the extent to which there is a distortion of the market, even whether there is a market, but a reality appears to be, with write-offs of around 30%, there must be settings of remuneration that seek to recoup losses and provide a reasonable recompense for work performed. Thus, AFSA acknowledges that trustees may set higher charge out rates that take account of the unfunded work which trustees inevitably do. To that extent, the market sets those rates. It would appear to mean that, in simple terms, the 30% loss is spread over estates with funds from which unfunded remuneration may be recouped.

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?

We do not respond to this question; it is best left for others to do so.

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

There is a range of options – to impose a levy on new company registrations, or annual fees, to levy on % of assets realised, or to fund from the general revenue.

A levy on new company registrations, or their annual fees, imposes the cost on all companies to meet the costs of those that fail; it is a broad enough levy to be fair; it might be said to cause companies not to factor in the costs of their disposal but that would be a minimal risk.

[15] (2022) 22(3&4) INSLB 33 M Murray

A levy on % of assets realised imposes the costs on creditors; that is also a broad enough group to be a fair impost, although creditors, who have lost out in an insolvency, are being asked to further fund its operation.[16]

Funding from the general revenue imposes the cost on the community, and given the broad purposes of insolvency, this might be seen as a fair option; however, it puts the levy at a long distance from the cost involved and may not meet current user pays approaches to funding.

We also suggest that the law and practice be made clear as to when an insolvency practitioner may cease to do work on a matter where there are no funds; or to define the minimum work that an insolvency practitioner is required to so in such cases. A re-drafted section 545 Corporations Act is required, given uncertainties in interpretation of the existing section.

5. International best practice

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?

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

Australia is a long-time member of UNCITRAL and has had input into UNCITRAL's Legislative Guide and more recently Part Five of the Guide *"Insolvency law for micro and small enterprises*"; see also the *UNCITRAL Legislative Recommendations on Insolvency of Micro- and Small Enterprises* of 2021.

The Guide offers general principles and recommendations applicable to all jurisdictions, hence much of it is principles based. It is too broad a question for us to answer whether Australia's insolvency laws meet the recommendations set out in the Guide.[17] Suffice to say that Australia's insolvency regime is good in comparison with comparable jurisdictions in balancing the rights of creditors, the debtor and the community, and is generally rated highly in international rankings.

We have however identified two areas where the Guide offers useful advice which Australia should consider, that is, where Australia's regime does not meet the Guide. One, as to dealing with assetless companies; and two, as to dealing with small business with both personal and corporate elements. These are issues we have raised in our original submission and in our article *Rebuilding the structure of the Australian insolvency system.*

5.1 Principles concerning assetless companies

Under the heading "debtors with insufficient assets", the Guide notes that

"(m)any debtors that would satisfy the criteria for commencement of insolvency proceedings are never formally liquidated, either because creditors are reluctant to initiate proceedings where it

[16] See also footnote 2.

[17] We gratefully acknowledge the report undertaken by the United Nations National Coordination Committee for Australia (UNCCA www.uncca.org) which answers this question on notice on behalf of the Law Council of Australia.

appears that the debtor has no, or insufficient, assets to fund the administration of insolvency proceedings or because debtors in such a position will rarely take steps to commence proceedings".

It goes on to say that some insolvency laws refuse any application for winding up if there are insufficient assets; others provide some mechanism for appointment and remuneration of an insolvency representative; or provide for a surcharge on creditors to pay for the administration of estates.

The Guide then gives a number of reasons, in particular of a public interest nature, for devising a mechanism to enable the administration of a debtor with apparently few or no assets under a formal proceeding. It continues:

"[73] …. Where an insolvency law does not provide for exploratory investigations of insolvent companies with few or no assets, it does little to ensure the observance of fair commercial conduct or to further standards of good governance of commercial entities. Assets can be moved out of companies or into related companies prior to liquidation with no fear of investigation or the application of avoidance provisions or other civil or criminal provisions of the law.

[74]. A mechanism for administration will assist in overcoming any perception that such abuse is tolerated and may provide a return for creditors where antecedent transactions can be avoided, as well as a means of investigating the conduct of the management of such debtors".

The Guide gives positive reasons also:

"[74] … It may also encourage entrepreneurial activity and responsible economic risk-taking through the provision of a discharge and fresh start for entrepreneurs and others engaging in economic activities—the punitive and deterrent aspects of insolvency laws will be less appropriate where the debtor is honest. For example, where an application to commence insolvency proceedings might otherwise be denied, some insolvency laws provide an exception for individuals with insufficient assets to fund the administration of proceedings, enabling the affairs of that debtor to be investigated to determine if there are assets that can be recovered and whether the debtor should receive a discharge".

At [75], the Guide offers mechanisms for pursuing the administration of such estates including levying a surcharge on creditors to fund the administration; establishing a public office (such as an official receiver) or using an existing office; establishing a fund out of which the costs may be met; or appointing a listed insolvency professional on the basis of a roster or rotation system.

In that last example, the guide suggests the insolvency practitioner be paid a prescribed fee by the State or the costs be borne directly by the insolvency practitioner and cross-subsidized by their other matters, with their remuneration rates being adjusted accordingly.

These issues and the suggestions can be directly related to the position in Australia as we have described.

We point out that this is not the position taken in Australia, the government having previously said that if creditors, or the debtor, were not willing to fund assetless liquidations, the open course was for them to be deregistered; that liquidators were not expected to work for no remuneration. A proposal for an official receiver role to as address those cases was not

accepted. These policy decisions are described in *Rebuilding the structure of the Australian insolvency system.*

We also mention that in a submission to government on *Modernising the Business Registers* in 2017, academics from Melbourne referred to the fact that

"(t)he risk that insufficient oversight of the deregistration process may be facilitating illegal phoenix activity was identified more than 20 years ago in the ASC's 1995 research paper into phoenix activities and insolvent trading: Importantly it would appear that approximately 92% of Phoenix companies are deregistered under the ASC's section 574 program [the predecessor to s 601AB of the Corporations Act]. Effectively the ASC is unintentionally assisting Phoenix offenders to escape prosecution and detection by deregistering the company and closing off the trail. This is particularly the case in circumstances where debts may be many, but small and no creditor action is taken to place the company under administration. A review of the objectives and goals of the s 574 program should be undertaken …"

The submission went on to suggest some of the areas to be covered in such a review. It then said that

"(d)espite this problem having been identified in 1995, there is still a significant risk that deregistration of [companies] may be effectively 'writing off' debts to creditors and employees on a large scale, as a result of the lack of scrutiny of abandoned companies".[18]

5.2 Small business insolvencies

As in most jurisdictions, small business comprises the vast bulk in numbers of Australia's businesses. These generally comprise both corporate structures and individual or partnership structures. But even in the case of a company, there is often an intertwining of company and personal debt of the owners, through personal guarantees, tax liabilities and the owners' use of their personal funds to support the business.

Thus, it has been said that

"personal insolvency regimes are often more relevant for entrepreneurs and small businesses. Indeed, the corporate vs non-corporate distinction in assets and liabilities is often blurred for small firms, either because lenders require personal guarantees or security – e.g. a second mortgage on the owner's home – or because prior to incorporating and obtaining limited liability protection, entrepreneurs typically use personal finances …".[19]

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[18] See Treasury's Modernising Business Registers inquiry. Submission by Professor Helen Anderson, Professor Ian Ramsay and Mr Jasper Hedges, Melbourne Law School, and Professor Michelle Welsh, Monash Business School, Monash University. 23 August 2017.

[19] *Design Of Insolvency Regimes Across Countries* 2018 OECD Economics Department Working Papers No. 1504 by Müge Adalet McGowan and Dan Andrews, citing Berkowitz, and White, "Bankruptcy and Small Firms' Access to Credit", (2004) 35 RAND Journal of Economics; Cumming, "Measuring the Effect of Bankruptcy Laws on Entrepreneurship across Countries", (2012) 16 Journal of Entrepreneurial Finance.

US studies have examined the extent to which personal difficulties cause corporate business bankruptcies,[20] for reasons including the owner's matrimonial property disputes; personal and family health problems, including illness or death of key personnel; and theft and criminal loss. Even the concept of consumer debt is not always sound when the business provides the financial support for the owner and their family.

Part Five of the Legislative Guide is to similar effect. It says:

"33. A number of States have insolvency laws that apply different rules to business debts as opposed to personal or consumer debts. In the context of MSEs, it may not always be possible to separate their debts into clear categories. Individual entrepreneurs, owners of limited liability MSEs and their family members may all be involved in the business and use consumer credit to finance the business either as start-up capital or for operations. Business insolvency may lead to personal or consumer insolvency once a business fails, even if the business is a separate legal entity. For that reason, separate proceedings with different access conditions and procedural steps applicable to various debts involved in MSE insolvency may not be an optimal solution. The MSE Insolvency Guide recommends therefore that all debts of an MSE debtor should be covered in a single simplified insolvency; where that is not possible under applicable domestic law, it recommends that at least procedural consolidation or coordination of linked insolvency proceedings should be ensured".

Further details are offered at Part N. *Treatment of personal guarantees; procedural consolidation or coordination*, including the comment that

"procedural consolidation or coordination of those proceedings would not only be procedurally convenient and cost-efficient but would also facilitate sharing of information to obtain a more comprehensive evaluation of the situation of the various parties involved and finding the best solution for all concerned".

At present, at the time of insolvency of a small corporate business, insolvency law must separate out and attend to corporate assets and liabilities, with any personal liabilities attended to separately and perhaps belatedly. This may require repayment by directors of their personal loan accounts or the liquidator may in fact claim on the director for damages for insolvent trading. Insolvency takes a strict legal view of those assets and liabilities of a business, as to whether they are the responsibility of the company alone, and/or the directors. Creditors of the company may also take proceedings directly against the directors under guarantees.

An added complication is that if the director goes bankrupt, the assets and ownership of the company vest in the director's trustee under the *Bankruptcy Act* and it is for the trustee to resolve the fate of the company. So called "small business restructuring reforms" often introduced by government are usually only focused on corporate liabilities and specifically do

[20] Warren and Westbrook "Financial Characteristics of Businesses in Bankruptcy" (1999) 73 Am Bankr LJ 499, 560–561. See also *Guide on the Treatment of Insolvent Micro and Small Enterprises in Asia*, a joint project by the International Insolvency Institute and the Asian Business Law Institute, 2022, Features of MSEs, pp 14-16.

not seek to resolve any personal liabilities from guarantees given, or other personal liabilities.[21] Company tax liabilities can be imposed directly on directors.

All this is compounded by that fact that insolvency practitioners' independence requirements generally prevent them from being liquidator of a company and trustee of the directors' bankruptcy.[22] In those cases, there is generally a need to have separate practitioners appointed from separate insolvency firms.

The economic efficiency of this has been questioned in Australia and recommendations have been made by the Australian Small Business and Family Enterprise Ombudsman (ASBFEO), for one, for coordination or harmonisation of the processes of small business insolvency.[23]

6. Data and research

Submitters to this inquiry and many previous inquiries and reviews have recommended that better data, statistics, and research is needed on corporate insolvency.

a. Are those recommendations difficult to progress, and if so, why?

To start with, we agree that better data, statistics, and research is needed, not only on corporate insolvency but in insolvency generally. This is not only for the purpose of monitoring for law reform purposes, but also for the use of AI in the analysis of the affairs of insolvent companies. As we explained earlier,[24] the nature of insolvency is such that its use of AI and IT mechanisms should be a priority.

We think that the collection and dissemination of data generally is lacking in Australia, with comments going back to the 2014 Financial Systems Inquiry and the 2017 Productivity Commission's Inquiry Report into *Data Availability and Use*. The *Data Availability and Transparency Act* 2022 (Cth), which would seek to establish a scheme for sharing public sector data for specific purposes in the public interest, offers some hope. This will assist the process of access to data generally.

As to insolvency, we enclose a letter from a number of academics including ourselves to the Office of the National Data Commissioner of October 2019 as to the history of the limitations – attachment B. These limitations generally remain the case today although we note that the new Australian Business Register will also provide more insolvency specific data.

One significant impediment in obtaining access to insolvency data has been the *Corporations (Fees) Regulations* 2001 (Cth), which require ASIC to charge fees for copies of documents and do not provide an exception for research or public interest purposes. This means that to undertake research using ASIC data can cost tens of thousands of dollars just to get access to basic information that is collected for the public benefit. An amendment to the underlying

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[21] For example, the protection of a guarantor under Corporations Act Part 5.3B applies only during the period of restructuring: s 453W Corporations Act.
[22] ARITA Code, Independence; unless with court leave.
[23] ASBFEO Submission to the Productivity Commission's 2022 Inquiry into Australia's Productivity Performance called for "Improvements … to insolvency processes for small and family businesses".
[24] See the AI/IT ideas shown at footnote 12.

fees regulations to provide for a public interest and/or academic research fee waiver would provide better access to information that would allow for more detailed academic empirical studies of how insolvency actually works. The new Data Sharing Rules being introduced should help, but these are for sharing data between institutions and don't necessarily enable individual (or teams) of academic researchers to access data for free for public interest research purposes.

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

The contents of that 2019 letter to the National Data Commissioner summarises what data the academic group considered was needed.

We also comment that in relation to the particular submission we make about a threshold inquiry into the adequacy of the insolvency system some more particular items of data required. These would include the numbers of companies that are registered by default and any trends in relation to those; the extent of assetless companies administered by liquidators and the value forgone; and more detail about the breaches of the law pursued by ASIC under section 533 *Corporations Act.* We also suggest there is a need to understand the costs associated with insolvency claims, that is, to know the average net return to creditors arising out of voidable transaction claims. There would be other such items of data that would assist any threshold inquiry.

At present we do not know how long insolvency procedures last for, how much they cost, how much is actually returned to creditors (as opposed to initial estimates of returns) and what the outcomes of insolvency processes are. The only data provided by ASIC is total numbers of appointments each year and who takes those appointments. The redesign of the initial insolvency report has been ongoing for the past 3 years so that there is no data about the asset or liabilities of companies that enter external administration since FY18-19.

Having said this we do not say that the inquiry cannot proceed on existing data, limited as it may be. Data is one important source of information but anecdotal and other information gleaned by the inquiry is also of great assistance.

We referred earlier to the International Monetary Fund paper - *The Use of Data in Assessing and Designing Insolvency Systems*[25].We commend that paper to the Committee. With the government giving increased focus to data collection, the note that the report concludes in saying that data is needed to allow legislative change to be properly targeted to address specific problems in an insolvency framework and that '[l]egislating "in the dark" is an anomaly in the age of big data'.

As to the inevitable questions about cost, the IMF says there are often existing multiple data sources which partially cover insolvency data which may simply need rationalization and simplification.

[25] See footnote 6 of this submission.

"In addition, the cost of implementing advanced systems should be compared with the cost of not having them: ignoring how the insolvency system works in practice, and where its main challenges lie, can result in severe consequences for the economy, and it may render legal reforms ineffective".

See also other papers on this topic.[26]

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

We would assume so and it is often the case that agencies only produce data in response to an inquiry such as this; in other times, the data is not disseminated. Much of the relevant data would be held by ASIC in the forms that are lodged with it by insolvency practitioners (such as annual returns that outline the costs and expenses involved in insolvency appointments). We understand that greater sharing of such data, in a controlled manner, is a purpose of the *Data Availability and Transparency Act* 2022.

Also, much of the core data in insolvency is held by the profession itself, in insolvency practitioners' files. There would be merit in the industry bodies making some attempt at releasing that data; for example, to allow analysis of the effectiveness of litigation recoveries in providing returns to creditors. We comment on this in our *Rebuilding the structure of the Australian insolvency system* article.

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? i. [If yes] Are there any steps required to mitigate this other than just waiting?

As noted above, ASIC has been rewriting the form submitted by insolvency practitioners previously known as the Schedule B report that set out preliminary information about companies that enter external administration (such as asset and debt levels, as well as reasons for insolvency and potential offences). The data from this form was then released each year by ASIC as a statistical report. The report was initially withdrawn (in 2019) due to changes from the *Insolvency Law Reform Act* 2016 (Cth) (ILRA 2016) that introduced an Initial Report and a 3-month report (in liquidation), annual administration returns (rather than the previous 6 monthly receipts and payments form) and end of administration returns. The new report based on data collected from these returns has not yet been released by ASIC. We are not aware whether this has been caused by the pandemic.

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

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

This is a matter that goes back to the Australian Constitution and the early days of federation. The Australian colonies had followed the English model of separate laws for companies and

[26] *The need for insolvency data*, paper given at the Insolvency Academics Network meeting on 2 December 2022, M Murray; *The use of empirical data in formulating bankruptcy policy,* Sullivan, T. A., Warren, E., and Westbrook, J. L., (1987) 50(2) Bankruptcy Revisited pp 195-235; *"What's the latest?" Corporate insolvency statistics* by Professors Chris Symes and David Brown (2010) 11(1) INSLB 2; and *The dark figures of insolvency*, M Murray, (2009) 10(1) INSLB 7.

individuals, and this was typical of many laws at that time. The Australian Constitution gave power to the federal parliament to make laws concerning "bankruptcy and insolvency", again on the then approach of treating them separately. The new federal government proposed two Bills - the Bankruptcy Bill 1908 and the Companies Bill 1908. Under those Bills, and consistent with the English approach, and New Zealand, an official receiver was to be created for both personal and corporate insolvency. That was the case under the Bankruptcy Act 1924 and this role continues. It would have also been the case in corporate insolvency in Australia but for a High Court decision[27] which found limitations in the power of the Commonwealth to legislate for corporations. As a consequence, the Companies Bill 1908 did not proceed and an official receiver and a federal corporate law do not seem to have been considered further. The States and Territories continued with their existing corporate laws and corporate insolvency laws up until the *Corporations Act* 2001 was enacted on the basis of a referral of state powers.

The 1988 Harmer Report considered the issue and decided that two separate Acts were satisfactory as long as there was attention given to any law reform changes being harmonised on an on-going basis, particularly those of a procedural nature.[28] This was never achieved, perhaps because each of personal and corporate insolvency was handled by different departments. The ILRA 2016 was a valid attempt to harmonise the law, however many differences remain, including (importantly) large differences in the approach taken by the corporate insolvency regulator (ASIC) and personal insolvency regulator (AFSA).

However, while ever bankruptcy comes under AGD and corporate insolvency under Treasury, we do not consider there is much scope for continued harmonisation of the law. A single unitary Insolvency Act would need to come under the jurisdiction of a single regulator and single government department.

b. What are the differences in insolvency law for trusts?

It is important to note that trusts are not a separate legal entity and cannot therefore be insolvency or be subject to insolvency procedures. It is in fact the trustee of the trust assets that becomes insolvent. A trustee may be a natural person or a corporation and this means that the applicable insolvency law will arise from the legal status of the person (natural or corporate) who acts as the trustee.

The law of trusts is primarily state law and operates to determine what may be considered the 'property' of the trustee, which includes equitable, contractual and statutory rights of indemnity against the trust assets. While the High Court has confirmed that a company in insolvency that has acted as trustee can exercise its right of indemnity against the trust assets or against their proceeds as property of the company, there are still many difficult practical and legal issues remaining. We note in our submission that the fact that insolvency

[27] *Huddart, Parker & Co Pty Ltd v Moorehead* [1909] HCA 36; (1909) 8 CLR 330

[28] ALRC 45 at [31].

practitioners must spend money otherwise available to creditors to seek court orders appointing them as receivers for sale in circumstances where the company has been removed from its position as trustee due to the insolvency appointment (and so the former trustee company can no longer exercise a right to deal with the trust assets under the terms of the trust instrument) is an unnecessary cost. The *Corporations Act* should be amended to allow liquidators to exercise a statutory power of sale without a further court order.

We note that leading experts in Australia on this issue including Dr Nuncio D'Angelo (partner, Norton Rose Fulbright) and the Hon Reginald Barrett AO (former Justice of the Supreme Court of New South Wales) have made submissions to this inquiry and that the Law Council of Australia's submission makes detailed reform recommendations in relation to trusts and insolvency.

c. What are the differences in insolvency law for partnerships?

There is no significant issue with partnerships, the insolvency of which is covered by the Bankruptcy Act 1966, ss 56A-56G. Individual partners become bankrupt and are then subject to the minimum 3-year period of bankruptcy restrictions. Corporate partners who are insolvent are covered by corporate insolvency law. However in the recent case of *Woodhouse v Francis*,[29] the Court held that partnership debts of corporate partners are to be dealt with under state partnership law rather than under the Corporations Act provisions. There may be a concern with inconsistent priority rules between the Corporations Act and the relevant state partnership laws.

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

There are necessary differences but themes such as court approval, time limits, meeting rules, voidable transactions, etc could be harmonised. A single form for initiating court insolvencies, standardised rules for creditor meetings, standardised powers for insolvency practitioners, standardised powers for the courts, standardised priority rules and insolvency practitioners being licensed to take all insolvency appointments without needing separate registration for personal and corporate insolvency appointments. Importantly, a single insolvency regulator could have oversight of the system and remove the inconsistencies in approaches that currently exist between AFSA and ASIC.

e. What barriers are there to creating a single insolvency act?

At present insolvency law is the responsibility of two different government departments with Attorney-General's covering personal insolvency and Treasury covering corporate insolvency. There are also separate insolvency regulators who take different approaches which increases compliance costs for insolvency practitioners. A single insolvency statute should be introduced with a single government department being responsible for the unified statute.

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[29] *[No 2]* [2022] WASC 318

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

Simplification and reduced complexity, consistency between personal and corporate insolvencies and streamlined registration and regulation of insolvency practitioners.

8. COVID-19 emergency reforms

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

To the extent that this is a question that is asking about the impact of the legislative concessions on business, we consider this question is better addressed by an economist.

b. Are there areas requiring normalization or reform that have been identified from the COVID19 emergency measures?

The COVID emergency measures have highlighted the need for streamlined insolvency and debt resolution schemes. As noted above, Singapore has introduced streamlined liquidation and streamlined restructuring for SMEs affected by COVID. Further resources should be put into facilitating debt resolution, particularly involving SMEs and encouraging directors and managers of SMEs to enhance their financial literacy and institute more robust accounting systems that will allow them to better track their business' financial position so that insolvency may be avoided. We support the ASBFEO's suggestion of a business viability review voucher. We also support the calls made in several submissions to improve director training.

9. Recent reviews

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 Insolvency Practices inquiry; and***
- ***The Insolvent Trading Safe Harbour statutory review.***

  a. ***Are there any barriers to implementing those recommendations?***
  b. ***Are there any of those recommendations that should not be implemented?***

As to the Whittaker review, we note that many business users of the PPSR will have implemented systems to work effectively with the current processes under the PPSA and this may mean that the cost of changing the PPSA to implement the hundreds of recommendations in the report will be outweighed by alternatives such as seeking to implement recommendations as to simplification and streamlining the existing regime.

As to the ASBFEO Insolvency Practice Report of 2020, there are a number of recommendations worthy of consideration, including the small business viability review, and debt hibernation, but all of the recommendations have to now be considered in light of law reform changes that have occurred since the report was released. The SBR scheme under Part 5.3B provides a quicker process for small corporate businesses in difficulty, as well as a

simplified liquidation process. There are now more on-line processes to documents and reports. As to the regulation of insolvency practitioners by the ASBFEO, a government agency, this may be considered in any review of the regulatory changes introduced by the ILRA 2016. We note that the report does not address small business insolvencies operated by individuals or partnerships. We suggest the report be considered in any root and branch review of the insolvency system.

As to the Insolvent Trading Safe Harbour review, we consider that all of its recommendations should be implemented.

10. Small business restructuring and simplified liquidation reforms.

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.

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

b. Are any adjustments required?

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.

a. What, if anything, does this trend say about take-up of the regime?

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

c. What factors may have influenced this increase?

We consider that we have responded to these questions in our answers to questions on notice of 27 January 2023. If not, please let us know.

11. Regulation of pre-insolvency advisors

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

Insolvency practitioners, lawyers and accountants all operate in highly regulated fields and are members of professional associations that have disciplinary processes and codes of ethics. It should be noted that these professionals are often called on to provide valuable advice prior to the tipping point of insolvency (whether actual insolvency or the commencement of an insolvent administration appointment). The term 'pre-insolvency advisor' has taken on a pejorative usage to refer to advisors (whether regulated professionals or not) who advise debtors on how to avoid paying their creditors.

This is an area that needs further regulation so that debtors are aware of trustworthy and untrustworthy advisors. Many debtors receive assistance in seeking out advisors through their

major lenders, but too many debtors rely on Google for referrals and unfortunately many advertisers on Google are promoting improper and untrustworthy advice. Amending the safe harbour laws to require safe harbour advisors to be members of a regulated profession (such as law or accounting) would go some way in reining in untrustworthy advisors, as would ASIC releasing guidance on who can be an appropriately qualified entity to give advice under the safe harbour laws (as recommended by the Treasury Review Report). Finally, requiring a minimum level of professional indemnity insurance and having a register of qualified advisors would also assist in addressing concerns about unregulated pre-insolvency advisors.

We concede that defining unlawful pre-insolvency advice in legislation would be difficult.

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

There would need to be a designated regulator, for both personal and corporate insolvency. There would be additional costs involved in obtaining pre-insolvency advice which may limit its access for some small business debtors. However, greater regulation would promote greater transparency and confidence in pre-insolvency advice. Encouraging more early action by directors and managers to seek out early advice could result in more companies being saved from insolvency or providing better returns in insolvency because the problems were addressed at an earlier time when the company was not in terminal insolvency.

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

We are not aware of any particular guidance in relation to pre-insolvency advisors save that the need for the debtor to obtain good advice is emphasised.

12. Recommendations in submissions and timing of reforms:

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?

No, thank you.

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.

Consistent with our views that there should be an initial threshold inquiry, settling upon the terms of reference for that, and the body to be engaged, would be desirable. Apart from that, we consider that the review of the law of trusts and insolvency, already initiated by Treasury, should proceed further.

Addendum

At the end of our session on 13 December 2022, the Chair referred to some additional questions pending, being these just responded to, as well as ones "about the official receiver,

personal and corporate liabilities and the differences between those, the burden that is shared there. You indicated a shift of the personal insolvency from Attorney-General to Treasury, the rationale for that".

To the extent these issues are not included in these questions, and our responses, we give these comments.

Our idea of an official receiver as explained in our *Rebuilding the structure of the Australian insolvency system* is that the Commonwealth's new role would include certain essential regulatory, oversight and registry and triaging functions, as well as estate administration. This would not be dissimilar to the structure of AFSA, with an Inspector-General, Official Trustee and an Official Receiver. The office would not be limited to court appointed liquidations (which is the case in the United Kingdom) nor would it be the sole personal insolvency administrator (as in New Zealand), but would have authority over both personal and corporate insolvencies and be able to enlist private sector insolvency practitioners as necessary.

We have not yet considered funding of the system in any detail but this could be drawn partly from the public revenue and partly from a levy on new or annual company registrations, as applies in NZ, or fees calculated on assets realised, as with AFSA, or both. The official receiver would administer 'national interest insolvencies' as may be required (ie, administrations with significant economic, social or environmental importance) and would investigate and prosecute wrongdoing by debtors and company directors where it is in the public interest to do so (notwithstanding that, or especially where, they will not give a financial return).[30] It would also administer assetless administrations.

As to "personal and corporate liabilities and the differences between those", and the burden shared, we assume this refers to the fact that in a small business, there may be both personal liabilities incurred by the owner, including by way of guaranteeing the company's liabilities, and corporate liabilities incurred by the company. It will depend on the particular terms of any contract as to how and by whom the debt was incurred.

As to the rationale for a shift of the personal insolvency system from Attorney-General's to Treasury, legislation for the creation of a single Insolvency Act or even greater harmonisation of the two systems would be legislatively and organisationally difficult under the present divided structure. In our view, a "soft law" approach would be to transfer personal insolvency responsibility to Treasury, with its social and economic focus, from its present focus of law enforcement. Personal insolvency would necessarily sit well with corporate insolvency, and with the ATO and the ASBFEO. That at least may start a process of harmonised consideration of insolvency laws generally.

[30] See also *Centring Debt Justice in Insolvency Reform,* Salman Shah, Insolvency Law Bulletin 2023, forthcoming.

Contact

Please contact us if we can explain or assist further.

M Murray

Michael Murray

J Harris

Professor Jason Harris

Attachment A

Extract from *Guide on the Treatment of Insolvent Micro and Small Enterprises in Asia.* See footnote 9.

Insolvency law plays an essential role in promoting economic growth. First, by providing a variety of tools that can save viable but financially distressed firms, insolvency law has the ability to preserve jobs and wealth created by businesses. Moreover, if entrepreneurs know that, in the event of insolvency, they will have access to a system that helps them remedy their financial situations, they will have more incentives to start a business and take risks in the first place. As a result, insolvency law can help promote entrepreneurship and innovation.

Second, by liquidating non-competitive businesses, insolvency law can serve as a valuable mechanism to reallocate resources towards more productive activities. Therefore, the quick liquidation of non-viable businesses will help reduce the number of zombie companies potentially existing in the real economy.

Third, if an insolvency system can effectively preserve value, creditors can maximise their recoveries. Hence, they will be more incentivised to extend credit, fostering economic growth. In addition, the maximisation of returns to creditors will also improve the financial position of a debtor's lenders. In the case of financial creditors, this aspect will reduce the level of non-performing loans and can enhance financial stability. In the context of non-financial creditors, achieving this goal will reduce the risk of many of them (especially those more exposed to the debtor, usually because they do not have a diversified business) becoming insolvent themselves.

Fourth, from the perspective of debtors, if entrepreneurs know that, in the event of insolvency, the insolvency system will help them preserve value and address their financial problems (if a business is economically viable) or provide them with a quick exit (where a business is no longer viable), they may have more incentives to pursue entrepreneurial and value-creating economic activities.

Insolvency law can thus serve as a powerful tool to promote entrepreneurship, innovation, access to finance and economic growth. However, these goals can only be achieved if the insolvency system provides an attractive solution for distressed firms. Unfortunately, most jurisdictions in Asia do not currently provide a suitable insolvency framework for the majority of businesses existing in their economies: MSEs. To address this problem, this Guide recommends the adoption of a simplified insolvency framework for MSEs.

Attachment B

Academics' letter to the Office of the National Data Commissioner, October 2019 [PDF follows].

Attention: Office of the National Data Commissioner
PO Box 6500
Canberra ACT 2600

Response to Discussion Paper and Privacy Impact Assessment about Data Sharing and Release reforms

We are a group of legal academics with an interest in corporate and personal insolvency data.

We make this submission from our joint perspective as teachers, researchers and writers on corporate and insolvency law reform and policy.

Summary

There is a serious lack of affordable corporate insolvency data available to assist with research projects that help inform and shape national public policy debates. The position in personal insolvency is better but could be improved. The need for access to affordable data has been the subject of comment for some decades. ASIC are the custodians for most of the relevant data regarding public and private companies in Australia, pursuant to its authority under the Corporations Act 2001. AFSA, and the Inspector-General in bankruptcy, holds much personal insolvency data, under the authority of the Bankruptcy Act 1966. Other agencies – ATO and the FEG recovery program, would also hold data relevant for research purposes.

Insolvency law reform and policy lacks empirical data on the most basic outcomes of the corporate regime – assets, realisations, recoveries, costs, returns to creditors, including employees – across liquidations and administrations. Personal insolvency reports some of these, across different types of administrations. Insolvency law reform, of its nature, should be based on empirical data. Insolvency law reform inquiries going back to 1988 have suffered from inadequate data and have made specific recommendations for data collection.

We support as a matter of principle making data more available for research, in particular corporate data, to promote informed policy debates. This may be either on a sharing or release basis.

Existing data

Insolvency data is held by AFSA comprising information on the NPII and other information held in statistics and other databases maintained by AFSA. Corporate insolvency data is held by ASIC through various registers, most of which require payment of a fee in order to obtain information lodged with ASIC. University researchers find it difficult to obtain funding to pay for search and download fees to access information contained on public registers which severely limits the scope and significance of research that can be undertaken. As scholars employed by publicly funded higher education institutions with a statutory mandate to produce high quality and high impact research, we believe that it is imperative that the proposed data sharing and release legislation give university researchers a more effective, efficient and economical way to obtain access to important data for research purposes.

AFSA and ASIC have different approaches to the maintenance of and release of data for academic purposes.

AFSA

AFSA has always extracted data on the operation of the bankruptcy system, and often published papers and outcomes. These usefully feed into bankruptcy law reform and policy. In addition, AFSA has a policy of inviting requests by academics for particular data sets which it will then try to meet. Academic research on such data sets can provide more useful policy information.

A recent example is a report on a 3 year research project funded by the Australian Research Council with scholars from the University of Melbourne[1] based on a long-term collaboration between Melbourne Law School and the Statistics team at AFSA.

It utilises a unique and significant dataset, provided by AFSA in line with its privacy policies and its commitment to facilitating independent bankruptcy research. The dataset contains the de-identified records of more than 28,000 individuals who declared bankruptcy between 2007 and 2016. The research also benefits from the expertise of several community organisation with specialist knowledge of debt problems and financial hardship. It draws upon three focus groups involving financial counsellors, consumer solicitors and social workers".

There are other such examples.

ASIC

ASIC produces statistics on numbers of insolvency and particular types, with some figures on returns to creditors. However, these are not of the level of detail produced by AFSA. Nor are we aware of ASIC having any similar approach to academic requests although it will try to meet them on payment of the statutory fees. Academics who have sought and obtained ASIC data have paid significant sums.

Background history

By way of background to our submission, we give this review of the long history of our concerns. The significant ALRC Harmer Report, 1988, which was the last major review of our insolvency laws, said that

[36] It is important that there be readily available pertinent statistical information about insolvency. Insolvency is, for example, a valuable indicator of trends in the economic system; it is relevant to ascertaining the impact of credit practices on different sections of the community and can be a helpful guide to the possible need for regulation of forms of business organisation (such as the proprietary limited company). Further, on a broader scale, valuable studies on the origin and performance of small businesses would be greatly assisted by readily available information as to the insolvency of such businesses".

[1] See further, https://law.unimelb.edu.au/centres/ccl/research/major-research-projects/personal-insolvency-project

The report went on [37-38] to say that
"one of the major handicaps that has impeded the Commission in this Reference has been the difficulty in obtaining pertinent statistical information about corporate insolvency in a readily available and intelligible form. Most, but not all, of the Corporate Affairs Commissions supply only very elementary information on an annual basis".

In contrast,
"the office of the Inspector-General in Bankruptcy has, for many years, collected and published detailed and relevant information relating to individual insolvency as part of an annual report on the operation of the Bankruptcy Act. Some of the statistical information is now being provided on a quarterly basis".

That inherent difference between the two types of insolvency remains. The Report went on to make various recommendations about the need for better statistics.

PJC Report
Sixteen years later, the 2004 report of the Parliamentary Joint Committee on Corporations and Financial Services - *Corporate Insolvency Laws: A Stocktake* commented that (at [1.19]):

"The Committee has not undertaken any empirical research itself and notes the lack of basic data on the operation of those laws. As one submission pointed out: There is little data on the operation of insolvency laws in Australia. We have only the bare minimum of information on the operation of our various corporate administrations. There is for example virtually no data on the operation of the voluntary administration procedure beyond the number of commencements. This is not a new observation. The Harmer Report expressed concern about the lack of pertinent statistical information on insolvency and put forward a number of proposals to improve information in relation to insolvent companies".

That Committee then made suggestions for enhancing the collection of statistical information about the impact and experience of insolvency. There were for example, concerns then about "phoenix company activity", with ASIC itself expressing concern "about allegations of phoenix company activity that relied heavily on anecdotal evidence without an appropriate level of underlying statistical support or analysis"; and about deregistered companies.

Both remain issues of concern today.

The Committee considered that there was "scope to enhance the quality of information collated and/or published in relation to companies that are the subject of statutory reports by external administrators, so as to improve its usefulness to management, journalists, academic researchers, the public, Parliament and the Government".
It then went on to list useful data that could be obtained:

- estimates of the level (number) of strategic insolvencies (phoenix companies),
- the numbers or incidences of:
    - cases raising the possible application of director disqualification provisions,

- so-called assetless companies,
- strategic insolvencies involving the use of corporate groups,
- liquidations that returned less than 50c in the dollar to creditors,

- cases involving holding company liability for insolvent trading by a subsidiary; and
- cases involving a shortfall in the payment of employee entitlements and superannuation; and
- fraud matters.

The government response was simply that this was a matter for ASIC.

Senate Report 2010

Six years later, a major Senate Report of 2010 recommended, in the context of a combining of the regulation role of ASIC with that of into one agency - the Australian Insolvency Practitioners Authority (AIPA) – the establishment of an agency to gather and report insolvency statistics.

The government rejected that proposal.

Other reports

We could draw to your attention a number of other inquiries into insolvency over the years where the inadequacy of statistics has been the subject of comment.[2]

Discussion paper

With reference to the discussion paper, we endorse several comments, for example that the data we seek, and its analysis, will "advance knowledge and create better public policy, by:

• Improving capability and the quality of research outcomes from Australia's universities and research institutions.

• Providing trusted researchers with the opportunity to more accurately evaluate the effectiveness of government policies and programs.

• Strengthening cooperation between the Australian government and researchers, leading to more robust outputs tested by leading experts"

While academic and professional research and input into insolvency law reform is of high quality, it lacks empirical data both as to be able to assess the need for a particular law and as to the effectiveness of that law once introduced.

To some limited extent academics researchers have endeavoured to assess the operation of the Australian insolvency regime by way of manual extraction of data, with very useful results, but much more could be done, in particular in corporate insolvency. [3]

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[2] See further Murray, '*The dark figures of insolvency*' (2009) 10(1) INSLB 7, which traces the largely failed efforts by government and regulator inquiries over the past two–three decades to collect and analyse statistics on corporate insolvencies in Australia.

[3] See for example, Routledge (1998) 16 Company and Securities Law Journal 4; Herzberg, Bender, and Gordon-Brown (2010) 18 Insolvency Law Journal 181; Wellard, "A Sample Review of Deeds of Company Arrangement under Part 5.3A of the Corporations Act" (ARITA 2014); Blazic, *Rehabilitation Regime or Corporate Graveyard: Practitioners' Perspectives of the Australian Part 5.3A Voluntary-Administration Legislation* (DBA thesis, University of Wollongong 2014).

We also endorse these comments, that university researchers have explained:

"the opportunities for them to do more to improve policies and programs by having better access to government data. Researchers pointed to their ability to help fill government capability gaps, using their expertise to help solve intractable problems which will lead to better outcomes for all Australians. Researchers supported a data sharing system actively encouraging and enabling collaboration with researchers".

The paper refers to the value of better data sharing between the Commonwealth and States and Territories, with research and policy problems spanning different levels of government and it refers to productive examples of sharing between States and the Commonwealth. That would assist given that while insolvency law is federally based, it is impacted much by state and territory laws, for example in building construction, transport, and small business. However, we would also add the need for better data sharing within the Commonwealth, between AFSA and ASIC, and FEG and ATO. For example, a corporate liquidation may often result in the bankruptcy of the directors, through personal indemnities or tax liabilities. The Melbourne University research, referred to earlier, gives much useful data about the extent of bankruptcies resulting from small business activity, which is very relevant to the current proposals to reduce the period of bankruptcy to one year. The intersection between family law and bankruptcy is another area where data would assist policy reform.

We also note the privacy assessment. As experienced academics, we are familiar with the need for privacy protection and the need for de-identification of data. We note that this was the case with the Melbourne University research into personal insolvency, where privacy issues are more direct.

We mention that there is a policy tension between insolvency law, which sees insolvency as necessarily a public process, and privacy of the individuals involved. These issues were raised by the ALRC 108 - https://www.alrc.gov.au/publication/for-your-information-australian-privacy-law-and-practice-alrc-report-108/44-new-exemptions-or-exceptions/insolvency-practitioners/
However, the views of the ALRC in favour of privacy protection do not contradict the points we make in this submission.

Conclusion
We strongly support the data sharing and release initiative under the new Commonwealth Data Commissioner's office. We recommend that the Commissioner's office provide a facility through which scholarly researchers can access and utilise Commonwealth data to produce high quality and high impact scholarship to improve the policy analysis of existing law and proposed and potential law reform.

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