Parliamentary Joint Committee on Corporations and Financial Services

Corporate insolvency in Australia

July 2023

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Recommendation 1

3.104 The committee recommends that as soon as practicable the government commission a comprehensive and independent review of Australia's insolvency law, encompassing both corporate and personal insolvency. The committee is also recommending that the government progress several other near-term actions as identified in the executive summary.

Recommendation 2

4.61 The committee recommends that the comprehensive review, as part of its early work, consider and report on the appropriate principles and objectives of insolvency law. The committee further recommends that the government respond quickly to this first report of the comprehensive review to allow the comprehensive review to continue with further stages of work in a timely way.

Recommendation 3

5.77 The committee recommends that the comprehensive review consider and make recommendations on options to enhance public interest objectives and the effectiveness of, and interaction between, the personal and corporate insolvency systems.

Recommendation 4

6.76 The committee recommends that the Australian Securities and Investments Commission collect high quality, granular data in relation to insolvency and provide this data in a timely way to relevant government agencies and regulators.

Recommendation 5

6.77 The committee recommends that the proposed comprehensive review of insolvency consult data holders, researchers, industry participants, and public sector organisations to progress the access to and analysis of insolvency data.

Recommendation 6

7.98 The committee recommends that the proposed comprehensive review consider and report on the current system of corporate insolvency pathways from a holistic systems analysis perspective.

Recommendation 7

7.101 The committee recommends that the government implement recommendations from the Safe Harbour Review, independent and likely in advance of the further review, and consider referring the remainder of safe harbour reform issues identified in this report to a comprehensive review.

Recommendation 8

7.107 The committee recommends that as soon as practicable the government consider and consult on potential reforms to the:

- **small business restructuring pathway; and**
- **simplified liquidation pathway.**

Recommendation 9

7.108 The committee recommends that the comprehensive review consider the:

- **voluntary administration pathway; and**
- **members voluntary liquidation pathway.**

Recommendation 10

7.110 The committee recommends that the Australian Securities and Investments Commission collect and analyse data from an appropriately sized sample of voluntary and compulsory deregistrations, to provide greater visibility of the solvency status of deregistered companies.

Recommendation 11

8.25 The committee recommends that the comprehensive review consider the requirements for the registration of small business restructuring practitioners to understand the reasons for the limited number of registrations to date.

Recommendation 12

8.30 The committee recommends that the government reform the experience eligibility requirements for registered liquidators, to address the inequity of the requirements and the gender imbalance in the population of registered liquidators. Reforms could potentially include:

- **increasing the period over which experience is demonstrated, or**
- **replacing part of the required hours with a competency-based exam.**

Recommendation 13

8.67 The committee recommends that the comprehensive review include consideration of the remuneration of insolvency practitioners, including:

- **the extent to which public interest work carried out by liquidators for no or limited pay is sustainable; and**
- **the impact of this on all stakeholders in external administrations.**

Recommendation 14

8.87 The committee recommends that the comprehensive review include consideration of the operation, efficacy, and efficiency of the current independence requirements for insolvency practitioners, including:

- **whether the current requirements are achieving the policy settings that inform them and whether these policy settings are optimal; and**
- **the advantages and disadvantages of formally separating the roles of advice and restructuring from formal appointments to liquidations and administrations.**

Recommendation 15

8.108 The committee recommends that the comprehensive review include consideration of the nature and extent of the harm posed by 'untrustworthy pre-insolvency advisors', and whether further regulation or enforcement measures are needed to address this issue. The committee further recommends that in the interim, the government take prompt action to improve the regulation and active enforcement of pre-insolvency advisers.

Recommendation 16

9.46 The committee recommends that the government consider changes to the Assetless Administration Fund to ensure that it is achieving its intended policy objectives.

Recommendation 17

9.51 The committee recommends that the Department of the Treasury consider assessing the potential benefit of the Public Interest Administration Fund proposed by the Productivity Commission in 2015, including the impacts of the required increase on the annual review fee for company renewals; and either consider implementing the proposal, or provide that analysis to a comprehensive review.

Recommendation 18

9.73 The committee recommends that the comprehensive review consider and make recommendations on options for funding the administrations of assetless companies, including reforms to the Assetless Administration Fund (noting the committee's recommendation 16) and the merits of creating a public liquidator for corporate insolvency.

Recommendation 19

10.35 The committee recommends that the comprehensive review consider whether the current statutory reporting obligations for insolvency practitioners are best serving the integrity, efficiency, and efficacy of the Australian corporate insolvency framework, including (but not limited to):

- **the ability of the Australian Securities and Investments Commission (ASIC) to appropriately process, utilise and respond to initial statutory reports on current resources; and**
- **the appropriateness of existing reporting thresholds, having regard to their regulatory value as well as the burden imposed on insolvency practitioners.**

The committee further recommends that in the interim, the government and ASIC consider whether any timely changes can be made to the regulations on reporting thresholds, and ASIC's response to insolvency practitioner reports.

Recommendation 20

10.54 The committee recommends that the comprehensive review examine the operation of the insolvent trading regime and its impact on the broader corporate insolvency framework.

Recommendation 21

10.105 The committee recommends that the comprehensive review analyse and make recommendations on the overall economic and social benefits and costs of Australian Taxation Office relief to potentially insolvent companies in hard economic times, in the context of the impacts on the purposes of the insolvency system.

Recommendation 22

10.106 The committee recommends that the Australian Taxation Office consult, act on and publish model creditor guidelines, consistent with its model litigant obligations.

Recommendation 23

11.37 The committee recommends that the comprehensive review consider the relative priority of employees, liquidators, and secured creditors, including the priority over circulating assets under section 561 of the Corporations Act 2001. The committee further recommends that this be a high priority topic for the comprehensive review.

Recommendation 24

11.79 The committee recommends that the government develop reforms to improve the framework designed to ensure the policy objective of access to the Fair Entitlements Guarantee as a scheme of last resort, both to prevent misuse by novel schemes of arrangement, phoenixing, and other practices and to ensure capture of all individuals with valid entitlements.

Recommendation 25

11.87 The committee recommends that the comprehensive review consider and report on franchising insolvency issues.

Recommendation 26

12.65 The committee recommends that the government provide a formal response to the Whittaker Review which was completed in 2015.

Recommendation 27

13.61 The committee recommends that the comprehensive review consider unfair preferences and voidable transactions as a core aspect of potential insolvency reform.

Recommendation 28

14.55 The committee recommends that the government amends the Corporations Act 2001 to expressly clarify the treatment of trusts with corporate trustees during insolvency.

Acronyms and abbreviations

AA Fund	Assetless Administration Fund
ABA	Australian Banking Association
ABRS	Australian Business Registry Services
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACF	Australian Credit Forum
ACN	Australian Company Number
ACTU	Australian Council of Trade Unions
ADI	Authorised Deposit Taking Institution
AFSA	Australian Financial Security Authority (formerly ITSA)
AGD	Attorney-General's Department
AICM	Australian Institute of Credit Management
AIIP	Association of Independent Insolvency Practitioners
ALRC	Australian Law Reform Commission
AMWU	Australian Manufacturing Workers' Union
ARITA	Australian Restructuring and Insolvency and Turnaround Association
ARITA	Australian Restructuring Insolvency and Turnaround Association
ASBFEO	Australian Small Business and Family Enterprise Ombudsman
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
ATO	Australian Taxation Office
AWEF	Approved Worker Entitlement Fund
Banking Code	Australian Banking Association *Banking Code of Practice*
Bankruptcy Act	*Bankruptcy Act 1966*
BETA	Behavioural Economics Team of the Australian Government
BLS LCA	Business Law Section of the Law Council of Australia
B-READY	World Bank *Business Ready*

CAANZ	Chartered Accountants Australia and New Zealand
CDD	Creditor-defeating disposition
CFMMEU	Construction Forestry Maritime Mining And Energy Union
committee	Parliamentary Joint Committee on Corporations and Financial Services
Constitution	*Commonwealth of Australia Constitution Act*
Corporations Act	*Corporations Act 2001*
CPA	Certified Practising Accountant
DEWR	Department of Employment and Workplace Relations
Director ID	Director Identification Number
DOCA	deed of company arrangement
DPN	Director Penalty Notices
Economics Committee	Senate Economics Reference Committee
ETU	Electrical Trades Union
FBT	Fringe Benefits Tax
FEG	Fair Entitlements Guarantee
FY	financial year
GST	Goods and Services Tax
HIA	Housing Industry Association
ILRA	*Insolvency Law Reform Act 2016*
IMF	International Monetary Fund
IPA	Institute of Public Accountants
ITSA	Insolvency and Trustee Service Australia (now AFSA)
Legislative Guide	United Nations Commission on International Trade Law *Legislative Guide on Insolvency Law*
MoU	Memorandum of understanding
MSE/s	micro to small enterprise/s
MSME/s	micro, small and medium business/es
MVL/s	member voluntary liquidation/s
NCI Forum	National Construction Industry Forum
PJC	Parliamentary Joint Committee on Corporations and Financial Services
PPS Act	*Personal Property Securities Act 2009*
PPSR	Personal Property Securities Register
SBR	Small Business Restructuring
SCoLA	Society of Corporate Law Academics
SME/s	small and medium enterprise/s

SPEE Act	*Corporations Amendment (Strengthening Protections for Employee Entitlements) Act 2019*
ROCAP	Report on Company Affairs and Property
The Principles	World Bank *Principles for Effective Insolvency and Creditor/debtor Regimes*
TMA	Turnaround Management Association Australia
Treasury	Department of the Treasury
UK	United Kingdom
UNCCA	United Nations National Coordination Committee for Australia
UNICTRAL	United Nations Commission on International Trade Law
US	United States
WEF	Worker Entitlement Fund

Overview of findings

NEAR-TERM ACTIONS

FOR ASIC CONSIDERATION

Collection and provision of granular data (rec 3, ch 6)

Data analysis to examine solvency of deregistered companies (rec 10, ch 7)

Insolvency practitioner reporting requirements and ASIC responses to them (rec 18, ch 8)

FOR GOVERNMENT CONSIDERATION

Implement the recommendations of the Safe Harbour Review (rec 7, ch 7)

Small business restructuring and simplified liquidation pathways (rec 8, ch 7)

Eligibility requirements of registered practitioners to address gender imbalance (rec 12, ch 8)

Improve regulation and active enforcement of untrustworthy pre-insolvency advisors (rec 15, ch 8)

Changes to the Assetless Administration Fund (rec 16, ch 9)

Potential benefit of a Public Interest Administration Fund (rec 17, ch 9)

Insolvency practitioner reporting requirements and ASIC responses to them (rec 19, ch 10)

Model creditor guidelines for ATO (rec 22, ch 10)

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Holistic systems analysis of corporate insolvency pathways (rec 6, ch 7)

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Independence requirements for insolvency practitioners (rec 14, ch 8)

Nature and extent of the harm posed by 'untrustworthy pre-insolvency advisors' (rec 15, ch 8)

Funding administrations of assetless companies and merits of creating a public liquidator (rec 18, ch 9)

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Operation of the insolvent trading regime (rec 20, ch 10)

Impact of ATO relief to business (rec 21, ch 10)

Relative priority of employees, liquidators and secured creditors (rec 23, ch 11)

Franchising insolvency issues (rec 25, ch 11)

Unfair preferences and voidable transactions (rec 27 ch 13)

Executive summary

1.1 This is the final report of the Parliamentary Joint Committee on Corporations and Financial Services' (the committee) inquiry into the effectiveness of Australia's corporate insolvency laws in protecting and maximising value for the benefit of all interested parties and the economy. The committee inquired into matters including:

(1) trends in the use of corporate insolvency in Australia;
(2) the operation of the existing legislation, common law, and regulatory arrangements, including recent reforms;
(3) other areas for reform, such as, unfair preference claims, trusts with corporate trustees, safe harbours, and international developments;
(4) supporting business access to corporate turnaround capabilities;
(5) the role, remuneration, financial viability, and conduct of corporate insolvency practitioners; and
(6) the role of government agencies in the corporate insolvency system.

1.2 In the committee's assessment, Australia's corporate insolvency system is overly complex, difficult to access, and creates unnecessary cost and confusion for both debtors and creditors. Tellingly, few parties seem satisfied with the system as it stands. Unsecured creditors are understandably frustrated by stubbornly low returns in insolvency processes. Debtors, particularly smaller businesses, regard opportunities for restructure as lacking, and system costs as excessive. Insolvency practitioners and other observers consider the system is not appropriately resourced to achieve its purposes.

1.3 While reforms introduced following the 1988 *ALRC Report 45* (Harmer Report) were cutting-edge at the time, the committee is concerned that Australia's insolvency system may not reflect modern business practice and needs. This is particularly the case for smaller and medium-sized businesses. It also appears that the insolvency system has not kept pace with changes in the Australian and global economy since the Harmer Report, including but not limited to the shift from fixed assets to intangibles and increasing levels of secured debt. The committee also notes evidence suggesting Australia may have also fallen off the international pace in terms of insolvency reform.

1.4 Since the post-Harmer Report reforms of the early 1990s, a great number of changes have been made to corporate insolvency law. Many of these reforms have made valuable contributions to the corporate insolvency system; indeed, assessed individually, they overwhelmingly appear worthwhile and sensible. However, the committee agrees that the approach to corporate insolvency law reform in recent years has been, at times, 'piecemeal' in nature, with reforms attending to parts of the insolvency system without always having regard to the whole. This has added to the complexity and, in places, inconsistency in the system, making it harder and more costly for all to navigate. The committee also notes how failings in one area—for example, the apparent extent of insolvent trading and lack of enforcement in response—creates pressures throughout other parts of the system.

1.5 The committee has concluded that, to address the shortcomings of the corporate insolvency system, there is a need for an independent and comprehensive review that addresses the system as a whole. The committee suggests that a comprehensive review should consider both corporate and personal insolvency.

1.6 The committee agrees that a comprehensive review would require expert understanding of the legislative frameworks, case law and regulatory arrangements that apply to both corporate and personal insolvency law, including appropriate expertise in relation to international frameworks. Equally, a comprehensive review should have access to expert knowledge and capability in relation to the economic and financial imperatives of insolvency.

1.7 The committee is mindful that a comprehensive review and any resulting reform process would likely require a considerable investment of time and other resources, both by the government and key stakeholders. The committee is firmly of the view that this investment will be worth it, given the importance of a robust, fit-for-purpose insolvency system.

1.8 The committee considers that it will assist both a comprehensive review and those who wish to engage with it if the government sets out in the terms of reference key matters to be addressed. This could be done without necessarily limiting the review to those matters. Those key matters, as the committee views them, are:

- re-examining the principles, purposes, and objectives of the insolvency system (recommendation 2);
- the interaction between the personal and corporate insolvency systems (recommendation 3);
- the need for improved insolvency data (recommendation 5);
- the current system of insolvency pathways, and reforms to specific pathways (recommendations 6, 7 and 9);
- the requirements for the registration of small business restructuring practitioners (recommendation 11);
- remuneration of insolvency practitioners (recommendation 13);
- the independence requirements for insolvency practitioners (recommendation 14);
- issues associated with of 'untrustworthy pre-insolvency advisors' (recommendation 15);

- options for funding the administrations of assetless companies, including reforms to the Assetless Administration Fund and the creation of a public liquidator for corporate insolvency (recommendation 18);
- statutory reporting obligations that apply to insolvency practitioners (recommendation 19);
- the operation of the insolvent trading regime and its impact on the broader corporate insolvency framework (recommendation 20);
- overall economic and social benefits and costs of ATO relief to potentially insolvent companies in hard economic times, in the context of the impacts on the purposes of the insolvency system (recommendation 21);
- the relative priority of employees, liquidators and secured creditors (recommendation 23);
- franchising insolvency issues (recommendation 25); and
- unfair preferences and voidable transactions (recommendation 27).

1.9 While a comprehensive review may delay some reform actions, the committee notes the value in generally progressing reforms as part of a holistic process. Nonetheless, the committee has identified some reform actions that should be progressed independent of a comprehensive review. These more immediate potential reforms would address clear and broadly recognised failings in the current law. The committee is satisfied that these recommended reform actions—the 'low hanging fruit' of corporate insolvency law reform—will help realise a balance between the need for a considered, holistic review and reform process, and timely responses to shortcomings in the law. The committee's recommendations on near term reforms and actions include:

- the collection of high quality, granular data by ASIC (recommendation 4);
- implementing the recommendations of the Safe Harbour Review (recommendation 7);
- reforms to simplify the small business restructuring pathway and the simplified liquidation pathway (recommendation 8);
- ASIC collecting and analysing data from an appropriately sized sample of voluntary and compulsory deregistrations, to provide greater visibility of the solvency status of deregistered companies (recommendation 10);
- reforms to the experience eligibility requirements for registered liquidators, to address the inequity of the requirements and the gender imbalance in the population of registered liquidators (recommendation 12).
- prompt action to improve the regulation and active enforcement of pre-insolvency advisors (recommendation 15)
- consideration of changes to the Assetless Administration Fund to ensure that it is achieving its intended policy objectives (recommendation 16);
- assessing potential benefits of a Public Interest Administration Fund (recommendation 17);

- consideration of amendments to the thresholds for reporting requirements for insolvency practitioners, and ASIC's responses to them (recommendation 19);
- the ATO to consult, act on and public model creditor guidelines, consistent with its model creditor obligations (recommendation 22);
- reforms to improve the framework designed to ensure access to the Fair Entitlements Guarantee, both to prevent misuse, and to ensure capture of all individuals with valid entitlements (recommendation 24);
- the government responding to the Whittaker Review of the *Personal Properties Securities Act 2009* (recommendation 26); and
- improving the insolvency process for trusts (recommendation 28).

Chapter 1
Introduction

Inquiry commencement and terms of reference

1.1 The Parliamentary Joint Committee on Corporations and Financial Services (the committee) is established by Part 14 of the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

1.2 On 28 September 2022, the committee commenced an inquiry into corporate insolvency in Australia pursuant to its duties under section 243 of the ASIC Act. That provision provides as follows:

> The Parliamentary Committee's duties are:
>
> (a) to inquire into, and report to both Houses on:
>
> (i) activities of ASIC or the Takeovers Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or
>
> (ii) the operation of the corporations legislation (other than the excluded provisions); or
>
> (iii) the operation of any other law of the Commonwealth, or any law of a State or Territory, that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); or
>
> (iv) the operation of any foreign business law, or of any other law of a foreign country, that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and
>
> (b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and
>
> (c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.[1]

1 *Australian Securities and Investments Commission Act 2001* (ASIC Act), s. 234.

1.3 The terms of reference agreed upon by the committee call for an inquiry into the effectiveness of Australia's corporate insolvency laws in protecting and maximising value for the benefit of all interested parties and the economy, including:

(1) recent and emerging trends in the use of corporate insolvency and related practices in Australia, including in regard to:

(a) temporary COVID-19 pandemic insolvency measures, and other policy measures introduced in response to the pandemic that may have had an effect on such trends and practices;
(b) recent changes in domestic and international economic conditions, increases in material and input costs for businesses and inflationary pressures more broadly, and supply shortages in certain industries; and
(c) any other contributory factors or events that have impacted insolvency patterns;

(2) the operation of the existing legislation, common law, and regulatory arrangements, including:

(a) the small business restructuring reforms (2021);
(b) the simplified liquidation reforms (2021);
(c) the unlawful phoenixing reforms (2019); and
(d) the operation of the *Personal Property Securities Act 2009* [PPS Act] in the context of corporate insolvency;

(3) other potential areas for reform, such as:

(a) unfair preference claims;
(b) trusts with corporate trustees;
(c) insolvent trading safe harbours; and
(d) international approaches and developments;
(e) supporting business access to corporate turnaround capabilities to manage financial distress;

(4) the role, remuneration, financial viability, and conduct of corporate insolvency practitioners (including receivers, liquidators, administrators, and small business restructuring practitioners);
(5) the role of government agencies in the corporate insolvency system, including:

(a) the role and effectiveness of the Australian Securities and Investments Commission (ASIC) as the corporate insolvency regulator;
(b) the Australian Taxation Office's (ATO) role and enforcement approaches to corporate insolvency, and relevant changes to its approach over the course of the COVID-19 pandemic;
(c) the role, funding and operation of relevant bodies, including the Assetless Administration Fund and the Small Business Ombudsman; and

(6) any related corporate insolvency matters.

Conduct of the inquiry

1.4 The committee called for submissions by advertising the inquiry on its webpage and wrote to relevant stakeholders and interested parties inviting written submissions by 30 November 2022. The committee also produced a media release which was published on the committee's webpage on 28 September 2022.[2]

Submissions

1.5 The committee initially resolved that submissions were to be provided by 30 November 2022. The committee continued to consider submissions and evidence provided after this date.

1.6 The committee received 78 submissions as well as supplementary submissions, additional information and answers to questions on notice, which are listed in Appendix 1.

Public hearings

1.7 The committee held the following public hearings:

- 13 December 2022 in Canberra;
- 14 December 2022 in Sydney;
- 21 February 2023 in Sydney;
- 28 February 2023 in Sydney; and
- 1 March 2023 in Canberra.

1.8 A list of witnesses who gave evidence at the public hearings can be found in Appendix 2.

Structure of this report

1.9 This report comprises 14 chapters, including this introductory chapter, with the remaining chapters set out as follows:

- Chapter 2 provides a snapshot of corporate insolvency in Australia;
- Chapter 3 discusses the purposes and performance of the corporate insolvency system;
- Chapter 4 examines proposals for a comprehensive review of insolvency;
- Chapter 5 considers suggestions for the harmonisations of corporate and personal insolvency;
- Chapter 6 addresses data and benchmarks that may be needed for a comprehensive review;
- Chapter 7 summarises the system of pathways for insolvency in Australia and proposals for reforms of pathways;

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2 See, Media Release relating to the Inquiry into corporate insolvency in Australia, 28 September 2022, https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/CorporateInsolvency/Media_Releases.

- Chapter 8 covers the administration of liquidations and insolvencies;
- Chapter 9 discusses assetless administrations and the role of the state;
- Chapter 10 examines the role of government agencies in corporate insolvency;
- Chapter 11 considers potential reforms for unsecured assets of the company and creditors' priority;
- Chapter 12 addresses secured assets and creditors and the PPS Act;
- Chapter 13 analyses the debate on voidable transactions and unfair preferences; and
- Chapter 14 considers corporate insolvency issues arising for property held in trust.

Acknowledgements

1.10 The committee thanks all individuals and organisations who contributed to this inquiry by preparing written submissions and giving evidence at the public hearings.

Notes on references

1.11 References and page numbers of the committee Hansard are to the proof Hansard. Please note that page numbers may vary between the Proof and Official transcripts.

Chapter 2
A snapshot of corporate insolvency in Australia

Overview of Australia's corporate insolvency regime

2.1 Australia's corporate insolvency framework is concerned with the financial affairs of corporations that enter financial difficulty and insolvency—a term describing a person's or company's inability to pay all their debts as and when they fall due.[1]

2.2 As the Department of the Treasury (Treasury) told the committee:

> '[i]nsolvency laws establish…fair, orderly, transparent and predictable processes' for dealing with the assets and liabilities of companies who enter insolvency, 'while promoting good corporate conduct and investor confidence'.[2]

2.3 The framework seeks to provide viable companies an opportunity to restructure and continue trading. Where this is not possible, it provides mechanisms for the closure of unviable businesses and reallocating resources towards other, productive uses, thus serving a broader function in the Australian economy.[3]

2.4 *Keay's Insolvency* explains that this framework manages the impact of insolvency on all relevant parties, including unpaid creditors, business owners, employees, families, shareholders, and the government.[4] The authors state:

> An absence of any insolvency regime could mean that creditors pursue their own remedies individually, invariably inefficiently, often with the stronger prevailing over the weaker, and with unlawful conduct involved. The debtor would be subject to harassment and undue pressure, at the same time their own involvement in disposing of assets would go undetected. The reallocation of the business assets to better economic use would be hampered by the potential for their break up or loss of value or utility in the process.[5]

2.5 In addition to the context of a corporation, natural persons may also become insolvent and enter bankruptcy. Insolvency may arise in the context of a corporate entity or a natural person, the latter of which is more commonly

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1 Mr Michael Murray and Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Insolvency Law and Practice*, 11th ed, Thomson Reuters, 2022, p. 5. In Australia, a person who is insolvent may go into bankruptcy. In contrast, a company which is insolvent may go into liquidation.

2 Department of the Treasury (Treasury), *Submission 34*, p. 2.

3 Treasury, *Submission 34*, p. 2.

4 Mr Murray and Professor Harris, *Keay's Insolvency*, p. 4.

5 Mr Murray and Professor Harris, *Keay's Insolvency*, p. 4.

referred to as 'bankruptcy'. This report focuses on the former, although the latter is considered throughout this report where relevant.

The Australian insolvency framework

2.6 Insolvency is indirectly defined in the definition of 'solvent' in section 95A of the *Corporations Act 2001* (Corporations Act), which states:

> (1) A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable.
> (2) A person who is not solvent is insolvent.

2.7 Common law consideration of solvency has articulated that 'solvency is a question of fact to be determined by reference to the company's financial position taken as a whole, viewed in light of commercial realities'.[6]

2.8 Australia's corporate insolvency framework is set out in Chapter 5 of the Corporations Act (including the Insolvency Practice Schedule (Corporations) in Schedule 2), the Corporations Regulations 2001, and the Insolvency Practice Rules (Corporations 2016). It is administered and regulated by the Australian Securities and Investments Commission (ASIC), while Treasury provides policy advice to government in respect of corporate insolvency policy and legislation.

2.9 Australia's personal bankruptcy regime is established under the *Bankruptcy Act 1966* (Bankruptcy Act) and is administered and overseen by the Australian Financial Security Authority (AFSA). The Attorney-General's Department is the relevant policy department in relation to bankruptcy.

Historical context

Development of Australian corporations and insolvency law

2.10 The Australian insolvency framework, like Australian corporations law more generally, derives from English law and has been thought to have emerged initially from the enactment of the first bankruptcy statute in 1542.[7]

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6 *Southern Cross Interiors Pty Ltd v Deputy Commissioner of Taxation* (2001) 53 NSWLR 213, 224 [54]; *Sandell v Porter* (1966) 115 CLR 666, 670; Department of the Treasury (Treasury), *Review of the insolvent trading safe harbour*, 5 December 2021, p 9, https://treasury.gov.au/sites/default/files/2022-03/p2022-p258663-final-report.pdf; . Treasury, *Submission 34*, p. 2.

7 Mr Murray and Professor Harris, *Keay's Insolvency*, pp. 7–8.

2.11 Prior to Federation, the first such Australian laws were enacted by colonial governments to regulate business associations,[8] corporations[9] and insolvency.[10] This legislation reflected English law to varying degrees.[11] While the frameworks differed across the colonies, calls for uniformity across jurisdictions emerged in the 1890s.[12]

2.12 Upon Federation, the *Australian Constitution* (the Constitution) empowered the Commonwealth to make laws with respect to 'foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth'[13] as well as 'bankruptcy and insolvency'.[14] The extent, scope and application of this power, which has become known as the 'corporations power', has been the subject of consideration on numerous occasions by the High Court of Australia.

2.13 While the Commonwealth first legislated to regulate bankruptcy law in 1924,[15] (with further significant reform in 1966),[16] State governments continued to hold primary responsibility for the governance of corporations in the post-Federation era. Agreements and other measures to facilitate uniformity across jurisdictions were introduced across States and Territories in the 1960s and evolved through the 1970s.[17]

2.14 In 1989, the Hawke government passed the *Corporations Act 1989*, which was the first national piece of corporations law to be enacted after Federation to regulate companies and securities, including the incorporation and administration of companies. However, a decision of the High Court of Australia in 1990 stated that section 51 (xx) of the Constitution did not in fact allow the Commonwealth to create laws that impacted the incorporation of companies, but it did have the

8 See, for example, *Association Incorporation Act 1858* (SA).

9 See, for example, *Companies Statute 1864* (Vic); *Companies Act 1890* (Vic); *Companies Act 1874* (NSW); *Companies Act 1864* (SA).

10 See, for example, *Debtors' Estates Distribution Act 1830* (NSW) (11 Geo IV No 7); *Insolvency Act 1841* (NSW) (5 Vic No 17); *Insolvency Act 1843* (NSW) (7 Vic No 19).

11 James Edelman, Henry Meehan and Gary Cheung, 'The evolution of bankruptcy and insolvency laws and the case of the deed of company arrangement', *Lloyd's Maritime and Commercial Law Quarterly*, 2019, p. 591.

12 Stephen Bottomley et al, *Contemporary Australian Corporate Law,* Cambridge University Press, 2018 pp. 18–19.

13 *Australian Constitution*, section 51(xx).

14 *Australian Constitution*, section 51(xvii).

15 *Bankruptcy Act 1924.*

16 *Bankruptcy Act 1966.*

17 Stephen Bottomley et al, *Contemporary Australian Corporate Law,* Cambridge University Press, 2018, pp. 21–25.

power to legislate in relation to companies already incorporated. This decision clarified that the Commonwealth did not have the complete power to legislate with respect to corporations and that the provisions pertaining to incorporation within the *Corporations Act 1989* were indeed invalid.[18]

2.15 Following that decision, a further uniform scheme was pursued, which was subject to further constitutional challenges.[19] The issue of the extent of the Commonwealth's legislative power with respect to corporations was eventually resolved by the 2001 referral of State powers to the Commonwealth under section 51(xxxvii) of the Constitution. This enabled the Commonwealth Parliament to enact the current Corporations Act.

Recent developments in insolvency law

2.16 On 20 November 1983, the then-Attorney-General referred to the Australian Law Reform Commission (ALRC) an inquiry into the 'law and practice relating to the insolvency of both individuals and bodies corporate'.[20] This review concluded in 1988 with the release of the *ALRC Report 45* —better known as the 'Harmer Report' after the Commissioner-in-charge, Mr Ronald Harmer. The Harmer Report recommendations gave rise to, among other things, the creation of the voluntary administration regime,[21] which was legislated in 1992 and commenced operation in 1993.[22] Since the Harmer Report, corporate insolvency law has been the subject of various reviews and legislative changes. One such review was by this committee between November 2002 and June 2004.[23]

2.17 The Australian Restructuring Insolvency and Turnaround Association (ARITA) outlined the key reforms to corporate insolvency law from 1993 to date which can be found in Figure 2.1.

18 *New South Wales v Commonwealth* (1990) 169 CLR 482.

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

20 Australian Law Reform Commission, *General Insolvency Inquiry*, Report No 45, Vol 1, 1988, Terms of Reference.

21 Australian Law Reform Commission, *General Insolvency Inquiry*, Report No 45, Vol 1, 1988, 30.

22 *Corporate Law Reform Act 1992*.

23 Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: a Stocktake*, June 2004, https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Completed_inquiries/2002-04/ail/index (accessed 22 May 2023).

Figure 2.1 Major changes in corporate insolvency law

Year	Reform
1993	*Corporate Law Reform Act 1992* - Introduction of the "Harmer" reforms including Voluntary Administration and insolvent trading
2003	*Corporations Amendment (Repayment of Director's Bonuses Act) 2003* - Recovery of director bonuses by liquidators
2007	*Corporations Amendment (Insolvency) Act 2007* - introduced declarations of independence, electronic communication, streamlined creditors' voluntary liquidations, professional indemnity insurance requirements instead of bonds, education and experience requirements for registration as a liquidator as well as a range of other reforms.
2011	*Personal Property Securities (Corporations and Other Amendments) Act 2010* – introduction of PPSA
2017	*Insolvency Law Reform Act 2016* – Wide ranging reforms to insolvency law including registration and discipline of liquidators, alignment of remuneration, reporting, meeting and banking requirements for external administrations.
2017	*Treasury Laws Amendment (2017 Enterprise Incentives No 2) Act 2017* - Safe Harbour and Ipso Facto reforms
2019	*Corporations Amendment (Strengthening Protections for Employee Entitlements) Act 2019* - Amendments to strengthen protections for employee entitlements from transactions meant to avoid obligations by the company, directors and advisors
2020	*Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020* - Creditor defeating dispositions
2021	*Corporate Amendment (Corporate Insolvency Reforms) Act 2020* - Small Business Restructuring and Simplified Liquidations

Source: ARITA, Submission 36, p. 27.

2.18 Further to the reforms listed above, additional inquiries, consultations and independent reviews have examined various aspects of Australia's corporate insolvency framework, including:

- the Productivity Commission's final report into *Business Set-up, transfer and Closure* (2015);[24]
- the Australian Small Business and Family Enterprise Ombudsman's (ASBFEO) *Insolvency Inquiry Report* (2020);[25]
- Treasury consultations:
  - proposed reforms to creditors' schemes of arrangement (2021);[26]
  - clarifying the application of corporate trusts in insolvency (2021);[27] and

[24] Productivity Commission, *Business Set-up, Transfer and Closure*, Report No. 75, 30 September 2015, https://www.pc.gov.au/inquiries/completed/business/report/business.pdf (accessed 23 May 2023).

[25] Australian Small Business and Family Enterprise Ombudsman (ASBFEO), *Insolvency Inquiry Report*, July 2020, https://www.asbfeo.gov.au/sites/default/files/2021-11/Insolvency%20Inquiry%20Final%20Report.pdf.

[26] Treasury, *Improving schemes of arrangement to better support businesses*, *https://treasury.gov.au/consultation/c2021-190907*.

[27] Treasury, *Clarifying the treatment of trusts under insolvency law*, https://treasury.gov.au/consultation/c2021-212341.

- independent reviews:
  - *Independent review of the insolvent trading safe harbour* (2021).[28]

Corporate insolvency and COVID-19 pandemic emergency responses

2.19 In March 2020, the Australian Government introduced temporary measures aimed at supporting businesses through the economic impacts of the COVID-19 pandemic, some of which directly related to corporate insolvency, and:

- temporarily increased the threshold at which creditors could issue a statutory demand on a company from $2,000 to $20,000
- temporarily extended the time companies had to respond to a statutory demand they received from 21 days to 6 months
- temporarily relieved directors of personal liability for insolvent trading with respect to debts incurred in the ordinary course of a company's business.[29]

2.20 These measures commenced on 25 March 2020 and were initially scheduled to end after six months; however, they were subsequently extended until 31 December 2020.

2.21 Although not directly related to insolvency, the JobKeeper payment nonetheless complimented these measures, assisting employers to continue to pay their employees' wages. This scheme commenced on 30 March 2020, and was originally due to end on 27 September 2020, but was extended until 28 March 2021, with some changes.

2.22 Concurrently, the Australian Taxation Office (ATO) paused most debt enforcement actions that would ordinarily have led to insolvency appointments.[30] The ATO's annual report for 2021-22 explained that '[d]uring the early stages of COVID-19 [the ATO] deliberately shifted [its] focus away from firmer debt collection action to assist businesses and the community experiencing challenges because of the pandemic'.[31] This assistance included:

- deferral of payment and [lodgement] dates,
- allowing businesses to vary their payment instalments,
- remitting interest and penalties, and
- withholding enforcement actions including Director Penalty Notices and wind-ups.[32]

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28 Treasury, *Review of the insolvent trading safe harbour – Final report* https://treasury.gov.au/publication/p2022-p258663-final-report.

29 Treasury, *Submission 34*, p. 9.

30 Australian Taxation Office (ATO), *Submission 35*, p. 6.

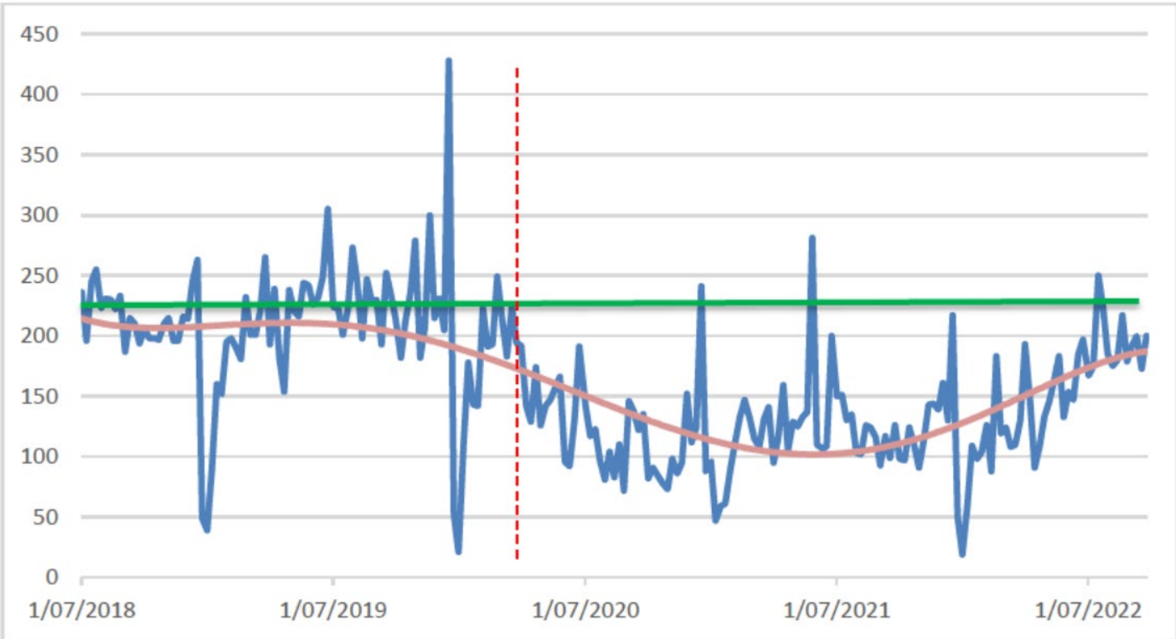
31 ATO, *Commissioner of Taxation annual report 2021-22*, October 2022, p. 18.

32 ATO, *Submission 35*, p. 6.

2.23 During this period, collectable debt owed to the ATO increased from $26.5 billion at 30 June 2019 to $44.8 billion at 30 June 2022, an increase of $18.3 billion or 69 per cent.[33]

2.24 The collective effect of these measures resulted in a dramatic decrease in the number of businesses entering administration, dropping by almost half in April 2020, and remaining at low levels until April 2022. Included at Figure 2.2 is a graph provided by ARITA which charts the number of weekly appointments of external administrators between 1 July 2018 and 1 July 2022 as reported by ASIC. The red line marks the commencement of the pandemic emergency measures.

Figure 2.2 Weekly external administrator appointments July 2018 to July 2022



Source: ARITA, Submission 36, p. 26. Data originally from ASIC.

2.25 The ATO's 2021–22 annual report identified addressing the debt accrued across this period as one of its key priorities in the recovery period. It sought to undertake this task by expanding its enhanced engagement program and making clients aware of potential firmer and stronger actions that could follow from a lack of engagement with the ATO in relation to an outstanding debt.[34]

2.26 After an initial awareness campaign launched in March 2022, the ATO issued 7,523 Director Penalty Notices (DPNs) between July and September 2022, which compared to only 125 DPNs issued over the same reporting period in the previous year. By December, the ATO issued an average of 150 DPNs each business day and rising. This compared to the pre-COVID era, in which the ATO

33 ATO, *Commissioner of Taxation annual report 2021–22*, October 2022, p. 18.

34 ATO, *Commissioner of Taxation annual report 2021–22*, October 2022, p. 18.

issued significantly fewer DPNs, averaging around 52 each business day in the 2019 financial year (13,120 in total).[35]

2.27 During the course of this inquiry, the committee was told that the number of insolvencies was expected to rise to pre-pandemic levels, and perhaps beyond. One reason proffered for this was that the support provided by the emergency measures, including the shift in the ATO's approach during the initial stages of the pandemic, kept a number of companies in operation that may not otherwise have been viable.[36] Thus, the removal of these measures, and the ATO's return to enforcement action in significant numbers, was expected to result in, and was observed as leading to, a rise in the number of companies entering insolvency.[37]

2.28 The projected increase in the number of insolvencies seems to be reflected in recent ASIC statistics. Figures released on 5 June 2023 indicate that in each month of the 2022-23 financial year to date, the number of companies entering external administration has increased relative to the same month of the previous two financial years, and nearing (if not exceeding) pre-pandemic levels.[38] These same statistics show that construction industry continues to be the most highly represented industry in these statistics.[39] The remainder of this chapter contains further discussion on trends in insolvencies demonstrated by ASIC statistics.

2.29 Mr Michael Brennan (Offermans) summarised the difficulties that directors of Micro, Small, & Medium Enterprises (MSMEs) face with insolvency, including:

- that practical day-to-day issues dominate more than regulations;
- unavoidable conflicts of interests between personal and business director duties can lead to:
  - interaction of personal and corporate insolvency law;
  - governance issues around business and private use of assets; and

35 ATO, *Submission 35*, p. 7.

36 See, for example, Business Law Section, Law Council of Australia, *Submission 30*, p. 20; Deloitte, *Submission 32*, p. [3].

37 See, for example, ARITA, *Submission 36*, p. 26; Business Law Section, Law Council of Australia, *Submission 30*, pp. 20–21.

38 ASIC, *Insolvency Statistics*, Series 1, Table 1, 5 June 2023 release, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-current/ (accessed 13 June 2023). The exception to this is October 2022, which observed 473 insolvencies, compared to 741 in October 2019, and November 2022, which saw 655 insolvencies, compared to 748 in October 2019.

39 ASIC, *Insolvency Statistics*, Series 1, Table 1.22, 5 June 2023 release, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-current/ (accessed 13 June 2023). Note: insolvency statistics by industry do not indicate what proportion of the industry is impacted. Therefore, it is difficult to compare statistics by industry because it would ordinarily be expected that there would be larger numbers of insolvencies in industries with low levels of aggregation.

  - difficulty in handling business non-performance in a timely way; and
- inability to diversify human capital.[40]

2.30 Mr Brennan expanded on the above issue in terms of the practical aspects of human psychology for real individuals who are both the business owner and the company director, interacting with a legal system that attempts to separate the principal (the owner) from the agent (the company director):

> The MSME owner is so inextricably linked to the success or failure of their business, that it is incredibly difficult to divorce their own feelings of failure when the business underperforms. In the context of agency theory, it is in the principal's best interest that an insolvency appointment occurs to maximise outcomes. Unfortunately, that would present multiple issues for the agent, least of which is the possible loss of employment, exposure of personal assets to attack and the mental health issues associated with the 'failure' of their business.
>
> The damage and loss to this human capital in MSME failures is devastating whilst being intangible and the fear of this loss must be addressed in every decision to engage in the insolvency framework.
>
> As a result, nearly all business owners faced with such a loss will delay seeking any advice or taking any steps that may ultimately lead to an admission of personal failure and the cessation of their business.[41]

The current state of corporate insolvency: a statistical snapshot

2.31 In order to understand the current state of corporate insolvency in Australia, analysis of data collated by ASIC on insolvency provides a useful backdrop. On a regular basis, ASIC publishes statistics on insolvency.[42] This section uses the ASIC insolvency statistics to summarise:

- corporate insolvency by sector, state, and type of administration;
- company size, reports by sector and reports statistics;
- level of assets and liabilities;
- impact on creditors;
- causes of company failure and types of misconduct; and
- registered liquidator demographics.

2.32 The data available in the ASIC insolvency statistics is discussed in Chapter 6, and contain significantly more detailed data, which is accessible on the ASIC website.

40 Mr Michael Brennan (Offermans), *Submission 73*, pp. 4–5.

41 Mr Michael Brennan (Offermans), *Submission 73*, pp. 4–5.

42 Australian Securities and Investments Commission (ASIC), *Insolvency statistics*, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/ (accessed 18 June 2023).

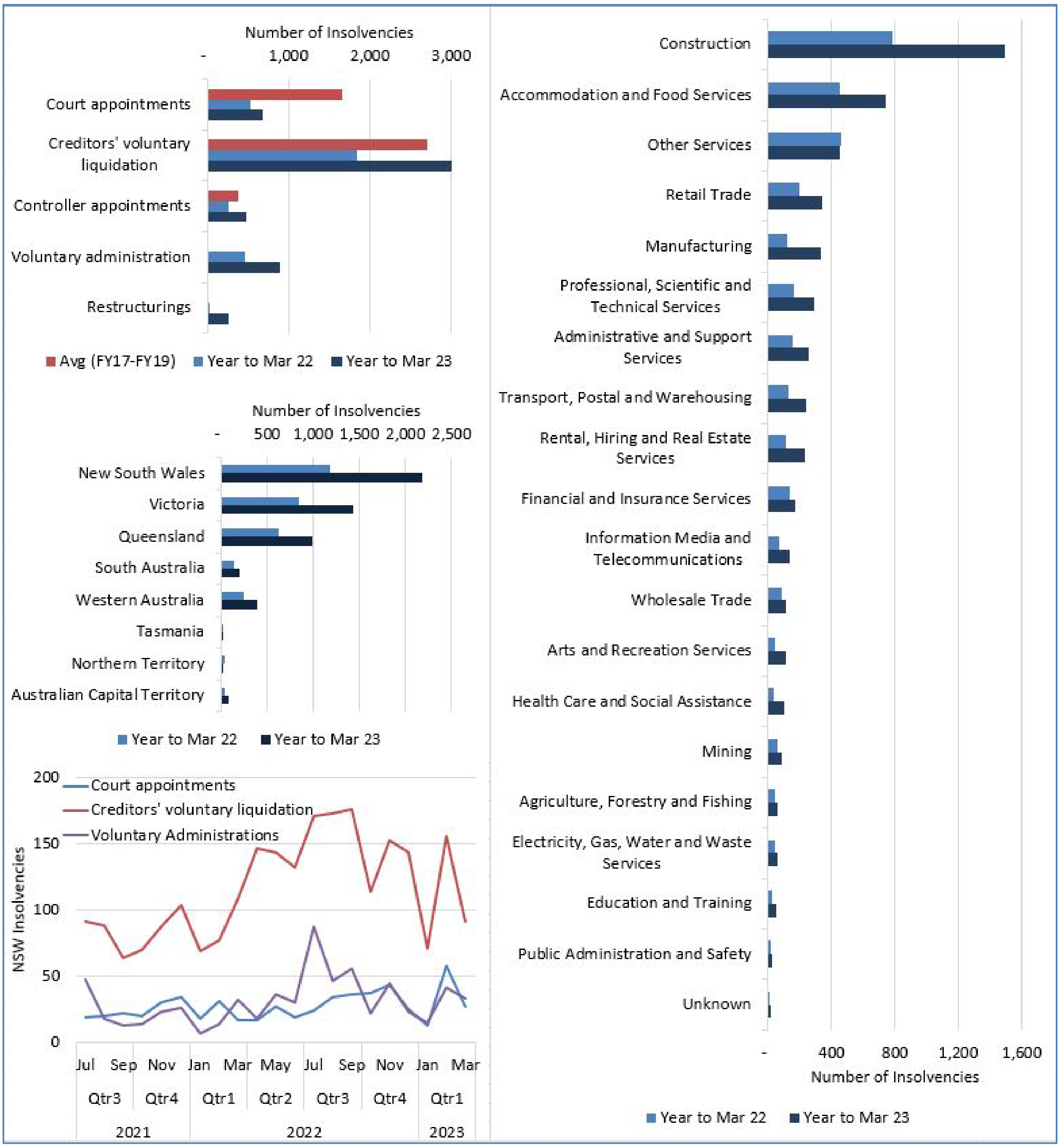
Corporate insolvency by sector, state, and type of administration

2.33 On a weekly basis, ASIC releases insolvency statistics to report on the level of company insolvency in Australia the first time a company enters external administration or has a controller appointed.[43] Summarised in Figure 2.3 below, the ASIC Series 1 data on corporate insolvencies indicates that:

- Over the last year, insolvencies increased significantly in almost all states and territories and in almost all sectors (see right panel):
  - construction, accommodation, food service, retail trade, and manufacturing have the highest numbers; however,
  - care should be taken in interpreting the relative numbers by sector, as the level of business aggregation can significantly influence numbers; for example, the Virgin Australian Airlines administration impacted a significant portion of domestic air travel capacity in the country, while it would only count as one insolvency event.
- All types of insolvency rose over the last year (top left panel), with the most common to least common types of insolvency being: creditor's voluntary liquidation; voluntary administration; court appointments; controller appointments; and restructuring.
- It is difficult to discern any meaningful trend in the type of insolvency due to significant variations over time for each type of insolvency, as shown for New South Wales (NSW) in the bottom left panel of Figure 2.3.

[43] ASIC, *Insolvency statistics (current)*, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-current/ (accessed 12 June 2023).

Figure 2.3 Corporate insolvency by sector, state, time, and type of administration



Source: Plotted by the committee secretariat from ASIC insolvency statistics, Series 1, 3 April 2023 Release, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/how-to-interpret-asic-s-corporate-insolvency-statistics/ (accessed 12 April 2023).

Company size, reports by sector and reports statistics

2.34 This and the following sections use Series 3 data collated by ASIC which is based on external administrators' and receivers' reports for Australia, selected industries with the highest number of external administrators' reports lodged by region for the financial year, as well as time series data.[44] ASIC Series 3 corporate insolvency statistics are summarised in Figures 2.4 to 2.7. Series 3 reports only cover those corporate insolvencies in which potential misconduct is identified or dividends of less than 50 cents in the dollar are expected (what could be called 'deep insolvency', a term used elsewhere in this report). ASIC noted that Series 3 reports capture the majority, if not all, companies.[45] However, in interpreting the data presented in Figures 2.4 to 2.7, it is important to note that insolvent companies that are not suspected of misconduct and are expected to return more than 50 cents in the dollar are *not* included in the dataset.

2.35 Figure 2.4 shows that:

- Most companies in Series 3 reports have fewer than five full-time employees (bottom left panel), and the sectors with the most Series 3 reports are accommodation and food, construction, and business and personal services (top right panel).[46]
- Over 90 per cent of Series 3 reports are submitted by liquidators, with most of the remaining reports submitted by voluntary administrators, indicating that liquidation is the most common pathway involving external administrators (middle left panel).
- Most types of administrators submit Series 3 reports to ASIC in the first three to five months from the beginning of insolvency (top left panel).
- On average, all types of administrators estimate that the time to complete the administration will likely be less than five months (55 per cent), with 10 per cent expected to take more than a year (top left panel).

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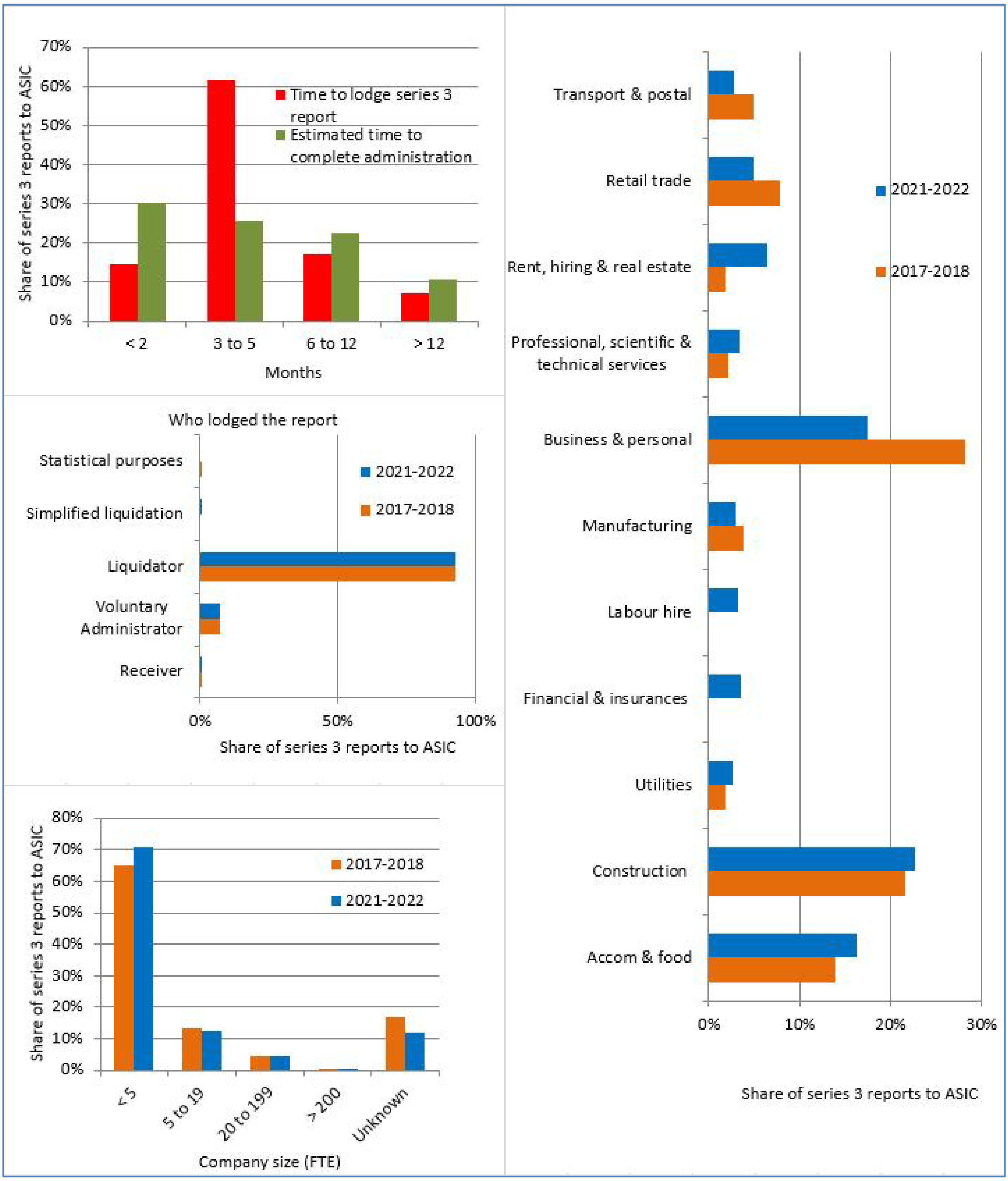
44 ASIC, *Insolvency statistics - Series 3 External administrator reports*, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-3-external-administrator-reports/ (accessed 12 June 2023).

45 Mr Warren Day, Chief Operating Officer, ASIC, *Committee Hansard*, 1 March 2023, p. 36.

46 This may be related to the profile of businesses in Australia generally and therefore does not necessarily lead to inferences about how size or industry affects the likelihood of insolvency.

Figure 2.4 Causes of failure, company size, reports by sector and reports statistics



Source: Plotted by the committee secretariat from ASIC insolvency statistics, Series3, January 2023 Release, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-4-quarterly-registered-liquidator-statistics/ (accessed 12 April 2023).

Level of assets and liabilities

2.36 Series 3 reports to ASIC include information on the estimated assets and liabilities of the company in administration.[47] This information indicates that companies with Series 3 reports are often deeply insolvent, with liabilities (top right panel, Figure 2.5) greatly exceeding assets (top left panel). Of note:

- The estimated level of assets in insolvent companies is less than $1 in 30 per cent of Series 3 reports and under $10,000 in a further 20 per cent of reports (top left panel).
- The estimated level of liabilities in insolvent companies is over $100,000 in 60 per cent of cases, with $250,000 to $1 million being the most frequent liability level (top right panel).

2.37 The deeply insolvent nature of most companies with Series 3 reports to ASIC is long-standing, with:

- Estimated assets occurring most frequently in the two lowest categories of <$1 or $1 to $10,000 for the past 15 years (bottom left panel).
- Estimated liabilities occurring most frequently in the categories of $1 to $250,000 or $250,000 to $1m for the past 15 years (bottom right panel).

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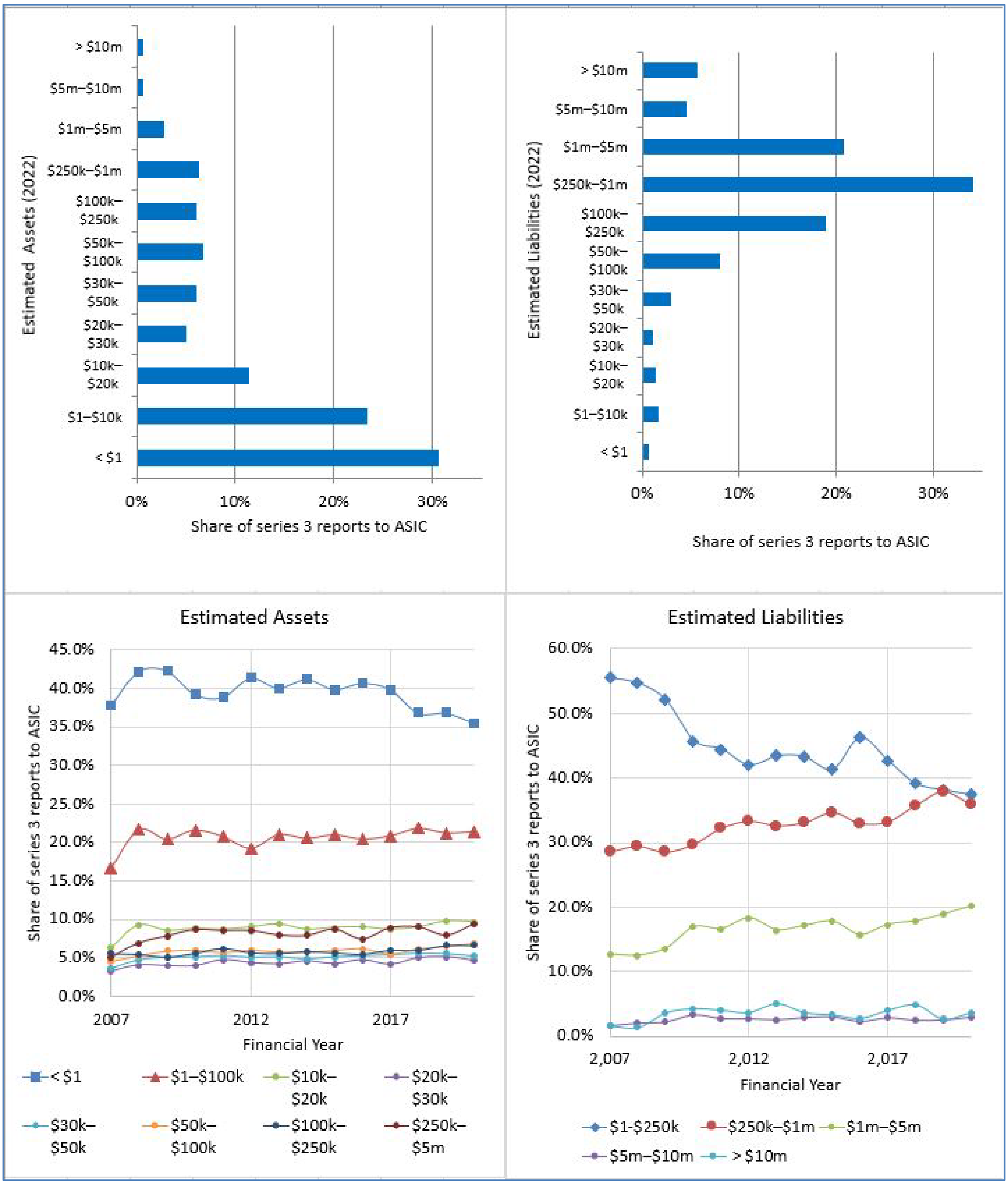
[47] ASIC, *Insolvency statistics - Series 3 External administrator reports*, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-3-external-administrator-reports/ (accessed 12 June 2023).

Figure 2.5 Level of assets and liabilities



Source: Plotted by the committee secretariat from ASIC insolvency statistics, Series3, January 2023 Release, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-4-quarterly-registered-liquidator-statistics/ (accessed 12 April 2023).

Impact on creditors

2.38 Series 3 reports to ASIC include information on the impacts on creditors shown in Figure 2.6, which indicate that:

- Unpaid employee entitlements (top panel) typically range between $1,000 and $150,000 and affect the following entitlements in decreasing size order: superannuation, annual leave, wages, pay in lieu of notice, long service leave, and redundancy.
- Estimated amounts owing vary by creditor type (middle left panel), with:
  - the majority of secured creditors having $0 owing;
  - most unsecured creditors being owed between $1 and $250,000, but with significant numbers nonetheless owed over $1m; and
  - outstanding taxes and charges most commonly from $1 to $250,000.

  (Other sources of data show similar trends. World Bank reports show returns for secured creditors in insolvency at 82.7 cents in the dollar. AFSA data shows average returns for unsecured creditors in bankruptcy at 1.6 cents in the dollar. AFSA notes that the Personal Properties Securities Register may contribute to the difference between returns to secured and unsecured creditors).[48]
- The dividend to creditors (bottom right panel) is estimated to be zero cents per dollar for 85 to 92 per cent of Series 3 reports over the past 15 years. ASIC's data collection and reporting method changed part way through 2020, leading to a recalibration of this statistic, which can be seen as the difference between the blue and red curve in the bottom right panel of Figure 2.6.[49]

---

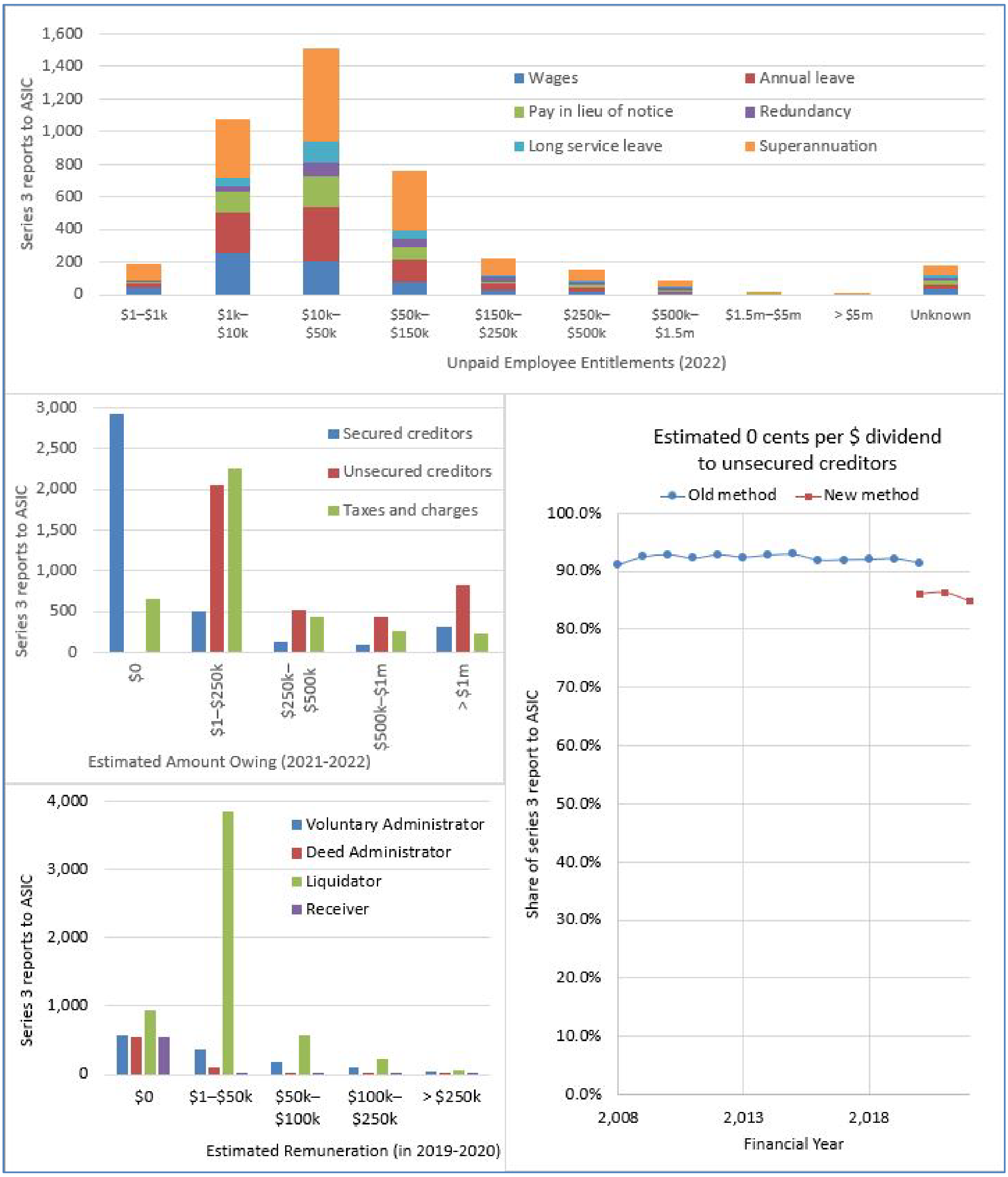
48 Australian Financial Security Authority (AFSA), *Supplementary Submission 7.1*, p. 37.

49 Partway through the 2019–2020 reporting year, a new category, 'not applicable', became available to report instances where a liquidator indicated there were no amounts owed to unsecured creditors. It appears likely that such instances amounted to a few per cent of reports in the last three years of data. This may suggest that instead of 92 per cent of unsecured creditors receiving zero returns (a commonly cited statistic through this inquiry) a slightly lower number of unsecured creditors (approximately 85 per cent) receiving zero returns, at least to the extent that a reasonably complete picture of liquidations is being provided by Series 3 reports. For more detail see notes below and further detail in Table 3.3.13 - Initial external administrators' and receivers' reports by unsecured creditors - ANNUAL in Tab 3.3.13 in ASIC's Series 3.3 insolvency statistics, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-3-external-administrator-reports/

Note: 2019–2020* data is for the period 1 July 2019 to 27 March 2020 due to discontinuation of Form EX01 on 27 March 2020. Note: 2019–2020** data is for the period 28 March 2020 to 30 June 2020 when the Initial Statutory Report was introduced. Note: Amendments were made to the Number and Amount owed to unsecured creditors and Estimated dividend ranges in 2006, and again in 2020 when the Initial Statutory Report was introduced. Note: 'Not applicable' is where the registered liquidator selected 'no' when asked if there are amounts owed to unsecured creditors.

- The most common level of liquidator remuneration was between $1 and $50,000, with voluntary administrators, deed administrators, and receivers typically having lower remuneration.

Figure 2.6 Series 3 impact on creditors



Source: Plotted by the committee secretariat from ASIC insolvency statistics, Series3, January 2023 Release, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-4-quarterly-registered-liquidator-statistics/ (accessed 12 April 2023).

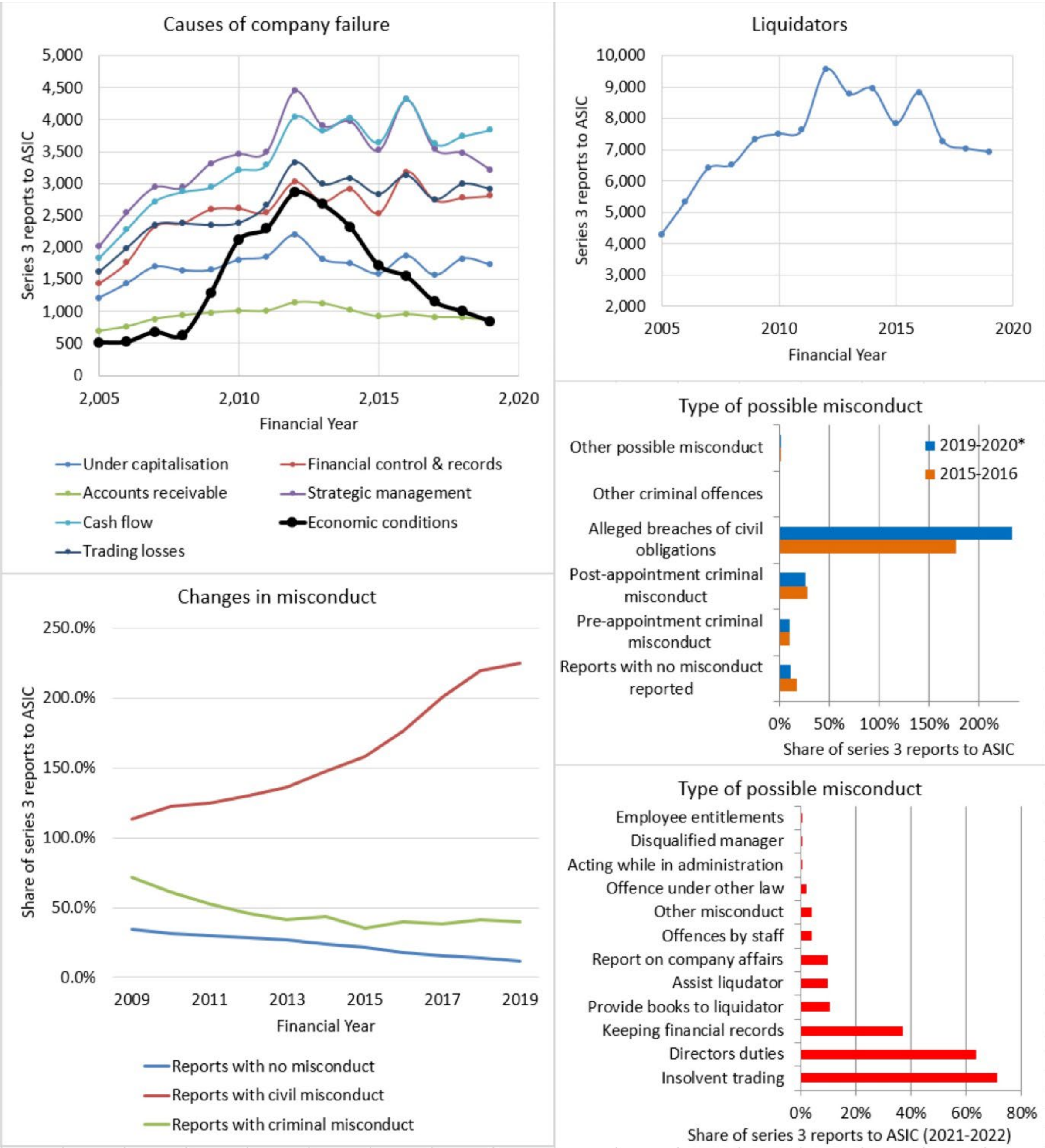
Causes of company failure and types of misconduct

2.39 Series 3 reports to ASIC include information on the causes of failure and types of misconduct[50] shown in Figure 2.7 (see below), which indicate that:

- The most common causes of company failure (top left panel), as categorised in Series 3 reports, include under capitalisation, cash flow, financial controls and record keeping, trading losses, strategic management, and economic conditions.
- In most cases, the variations over time in the causes of company failure relative to each other (top left panel) follow the number of liquidator reports (top right panel). However, the number of reports identifying economic conditions (thick black line top left panel) is a clear exception. The number of Series 3 reports citing economic conditions increased by nearly a factor of six following the Global Financial Crisis.
- Of the possible misconduct identified by Series 3 reports (middle right panel), breaches of civil obligations are the most common. The share of Series 3 reports with possible civil misconduct exceeds 100 per cent because multiple breaches are typically identified per company.
- Possible criminal misconduct is identified in around 40 per cent of Series 3 reports, with post-appointment misconduct being significantly more common in reports than pre-appointment misconduct.
- Over time, the incidence and relative share of different types of misconduct reported have changed significantly:
  - The number of possible civil breaches identified per report has approximately doubled over a decade.
  - The share of Series 3 reports identifying possible criminal misconduct has fallen from 70 per cent to below 50 per cent.
  - The share of Series 3 reports identifying no misconduct has fallen from 40 per cent to around 10 per cent.
- The bottom right panel shows further detail on the relative frequency of types of misconduct, indicating that the most common types of misconduct are insolvent trading, breaches of director's duties; and failure to keep financial records.

50 ASIC, *Insolvency statistics - Series 3 External administrator reports*, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-3-external-administrator-reports/ (accessed 12 June 2023).

Figure 2.7 Causes of company failure and types of misconduct



Source: Plotted by the committee secretariat from ASIC insolvency statistics, Series3, January 2023 Release, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-4-quarterly-registered-liquidator-statistics/ (accessed 12 April 2023).

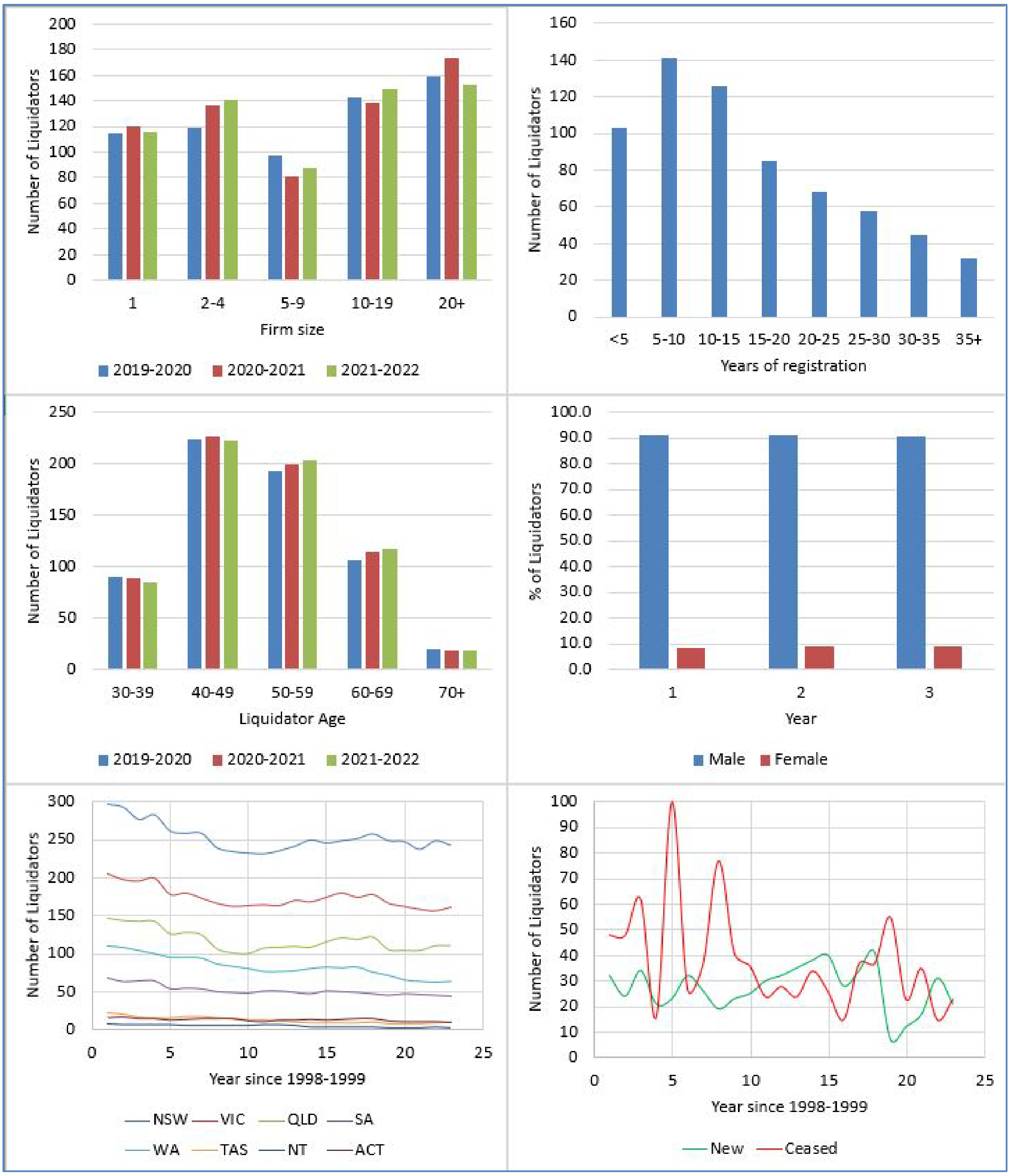
Registered liquidator demographics

2.40 The ASIC Series 4 data on registered liquidator demographics[51] is summarised in Figure 2.8, which indicates that:

- firm sizes range from one to more than 20 liquidators per firm, and there is no predominant firm size (top left panel);
- most liquidators are between 40 and 60 years old (middle left panel);
- liquidator numbers have declined slightly over the last two decades (bottom left panel);
- the majority of liquidators are in NSW, Victoria and Queensland (bottom left panel);
- the number of years since a liquidator was registered peaks between five to ten years and falls steadily for longer periods of registration (top right panel);
- the share of female liquidators is below 10 per cent (middle right panel); and
- over the past 15 years, approximately 30 new liquidators are registered each year, with the same number ceasing their registrations; however, the numbers vary significantly from year to year (bottom right panel).

[51] ASIC, *Insolvency statistics - Series 4 Quarterly registered liquidator statistics*, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-4-quarterly-registered-liquidator-statistics/ (accessed 12 June 2023).

Figure 2.8 Registered liquidator demographics



Source: Plotted by the committee secretariat from ASIC insolvency statistics, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-4-quarterly-registered-liquidator-statistics/ (accessed 12 April 2023).

Chapter 3
Purpose and performance of the corporate insolvency system

3.1 This chapter considers the broad objectives of the corporate insolvency regime, whether those objectives are appropriately set and articulated in policy and legislation, and the extent to which they are currently being achieved.

3.2 This chapter highlights several broad categories of concern raised by inquiry participants about the current corporate insolvency system. These include the complexity of the system, poor returns to creditors, poor engagement by debtors, funding gaps and a problematic division between corporate and personal insolvency law.

3.3 This chapter summarises approaches taken in other jurisdictions to insolvency reform in recent years, highlighting examples which inquiry participants considered Australian policymakers might usefully examine.

3.4 In assessing this evidence, this chapter also examines calls made by inquiry participants for a comprehensive review of Australia's insolvency law—what many have referred to as a 'root and branch review'.

3.5 The next chapter in this report considers what the appropriate structure, scope and process of a comprehensive review might look like.

The purposes of the corporate insolvency system

3.6 As the Australian Restructuring Insolvency & Turnaround Association (ARITA) points out, except in relation to voluntary administration there is no 'objects clause' within the Corporations Act setting out the objectives of the corporate insolvency regime.[1] While no legislative definition of the purposes of the corporate insolvency regime exists, the Harmer Report and the Productivity Commission's 2015 report both provide useful insights as to how those purposes are generally understood.[2]

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[1] Australian Restructuring Insolvency & Turnaround Association (ARITA), *Submission 36*, p. 17. The preamble to the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (incorporated into law as schedule 1 of the *Cross-Border Insolvency Act 2008*) sets out purposes of the Model Law. These purposes, while not inconsistent with other legislative expressions of Australian insolvency law, are more specific to cross-border insolvency law.

[2] This committee considered the underlying policies and values of insolvency law in its 2004 'stocktake' of insolvency law. Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: a Stocktake* (June 2004), pp. 19–22.

3.7 The Harmer Report summarised the principles and purposes of insolvency law as follows:

- The fundamental purpose of an insolvency law is to provide a fair and orderly process for dealing with the financial affairs of insolvent individuals and companies.
- Insolvency law should provide mechanisms that enable both debtor and creditor to participate with the least possible delay and expense.
- An insolvency administration should be impartial, efficient and expeditious.
- The law should provide a convenient means of collecting or recovering property that should properly be applied toward payment of the debts and liabilities of an insolvent person.
- The principle of equal sharing between creditors should be retained and in some areas reinforced.
- The end result of an insolvency administration, particularly as it affects individuals, should, with very limited exceptions, give effective relief or release from the financial liabilities and obligations of the insolvent.
- Insolvency law should, as far as convenient and practical, support the commercial and economic processes of the community.
- As far as is possible and practical, insolvency laws should not conflict with the general law.
- An insolvency law should enable ancillary assistance in the administration of an insolvency originating in a foreign country.[3]

3.8 In its 2015 report, the Productivity Commission's characterisation of the objectives of the insolvency regime reflected a similar balance of creditor and debtor interests, while placing greater emphasis on the restructuring of economically viable companies. In addition to highlighting the role of the regime in encouraging economic activity through the productive use of assets (discussed below), the Productivity Commission concluded:

> The objective of the insolvency regime should be to provide a genuine opportunity for restructure for economically viable companies, without providing incentive for strategic behaviour by debtors and creditors. If restructure is not possible, the insolvency system should aim to provide an efficient (expedient and inexpensive), effective and orderly process for winding up the company. This process should involve consideration of creditors, as well as other stakeholders, and provide certainty regarding future developments. The regime should foster a coordinated approach to recovery of a company, or its assets.[4]

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3 Australian Law Reform Commission (ALRC), Report No. 45, *General Insolvency Inquiry*, Vol. 1 (1988), pp. 15–17. Each dot point is expanded upon in the report.

4 Productivity Commission, Inquiry Report No. 75, *Business Set-up, Transfer and Closure* (September 2015), p. 353.

3.9 Mr Murray and Professor Harris pointed the committee towards their textbook, *Keay's Insolvency*, where they explained that the aims of corporate insolvency law include 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.[5]

3.10 In *Keay's Insolvency*, Mr Murray and Professor Harris observed that the 'aims and purposes [of insolvency law] are generally sound and long-standing, although they are not static, and some wax and wane'.[6] They noted that over time:

> …corporate insolvency has assumed a more rehabilitative focus, recognising the need and the ability to preserve value and to promote enterprise, with some element of censure for business failure. Economic purposes of insolvency have also developed in seeing insolvencies as an inevitable product of a competitive economy, thereby necessitating an efficient process of disposal. The rights of creditors have received more emphasis over time, perhaps too much so for the results achieved, while at the same time the protection of security interests continues to be maintained.[7]

3.11 The rehabilitative aspect of insolvency law is expressly acknowledged in Part 5.3A of the Corporations Act, which establishes the voluntary administration regime. Section 435A of Part 5.3A states that the primary objective of the voluntary administration regime is to provide for the business, property, and affairs of an insolvent company to be administered in a way that:

(a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or
(b) if it is not possible for the company or its business to continue in existence—results in a better return for the company's creditors and

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5 Mr Michael Murray and Professor Jason Harris, answers to questions on notice, 22 December 2022 (received 10 February 2023), pp. 5–6.

6 Mr Michael Murray and Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Insolvency Law and Practice*, 11th ed, Thomson Reuters, 2022 p. 21.

7 Murray and Harris, *Keay's Insolvency*, p. 21.

members than would result from an immediate winding up of the company.[8]

3.12 As considered in chapter 7, other parts of the corporate insolvency regime provide for the restructuring of an insolvent business and workouts.[9] Reforms in recent years have also been aimed at rescuing financially distressed businesses so that they can avoid formal insolvency and continue to operate.

3.13 For its part, ARITA submitted that as part of a broader re-drafting of insolvency law, a clear statement of objectives should be added.[10] ARITA stated that a unified personal and corporate insolvency law should have as its objectives:

3.14 Responding to ARITA's recommendation on the objectives on insolvency law, Ashurst raised a concern in relation to point 'e'. It suggested that while there may be instances where a larger public interest required the continuation of a particular business, how this was achieved should be addressed by the government on a case-by-case basis:

> The ARITA proposal, if adopted, would result in the introduction into insolvency law of a degree of "moral hazard" to the extent that it may encourage those responsible for the management of some businesses to proceed on the premise that they are too important to fail. Beyond that, such a stipulation may operate as a statutory limitation on the options available to government as to how those goods or services should be supplied in the future.[11]

3.15 Ashurst also noted that 'it is important for any insolvency law to recognise that it is just as important for individuals (in particular, consumer debtors) to be able to restructure their financial affairs as it is for a corporation irrespective of its size'.[12] It advised that if the government were to determine that it was appropriate to adopt a unified insolvency law in Australia, then the principal objective of insolvency law might be stated as follows or similar:

> The object of this Act is to provide for the financial affairs of individuals and companies who are insolvent or near insolvent to be administered in a way that:
>
> (a) maximises the chances of those affairs being rehabilitated or restructured; and

8 Part 435A, *Corporations Act 2001*.

9 For a summary of what is generally meant by the terms 'restructuring' and 'workout' (and noting the related term, 'turnaround') see Murray and Harris, *Keay's Insolvency*, pp. 947–48.

10 ARITA, *Submission 36*, p. 18.

11 Ashurst, answers to questions on notice, 23 December 2022 (received 15 February 2023), p. 2.

12 Ashurst, answers to questions on notice, 23 December 2022 (received 15 February 2023), p. 2.

(b) only if that is not possible, results in a better return to the creditors of the individual or the company than would result from their immediate bankruptcy.[13]

3.16 Ashurst also argued that the law should better acknowledge the importance of the rehabilitation or restructuring of the affairs of companies and individuals in financial difficulty (which should be the 'primary objective' of insolvency law).[14]

3.17 Like ARITA, the Association of Independent Insolvency Practitioners (AIIP) observed that the 'purpose or object of Australia's insolvency laws is substantially absent in the legislation for corporations and individuals'. The AIIP suggested the Harmer Report's summary of the purposes of insolvency law remained relevant, while observing the need for:

> …the addition of narrative to indicate that the objective of the insolvency regime should be to provide a genuine opportunity for restructure for economically viable businesses, and if restructure is not possible, the insolvency system should aim to provide an expedient and inexpensive, effective and orderly process for the winding up [of] the company.
>
> There should not be room or incentives for inappropriate behaviour by directors and officers, debtors and or creditors. Directors must be able to readily understand their obligations with respect to insolvency and their options when businesses experience difficulties.
>
> Creditors must be able to easily understand their rights in relation to recovering the monies owed to them.[15]

3.18 Throwing into sharp relief the tension between the purposes of business rescue and the protection of creditor interests (including employees, as priority creditors) the ACTU took aim at what it called the recent 'counter-productive public narrative encouraging entrepreneurship by destigmatising failure'. In this narrative, the ACTU argued, risk was 'externalised onto workers, creditors and the wider community'. In contrast to inquiry participants arguing the case for more explicit emphasis on the rehabilitative objects of insolvency law, the ACTU stressed that it stood:

> …opposed to any measures that make the existing regime more permissive by further derisking failure and allowing directors and shareholders to externalise losses onto others without consequence. In this regard the previous government's Covid measures (temporary insolvency measures and increasing the statutory demand threshold) worked against earlier measures designed to increase personal/director accountability (personal property security, corporate accountability (by addressing FEG misuse and

13 Ashurst, answers to questions on notice, 23 December 2022 (received 15 February 2023), p. 2.

14 Ashurst, answers to questions on notice, 23 December 2022 (received 15 February 2023), p. 3.

15 AIIP, answers to questions on notice, 23 December 2022 (received 23 February 2023), p. 3.

combating phoenixing) and liquidator accountability (Insolvency Law Reform Act).[16]

3.19 Evidence put to the committee also underlined the function of insolvency in encouraging and facilitating the provision of credit and productive allocation of capital and other assets in the economy. Referring back to the historical public purposes of insolvency law, Treasury explained that the original rationale, which still held, was:

> …that what you're trying to do is hold people to account such that you can have security for creditors. That security for creditors then generates the desire to lend money into an economy, you get the inflow of capital and, as a consequence, you can generate economic growth. So economic growth is one of the objectives.[17]

3.20 Professor Brand, Society of Corporate Law Academics (SCoLA), emphasised the importance of a well-functioning corporate insolvency system in underpinning the construct of the limited liability company (LLC). The LLC was predicated on the notion that the owners 'can walk away and not be personally responsible for the debts of the company', but this only operated to the extent that creditors had confidence in the insolvency system.[18] Setting out the potential economic impact of insolvency law reform, she advised:

> …insolvency has tentacles through all of our economy and, more broadly, through society, and that reform of insolvency law has almost a disproportionate capacity to affect broader outcomes—almost more perhaps than many other areas of commercial law. It's uncontentious that well functioning markets require efficient and effective insolvency systems, and the confidence to provide credit is based very centrally on the operation of an effective insolvency system. That's a model that's served us and Western democracies well for a very long time. It enables the assumption that the privilege of limited liability won't lead to destructive or undesirable outcomes.[19]

3.21 ARITA noted the importance of insolvency in 'increasing average levels of productivity in the economy by facilitating structural change within and between businesses and sectors, allowing entrepreneurs and others to learn and experiment, and transferring skills and information between businesses'. ARITA further submitted that in circumstances where a business cannot be

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16 ACTU, *Submission 75*, p. 13.

17 Mr Tom Dickson, Assistant Secretary, Corporations, Treasury, *Committee Hansard*, 13 December 2022, p. 3.

18 Associate Professor Vivienne Brand, President, SCoLA, *Committee Hansard*, 14 December 2022, p. 40.

19 Associate Professor Vivienne Brand, President, SCoLA, *Committee Hansard*, 14 December 2022, p. 39.

saved, 'it is critical that the insolvency framework enables efficient (in terms of both time and cost) redeployment of employees and capital'.[20]

3.22 Reflecting on the evidence provided in other submissions, Mr Michael Brennan, Productivity Commission, told the committee:

> … the submissions that I've read seem to reflect a sophisticated view about what it is that we want from an insolvency system: namely, balancing the desire for restructuring to occur and the desire for businesses to be given every chance while, at the same time, not being so naive as to think that it's the goal of the regime to minimise insolvency. Insolvency and business exit play a very important part in maintaining the dynamism of the economy. They ensure that it's an innovative and constantly changing economy. Whilst there's an element of pain associated with financial distress, sometimes business exit is an important way for us [to] get economic growth through innovation and different business models, and in some industries in particular that is a mechanism by which innovation and productivity growth occur.[21]

3.23 An OECD paper comparing the insolvency regimes across countries summarised how a well-designed insolvency system contributes to the efficient and productive allocation of capital in the economy:

> Policies affecting the way failing firms can exit markets or be restructured can shape aggregate productivity through a variety of channels…These include the strength of market selection – which increases in the economy's ability to dispose of non-viable firms and facilitate the restructuring of viable firms – and the scope and speed at which scarce resources consumed by failing firms can be reallocated to more productive uses. But market imperfections often generate obstacles to the orderly exit of failing firms, implying that well-designed insolvency regimes are crucial to realise the potential productivity gains from firm exit.[22]

3.24 In another OECD paper, 'Insolvency Regimes and Productivity Growth: A Framework for Analysis', it was pointed out that a 'well-functioning exit margin, which sorts successful market activities from unsuccessful ones, is vital to aggregate productivity growth'.[23]

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20 ARITA, *Submission 36*, p. 15.

21 Mr Michael Brennan, Chair, Productivity Commission, *Committee Hansard*, 13 December 2022, p. 16.

22 Müge Adalet McGowan and Dan Andrews, 'Design of insolvency regimes across countries,' OECD Economics Department Working Papers, No. 1504 (September 2018), p. 6, available at https://one.oecd.org/document/ECO/WKP(2018)52/En/pdf (accessed 6 April 2023).

23 McGowan and Andrews, 'Insolvency Regimes and Productivity Growth: A Framework For Analysis,' OECD Economics Department Working Papers No. 1309 (July 2016), p. 7, available at https://www.oecd-ilibrary.org/economics/insolvency-regimes-and-productivity-growth_5jlv2jqhxgq6-en (accessed 22 June 2023).

3.25 Moreover, '[t]he gains to aggregate productivity are magnified if the scarce resources once consumed by exiting firms – capital, labour, skills and ideas – can be reallocated to more productive uses'.[24]

3.26 The paper suggests that market imperfections (such as incomplete contracts and bargaining frictions) underpin part of the policy rationale for insolvency regimes. It also points to factors relevant to the optimal design of such regimes, including appropriate regulatory responses to market imperfections. The market imperfections identified include: asymmetric and incomplete information, the potential for the interests of individual creditors to conflict with collective creditor interests, and high transaction costs.[25]

3.27 The Australian Institute of Company Directors (AICD) referred to the economic importance of insolvency law in making the case for a comprehensive review of the insolvency regime. The AICD noted its long-standing view that insolvency law reform was:

> …a key, and often underappreciated, area of microeconomic reform. In our view, the insolvency regime should encourage entrepreneurialism, maintain employment and enable directors to save businesses that are fundamentally viable in the long-term.[26]

3.28 Asked about the value of more clearly and succinctly setting out the high-level objectives of the insolvency regime, Treasury acknowledged:

> Good policy flows from having clearly articulated objectives. As you mention, the goals around maximising value, or, if you like, protecting creditors, are very important goals as well to articulate. It serves as a useful guidepost for future reform if you were to pursue reform, but it also serves to explain how the system is meant to function so that people who are operating in the system understand what the goals are. Some people can enter the system with perhaps a different perspective around what the goals could be and then find that their expectations aren't met.[27]

3.29 Mr Murray and Professor Harris also suggested there would be merit in having the principles underpinning insolvency law 'settled and legislated in some way, and measured where possible on an ongoing basis as to whether they are and continue to be met'.[28]

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[24] McGowan and Andrews, 'Insolvency Regimes and Productivity Growth: A Framework For Analysis,' p. 7.

[25] McGowan and Andrews, 'Insolvency Regimes and Productivity Growth: A Framework For Analysis,' p. 11.

[26] Australian Institute of Company Directors, *Submission 44*, p. [2].

[27] Mr Tom Dickson, Assistant Secretary, Corporations, Treasury, *Committee Hansard*, 13 December 2022, pp. 10–11.

[28] Mr Michael Murray and Professor Jason Harris, answers to written questions on notice, 22 December 2022 (received 10 February 2023), p. 7.

Committee view

3.30 The committee considers there would be value in more clearly articulating, in legislation and policy, the guiding principles and objectives of the corporate insolvency system. This will help facilitate ongoing assessment of how the system is performing and enhance transparency and understanding of it.

3.31 The purposes of insolvency law were expressed in the Harmer Report, and later in the Productivity Commission's 2015 review, which placed greater emphasis on opportunities for restructure of economically viable businesses. The committee considers these expressions of the system's purposes remain broadly sound. At the same time, the committee does not think it would be useful to itself attempt a definitive statement of those purposes. Insolvency law balances a range of complex and sometimes competing interests, and this task requires further consideration and consultation. As will be discussed in chapter 4, the committee considers this work should be done as a dedicated and early aspect of a separate comprehensive review of insolvency law.

Assessments of the system and calls for a comprehensive review

3.32 A wide range of inquiry participants argued that the corporate insolvency system was falling short of achieving its purposes. This part of the chapter summarises central and recurring themes in the critiques made of the system as it stands. In doing so, this chapter also outlines the evidence in support of a comprehensive, holistic (or 'root and branch') review of insolvency law.

Legislative complexity and the case for holistic reform

3.33 A common theme in much of the evidence received was that the corporate insolvency legislative framework has become overly complex, adding cost and hindering access to insolvency processes. As discussed below, a range of witnesses argued that a holistic, comprehensive review of the insolvency law was required to remedy this complexity.

3.34 The Business Law Section of the Law Council of Australia (BLS LCA) characterised the insolvency system's legislative scheme as a 'piecemeal mishmash of legislative drafting techniques and policy, which have resulted in provisions scattered across various Acts, schedules, regulations, and regulatory instruments'.[29] It recommended that the legislative scheme be 'redesigned to eliminate unnecessary and obsolete provisions, establish a single source of relevant law, and provide a more easily navigable system for stakeholders'.[30]

3.35 Professor Harris also indicated that the ALRC's current approach in its ongoing inquiry into the legislative framework for corporations and financial services

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[29] Law Council of Australia, Business Law Section, answers to written questions on notice, 23 December 2022 (received 14 Februrary 2023), p. [7].

[30] Law Council of Australia, Business Law Section, *Submission 30*, p. 32.

regulation may be useful in resolving some of the legislative and regulatory complexity in relation to insolvency. While the ALRC's current review is focused on Chapter 7 of the Corporations Act:

> …what they are recommending, particularly in terms of legislative drafting and legislative schemes going forward in corporate law, I think, would offer a lot of value to insolvency. Because at the moment we certainly don't have that kind of hierarchical approach that they're recommending in terms of broad-based principles; thinking where the rules fit in; having an independent advisory committee that is basically looking for out-of-date provisions, anomalies, redundant provisions. So that would be very beneficial in insolvency because a number of our rules date back to the 16th century.[31]

3.36 Mr Hathway, AIIP, explained that legislative complexity and confusion made it harder for insolvency practitioners to carry out their work, which adds expense and stress for all involved:

> In the frustration of our work, this idea of just bolting on answers and not having clarity in our work drives us to courts, and having the confusion of trying to determine on each case brings enormous bearing on the costs of liquidations, if not the emotional costs of running these things. […] Where there's confusion in the legislation there's confusion in our advice, and it leaves the consumers, Australian citizens, very confused when it's sometimes a very traumatic part of their life.[32]

3.37 BlueRock submitted that Australia's 'unduly complex' corporate insolvency regime was 'difficult to understand even for experts in the field', leading to 'wasted legal costs associated with the often Herculean task of gleaning an answer to a straightforward question' on insolvency law.[33]

3.38 Dr Duffy, SCoLA, also emphasised the importance of the system being comprehensible, accessible and transparent for the businesses, members of the public, employees and other creditors who might need to engage in insolvency processes.[34]

3.39 Mr Winter, ARITA, spoke to ARITA's 'very strong belief' that a comprehensive review was required to address the cost and complexity that had come to characterise the system:

> The law has become pancaked by decades of legislation, legislative change upon legislative change, and it's now gotten to the point where—and I'll say this quite frankly; as a non-insolvency practitioner, I've been in this job for

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31 Dr Jason Harris, *Committee Hansard*, 13 December 2022, p. 39.

32 Mr Stephen Hathway, President, Association of Independent Insolvency Practitioners, *Committee Hansard*, 14 December 2022, p. 48.

33 BlueRock, *Submission 8*, p. 2.

34 Dr Michael Duffy, Secretary, Society of Corporate Law Academics, *Committee Hansard*, 14 December 2022, p. 39.

> nine years, and I know the ins and outs of this—I could not run an insolvency myself. If somebody with my level of expertise is faced with that challenge, what hope does a director of a business have in navigating their way through what is a minefield?[35]

3.40 Describing Australia's insolvency regime as 'notoriously complex', the Housing Industry Association also wrote in support of a 'holistic in-depth review of Australia's insolvency laws'.[36]

The 'piecemeal' approach to insolvency reform in recent years

3.41 A range of witnesses characterised insolvency law reform in the years since the Harmer Report reforms as 'piecemeal', arguing this had added complexity and inconsistencies to the system. For example, Professor Harris said insolvency reform over the past 30-plus years had focused on:

> …particular issues that are raised— how do particular rules work and can we make them work better? We say, and many others are saying, that this is just adding to the complexity of our system and that really what we need to do is not say, 'Can we make insolvent trading work better or can we make preferences work better?' but, as you just said, Chair, very eloquently, 'How is the system working? What are the goals? What are we trying to achieve? Are we achieving the goals in the best way that we can?' We really haven't had that discussion since the early 1980s when the Harmer committee was convened. We say that the economy has fundamentally changed in that time and that, therefore, this calls for a reconsideration of those fundamental goals, because without that shared understanding of what is the system trying to achieve and is it actually achieving it—it's only once we understand that that we can then investigate the reform of particular rules…[37]

3.42 Mr Pearce, BLS LCA, also noted that reforms in insolvency law had been pursued in response to a particular problem, rather than with a whole-of-system perspective. Mr Pearce indicated that a comprehensive review might provide an opportunity for a more holistic approach:

> Over the course of a period of time there have been lots of piecemeal bolt-ons to the Corporations Act and to the regulatory regime more generally. A lot of those changes have been focused on particular stakeholder groups and addressing particular issues at the expense of a view of the regime as a whole. Consequently, at times we have an overly complicated system that is expensive to operate that doesn't necessarily focus on what's best as a whole—credit returns, for example. To address those matters, one needs to take a step back to look at the whole system and to do so with all the necessary policy considerations and data. What needs to be done in order to

35 Mr John Winter, CEO, ARITA, *Committee Hansard*, 14 December 2022, pp. 4–5.

36 Housing Industry Association, *Submission 21*, p. 14.

37 Dr Jason Harris, *Committee Hansard*, 13 December 2022, p. 39.

> conduct that process? If that's a root-and-branch review of the system, then perhaps that's what needs to happen.[38]

3.43 Professor Brand agreed that reforms in recent years had sought to resolve the concerns of specific constituencies, leading to imbalances in a system characterised by varied and often competing interests. She noted that in corporate insolvency law:

> …there's a really strong level of competition between lots of different ideas, all of which are right in themselves, but maintaining an appropriate equilibrium requires a fair bit of attention to be paid. I guess we would say that, as a society, insufficient attention has been paid to the helicopter view of insolvency for a long time.[39]

3.44 Making the case for a comprehensive review, the TMA also highlighted what it regarded as the 'piecemeal approach' to insolvency law reforms since the Harmer Report. The complexity of insolvency law:

> …has been compounded by ad hoc reforms which have resulted in inconsistencies which make the processes unnecessarily time consuming and costly. The TMA's view, as previously raised with government, was that there were significant advantages in undertaking a holistic and thorough review of Australia's restructuring and insolvency framework by a suitably qualified and diverse panel of experts, with appropriate time and breadth taken to consider views of all stakeholders, using position papers, hearings and fuller submissions. We do not see much utility in ongoing bandaid solutions, which otherwise could be referred to as lazy regulation.[40]

3.45 The AICD, which argued in favour of a comprehensive review, also contended that approaches to reform since the Harmer Report had been 'piecemeal', and included in this category the introduction of Safe Harbour, the SBR regime, the FEG scheme, the COVID-19 moratorium, and steps to combat illegal phoenix activity:

> These separate insolvency policy reforms over the past two decades have had distinct policy objectives with a number resulting in improvements in the regime and economic benefits, for instance the Safe Harbour. However, in totality the ad hoc and disjointed manner of reform has contributed to an insolvency regime that is increasingly complex and challenging for users, observers and regulators to navigate and oversee.[41]

3.46 The committee also received evidence from the Institute of Public Accountants, MinterEllison, SV Partners and Deloitte critical of the piecemeal approach to

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38 Mr Christopher Pearce, Chair, Insolvency & Restructuring Committee, Business Law Section, Law Council of Australia, *Committee Hansard*, 14 December 2022, p. 28.

39 Associate Professor Vivienne Brand, President, Society of Corporate Law Academics, *Committee Hansard*, 14 December 2022, p. 45.

40 Ms Jennifer Ball, Chair, National Board, Turnaround Management Association of Australia, *Committee Hansard*, 14 December 2022, p. 46.

41 Australian Institute of Company Directors, *Submission 44*, p. [2], [6].

legislative reform in recent years and the complexity this had created, and calling, in various degrees, for a holistic review of insolvency law.[42]

Economic and other changes since the Harmer Report

3.47 In support of a comprehensive review, some witnesses also argued that economic and other changes in Australia since the Harmer Report made it necessary to consider if the policy architecture put in place in the early 1990s remained fit-for-purpose. For example, MinterEllison submitted that since the Harmer Report there had been 'significant economic, technological and social change in Australia', alongside growing complexity in Australia's insolvency laws.[43] Similarly, Professor Brand, SCoLA, noted that 'much has changed in the economy, in business systems and in social attitudes to debt and insolvency' since the Harmer Report, and the time was right for 'significant wholesale referral of insolvency law to the ALRC'.[44]

3.48 Mr Murray and Professor Harris also pointed to changes in business practice since the Harmer Report as a relevant consideration. They submitted that:

> …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.[45]

3.49 Professor Hargovan, SCoLA, said that in advocating for a major inquiry into both the policy and technical aspects of insolvency law, SCoLA joined 'a steady chorus led by law reform bodies, judges and academics'. This was unsurprising, Professor Hargovan added, given the time that had passed since the Harmer Report and the problems arising from the 'cycle of ad hoc reforms' and 'piecemeal tinkering' since. While noting that the Harmer Report had led to 'cutting-edge reform':

> …the world has changed since then, and we say a golden opportunity should be seized on this occasion to re-evaluate if our current insolvency

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42 Ms Vicki Stylianou, Group Executive, Advocacy and Policy, Institute of Public Accountants, *Committee Hansard*, 28 February 2023, p. 40; MinterEllison, *Submission 4*, p. 2; Deloitte, *Submission 32*, p. 1; SV Partners, *Submission 50*, p. 5.

43 MinterEllison, *Submission 4*, p. 1. Also see King Wood & Mallesons, *Submission 45*, p. 1.

44 Associate Professor Vivienne Brand, President, Society of Corporate Law Academics, *Committee Hansard*, 14 December 2022, p. 39. Also see Dr Sulette Lombard, *Submission 46*, p. 6.

45 Mr Michael Murray and Professor Jason Harris, answers to written questions on notice, 22 December 2022 (received 10 February 2023), p. 7.

> system remains fit for purpose and remains competitive with other nations that have re-examined their insolvency systems.[46]

Complexity and the division between personal and corporate insolvency law

3.50 For many inquiry participants, a major driver of the complexity in the current system was the legislative, regulatory and judicial division between the corporate and personal insolvency systems. For some inquiry participants, a root-and-branch review was supported as a path toward simplification and harmonisation of Australia's insolvency laws. This issue is considered in detail in chapter 5.

3.51 It might briefly be noted here that while this inquiry's focus was very much on Australia's corporate insolvency system, calls for a comprehensive review in evidence to the committee were generally framed as a review of insolvency law in total—that is, corporate *and* personal insolvency.

Returns to creditors, the problem of deep insolvency, and insolvent trading

3.52 Typically, when an insolvent company in Australia is liquidated, unsecured creditors receive minimal returns. Indeed, one headline statistic invoked at various points during this inquiry is that approximately 90 per cent of unsecured creditors get nil returns in a liquidation.[47]

3.53 As some witnesses pointed out, the insolvency system does not seek to guarantee creditors against loss. Asked what low returns to unsecured creditors said of the system, Treasury noted the 'fundamental tension' in insolvency law between managing the downside of risk-taking and allowing innovation and economic activity:

> Looking at the history of insolvency law, going back to the 1200s, that has always been the tension that has existed. Insolvency law can deal with part of the challenge, which is to foster a smooth process and ensure that the process is understood, that it's predictable and it addresses the distribution of assets when failure occurs. What we don't have are laws that prevent people from being entrepreneurs and having a go, and we don't have laws that prevent people from experiencing losses. Losses can occur for a variety of reasons. Changes in the weather; you can have dramatic weather events that can generate losses. You can have unanticipated changes in market

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46 Associate Professor Anil Hargovan, Executive Member, SCoLA, *Committee Hansard*, 1 March 2023, p. 10. Also see Professor Christopher Symes, *Submission 25*, p. 1.

47 As explained in that 'statistical snapshot' in chapter 2, recent changes in the statistical collection method by ASIC suggest that the oft cited figure of ~92% of unsecured creditors getting zero returns could be revised downward to ~85%. The more recent figure may remain inexact, to the extent it relies on Series 3 reports, which do not include insolvent companies that are not suspected of misconduct and are expected to return more than 50 cents in the dollar. Notwithstanding these qualifications, it is reasonable to conclude that *approximately* 90 per cent of liquidations result in nil returns to unsecured creditors, and this figure is broadly consistent with evidence put by expert witnesses and submitters in this inquiry, and therefore used here.

> conditions. So out of that outcome there can be no assets left to distribute, and that's how you can find the outcome that you're describing which is there are zero cents in the dollar for some people at the end of the process.[48]

3.54 In response to a question about whether the current returns to creditors 'meets with Australians' expectations about the right to access the funds for the services or the goods that they've provided', Mr Day, ASIC, noted the risk inherent in business meant creditors would often go unpaid in insolvencies:

> I'm not saying it's right or wrong; I'm just saying often you will hear that refrain from the general public and obviously from small business, saying: 'Well, I've got to get paid. Who allowed this to happen?' The short point is: you're in business and you're taking on risk. If you're dealing with businesses, you're taking on risk. There are lots of checks and balances to try and minimise the impact or the occurrence of that. But can the system ever prevent that? The answer is no.[49]

3.55 Notwithstanding the above points, some witnesses suggested the low rates of return to creditors were indicative of broader failures in the system.

3.56 A point repeatedly put in the inquiry was that many companies are so deeply insolvent by the time they enter administration there is neither a business left to restructure or proceeds remaining to distribute to creditors. Mr Winter, ARITA, asked about the low returns to unsecured creditors, explained the need to encourage access to earlier supports for companies in or approaching financial trouble:

> While the statistic on that is easy to say—you've got 92 per cent that don't get paid—the principal cause for that is that directors, particularly in small to medium-sized businesses, do not get help early enough. So, by the time a liquidator arrives […] there is nothing left, and a lot of small-business people will get into the position where they go, 'I know I'm broke. I can't get more broke than broke, so I'm going to keep going, and perhaps the Powerball numbers will drop.' That means that you're in an absolutely negative situation.[50]

3.57 Associate Professor Wellard contended that changes in business practice, and in particular the 'excessive or reckless incurring of debt' and the prevalence of insolvent trading, made a comprehensive review of the insolvency system necessary. He suggested the issue of directors trading on their companies and incurring debt long past the point a business was viable should be 'front and centre' in any comprehensive review, given the damage it inflicted on creditors, the economy, and directors themselves:

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48 Mr Tom Dickson, Assistant Secretary, Corporations, Treasury, *Committee Hansard*, 13 December 2022, p. 3.

49 Mr Warren Day, Chief Operating Officer, ASIC, *Committee Hansard*, 14 December 2022, p. 63.

50 Mr John Winter, CEO, ARITA, *Committee Hansard*, 14 December 2022, pp. 10-11.

> In my view, the disenchantment we often hear about our insolvency system, whether it's liquidator remuneration or proceeds of preference claims not getting to creditors, is caused more by the reality that many company balance sheets are leveraged into oblivion well before a liquidator arrives on the scene. In short, you cannot get something from nothing.[51]

3.58 Detailing the extent of deep balance sheet deficiencies, and the resulting 'abysmal returns to creditors', Associate Professor Wellard submitted that the:

> …'corporate rescue' narrative and associated reforms (important though they are) should not preclude a debate about what creditors, our economy and society legitimately expect from corporate failures and what, if anything, should be done about the prevalence of insolvent trading by directors of SMEs.[52]

3.59 The Australian Institute of Credit Management (AICM) also observed that unchecked growth in insolvent trading, and the failure to properly enforce insolvent trading rules, came at a direct cost to creditors. Such practices, it added, also reduced the chances of a viable company emerging from the insolvency process.[53]

3.60 The AICM pointed to the issue of creditor disengagement in insolvency processes, suggesting that this was driven by both complexity and poor returns. While the insolvency regime provides creditors with powers to challenge and approve decisions of insolvency practitioners, credit professionals:

> …require a clear understanding of the process and legislation to have confidence to query an insolvency professional, challenge a decision or assert their rights. Due to the complexity of the current system this confidence can only be obtained with the benefit of legal advice which is not commercially viable for most creditors.
>
> The impact of the complexity and cost of obtaining clarity is compounded by the fact creditors can generally expect little to no return from the insolvency, as evidenced by ASIC statistics in 2018-19 that showed in 96% of cases, the dividend estimate was less than 11 cents in the dollar.[54]

3.61 Scanlan Carroll contended that the operation of the unfair preference regime compounded the problem of poor creditor returns, particularly where trade creditors were also subject to unfair preference claims:

> Often, the return to unsecured creditors at the beginning versus the end of protracted litigation does not change, it remains at zero cents on the dollar. However, the preference claim regime, if the defences are not applied

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51 Associate Professor Mark Wellard, Private capacity, *Committee Hansard*, 1 March 2023, p. 12.

52 Associate Professor Mark Wellard, *Submission 51*, p. 3.

53 Australian Institute of Credit Management, *Submission 9*, p. [2]. The issue of insolvent trading and importance of enforcement in relation to director misconduct is considered in chapter 8.

54 Australian Institute of Credit Management, *Submission 9*, p. [9].

correctly, can result in large portions of creditors of the company also subsequently entering into liquidation.[55]

3.62 In calling for a 'single unified insolvency law'[56], ARITA suggested a new law should encourage 'a turnaround and restructuring culture that is focused first on saving viable but distressed businesses'; and 'enhance creditor outcomes by reducing unnecessary processes and other regulatory burdens'.[57]

3.63 Adding some context to the low returns to creditors, Mr Pearce, BLS LCA, noted that some businesses that may previously have provided returns were now able to avoid going into administration or restructure, which had some bearing on the statistics:

> We introduced the safe harbour regime some years ago. The intention of that regime is to keep businesses out of administration where possible. To the extent you strengthen a solvent and informal restructuring regime so that those businesses don't go under in the first place, that's going to concentrate the businesses that fail on those that really weren't salvageable, and that should reduce the credit of return of businesses that go into administration—the fact that the ones that were providing quite high returns are now not going under at all.[58]

3.64 Mr Pearce added that an administration could involve complex and difficult trade-offs, and creditor returns were by no means the only relevant consideration. He discussed, by way of example, a hypothetical practitioner appointed to a company with some money in the bank:

> [I]f you're appointed, do you trade on and try and save the business, potentially at the expense of employee creditors, so that the FEG scheme needs to be called on, or do you shut down everything, and everyone loses their jobs and all the trade creditors are unpaid but at least you've got some money to pay some creditors something? These are policy questions that are not easily answered.[59]

Small business engagement in insolvency processes

3.65 One concern raised by a range of inquiry participants was that administration was often too costly for SMEs to access. The committee also heard that SME directors may be reluctant to engage with an insolvency system that did not

55 Scanlan Carroll, *Submission 59*, p. 2. Issues relating to the unfair preferences regime are considered in chapter 11.

56 ARITA's call for a unification of personal and corporate insolvency law, to be administered by a single, for purpose insolvency regulator, is discussed in chapter 5.

57 ARITA, *Submission 36*, p. [1].

58 Mr Christopher Pearce, Chair, Insolvency & Restructuring Committee, Business Law Section, Law Council of Australia, *Committee Hansard*, 14 December 2022, p. 29.

59 Mr Christopher Pearce, Chair, Insolvency & Restructuring Committee, Business Law Section, Law Council of Australia, *Committee Hansard*, 14 December 2022, p. 29.

provide adequate restructuring and turnaround opportunities for SMEs experiencing financial difficulty.

3.66 In its submission, the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) argued that SMEs often face high costs in insolvency processes, and a lack of certainty regarding insolvency practitioner fees.[60] Mr Billson, ASBFEO, told the committee that SMEs, confronted with these high and uncertain costs, were reluctant to engage with the insolvency system. The insolvency process, he contended, is:

> …not only about secured creditors but also about business owners who have put their life into it, employees who would love to see the business going, and investors who kind of wonder, 'Where's my spot in this conversation?' at times when significant proportions of residual assets end up going to the practitioner.[61]

3.67 The NSW Small Business Commissioner suggested SMEs were often reluctant to engage with insolvency practitioners in a timely manner out of concern the practitioner was incentivised to move quickly to a winding-up:

> There is often a perception that as insolvency practitioners are paid through the restructuring process, they are incentivised to close businesses to pay creditors as quickly as possible. This perception, whether real or perceived, means some small businesses fail to act early and engage professional advice prior to their situation worsening.[62]

3.68 The availability and accessibility of restructuring options for SMEs was also raised as a potential issue with the current corporate insolvency system. Mr Billson, ASBFEO, suggested the current insolvency system 'is not sympathetic to honest failure and genuine prospects for recovery of the business or the business owner'.[63]

3.69 In late 2020, a new Part 5.3B was added to the Corporations Act (commencing 1 January 2021), which established a new formal debt restructuring process, known as Small Business Restructuring (SBR). This regime allows for financially distressed but viable small companies to restructure their existing debts so they can continue to trade, with the process to be supervised by Small Business Restructuring Practitioners. However, as discussed in chapter 7, the SBR regime

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60 Australian Small Business and Family Enterprise Ombudsman, *Submission 31*, p. [11]. It might be noted that a case study provided by ASBFEO in support of this point was disputed by ARITA, which submitted that 'concerns expressed regarding remuneration often overlook a great deal of detail. In particular, we would observe that the costs incurred by practitioners, as opposed to their remuneration, is often confused.' ARITA, *Supplementary Submission 36.1*, p. 51.

61 Mr Bruce Billson, Ombudsman, Australian Small Business and Family Enterprise Ombudsman, *Committee Hansard*, 13 December 2022, p. 33.

62 NSW Small Business Commission, *Submission 57*, p. [3].

63 Mr Bruce Billson, Ombudsman, Australian Small Business and Family Enterprise Ombudsman, *Committee Hansard*, 13 December 2022, p. 27.

has seen relatively low (albeit recently increasing) uptake, and inquiry participants were generally critical of the design and implementation process of the reforms, even when supportive of the intent.

'Pulling down the shutters': company deregistration

3.70 A concern raised throughout the inquiry was the apparent prevalence of small business directors simply 'pulling down the shutters' and walking away from an insolvent company, rather than going through a formal insolvency process. Some inquiry participants suggested this practice was indicative of a system that was not fit for purpose. For example, SCoLA suggested the increase in deregistrations indicated some small business owners considered it better to abandon their companies and have them deregistered, rather than seek the appointment of a liquidator or administrator.[64]

3.71 On the oft-cited statistic that 13 out of 14 companies are simply deregistered rather than put through an insolvency process, Mr Winter, ARITA suggested this:

> …says that our system is not fit for purpose, because the wholesale avoidance by deregistration shows that people are either too confused by what the regime offers or it's too complex and too hard for them to get into.[65]

3.72 The committee heard that the statistic of 13 out of 14 companies simply being deregistered should be understood in context. Not all companies left creditors unpaid—some, Mr Hathway, AIIP, told the committee, are simply businesses that quite appropriately 'have a go, experiment with something, pay everyone off and go and deregister'.[66]

3.73 However, other inquiry participants raised concerns that companies were either: misusing voluntary deregistration procedures, falsely making the required claim of no liabilities, but without fear that claim would be properly scrutinised; or engineering a compulsory deregistration by ASIC, achieved by deliberately not lodging annual documents with the regulator. Deregistration, in this analysis, was potentially being abused to conceal misconduct and avoid creditors' claims, not least outstanding tax debts.[67]

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64 Society of Corporate Law Academics, *Submission 37*, p. 2.

65 Mr John Winter, CEO, ARITA, *Committee Hansard*, 14 December 2022, pp. 10–11.

66 Mr Stephen Hathway, President, Association of Independent Insolvency Practitioners, *Committee Hansard*, 14 December 2022, p. 50.

67 Mr Russell Morgan, *Submission 2*. Deregistration as an insolvency pathway is also addressed in chapter 7.

Funding insolvency processes and the role of the state

3.74 Another category of concerns raised in evidence was the apparent gaps in the funding of the work that is undertaken, or should be undertaken, in the corporate insolvency system.

3.75 Currently, it appears insolvency practitioners undertake a significant degree of underfunded or unfunded work, with the cost of this work passed through the system through what some characterised as a cross-subsidisation model. In this sense, where an insolvency practitioner does engage in unremunerated work on a company with insufficient assets to cover their costs, some witnesses expressed the view that insolvency practitioners cross-subsidise this through higher charge out rates where assets can be realised. However, that view was disputed. This issue is explored in chapter 8.

3.76 A range of inquiry participants also argued that the current corporate insolvency system failed to appropriately task or adequately fund the public interest functions of the system. In particular, inquiry participants contended that the corporate insolvency system does not adequately fund or otherwise provide for the orderly and consistent administration of insolvent companies with few or no assets. This issue, and the role of the state in resourcing the insolvency system, is examined in chapter 9.

Evidence on the strengths of the current system

3.77 Not all witnesses were convinced of the need for a comprehensive review or thought the insolvency regime in need of fundamental reconstruction. KPMG suggested that Australia's insolvency laws are 'well-designed and operate efficiently and cost-effectively'. It added that it was 'not aware of any empirical evidence that suggests that a significant change to our insolvency laws would result in any better outcome for insolvency businesses or their stakeholders'.[68] KPMG therefore recommended 'limited rather than fundamental change', suggesting the:

> …final reports and stakeholder submissions from recent reviews into safe harbour, schemes of arrangement, trading trusts and unfair preferences as we believe many of those recommendations represented sensible proposals for consideration.[69]

3.78 Asked about its position at a hearing, KPMG responded that while it was not resistant to change, it considered that the law was fundamentally well-designed and efficient, and 'does allow, compared to international systems, for some quite rapid and cost-effective solutions'. KPMG pointed to the successful voluntary administration of Virgin Airlines, which, in an 'extremely complex situation

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68 KPMG Australia, *Submission 55*, pp. 3, 6.

69 KPMG Australia, *Submission 55*, p. 16.

involving lots of parties', saved the business. While acknowledging imperfections, KPMG maintained the current corporate insolvency system:

> …works reasonably well. It allows for a rescue culture and pushes that forward, and that's got to be our main aim. Where a rescue is not possible, it provides for a relatively equitable allocation of the cost of business failure. It protects vulnerable creditors, employees being probably uppermost there. Where the company has completely failed, it allows for a relatively quick liquidation process, some investigation and the possibility of enforcement action. So, if you think about the basic tenets of an insolvency system and how they serve the economy, we think that the Australian system is fundamentally well designed.
>
> Could it be improved? Certainly. Insolvency law, because it interacts with almost every other law of the land, needs to be constantly updated and revised to make sure that it keeps pace with the economy, with society's expectations and with changes in other laws around the country. That's why we end up with what I think has been described as a patchwork quilt of legislation which has been built up, which is complex and could be simplified, of course, but is almost a necessary evil because of the need to continually update the insolvency law to ensure that it stays relevant.[70]

3.79 The Australian Banking Association (ABA) argued that the committee should look to improve Australia's corporate insolvency regime, rather than seek to replace it.[71] It maintained that the current regime 'still serves Australia appropriately', even allowing that there were areas that could be reviewed to remove complexity, especially for small businesses[72]:

> The ABA's view is that it is appropriate to review and improve the current corporate insolvency regime, rather than replacing it. We believe that there should be support for reforms that make the law simpler and more cost effective to access. […] We certainly support a review to improve rather than replace the current system.[73]

3.80 It was put to the ABA that, as a body representing the views of secured creditors, its views contrasted with those put to the committee by unsecured creditors. The ABA responded by noting that changes to the system would have cost implications:

> Yes, and I suppose, when you think of the unsecured versus secured, it's a balance of economics—that the more groups that are brought into preference or come up the stack in an insolvency then there's a cost to

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70 Mr Peter Gothard, Leader, Asia Pacific Restructuring Services, KPMG, *Committee Hansard*, 21 February 2023, p. 52.

71 Mr Steve Blinkhorn, Director of Legal Affairs, Australian Banking Association, *Committee Hansard*, 28 February 2023, p. 1.

72 Mr Ross McNaughton, Group Head of Credit Restructuring, Assurance and Model Risk, Westpac (appearing with Australian Banking Association), *Committee Hansard*, 28 February 2023, p. 9.

73 Mr Steve Blinkhorn, Director of Legal Affairs, Australian Banking Association, *Committee Hansard*, 28 February 2023, p. 9.

> secured creditors for that, and so, if a secured creditor is going to receive less or is likely to receive less in an insolvency situation, there is a cost upfront to that, just balancing risk and reward.[74]

3.81 While Treasury did not argue against a comprehensive review, it did point to recent reforms as strengthening the insolvency system. Asked if the insolvency system, as it currently stood, was 'fair and efficient', Mr Dickson, Treasury, noted that one issue that had been raised was the stigmatisation of business failure that occurs—more so in Australia than in some overseas jurisdictions—and steps had been taken in recent years to address this and drive the long process of cultural change. Mr Dickson pointed, in this respect, to the introduction of the safe harbour for insolvent trading (which was 'operating quite well and as intended'), the stay on ipso facto clauses, and recent new mechanisms such as simplified liquidation, as recent improvements.[75]

3.82 On whether the insolvency system was equipped to deal with what some fear will be a major increase in insolvency events, Mr Dickson responded that past experience suggested the system was robust:

> With regard to the forecast, as people say, cliff of insolvencies, I've heard that forecast for a few years. It hasn't eventuated as yet, but one thing to note is that the insolvency system that we have today was the insolvency system that we had during the global financial crisis. If we're operating at roughly 4,000 or 5,000 insolvencies a year now, in the GFC it was above 10,000, so we've already operated in a time when we've had double the number of insolvencies. I would say that the system that we do have is robust and it does cope with peaks and troughs.[76]

International comparisons

3.83 Some inquiry participants pointed to international approaches to corporate insolvency that might be considered in Australia, including in the context of a comprehensive review process.

3.84 ASBFEO, looking at the outcomes of the current insolvency system from the perspective of debtors (with a focus on SMEs) suggested that, relative to other countries, Australia's is 'considered to have one of the least debtor-friendly [insolvency] laws'.[77] Ms Grazhdannikova, ASBFEO, told the committee that,

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74 Mr Ross McNaughton, Group Head of Credit Restructuring, Assurance and Model Risk, Westpac (appearing with Australian Banking Association), *Committee Hansard*, 28 February 2023, p. 9.

75 Mr Tom Dickson, Assistant Secretary, Corporations, Treasury, *Committee Hansard*, 13 December 2022, p. 8.

76 Mr Tom Dickson, Assistant Secretary, Corporations, Treasury, *Committee Hansard*, 13 December 2022, p. 8.

77 Australian Small Business and Family Enterprise Ombudsman, *Submission 31*, p. [8]. In support of this point, ASBFEO referred to Sylwia Morawska et al., 'Bankruptcy Law Severity for Debtors: Comparative Analysis Among Selected Countries', *European Research Studies Journal*, Vol 23, Special Issue No. 2 (2020), pp. 659-86.

from her background research on the matter, it appeared the insolvency system in Canada, and possibly the UK and Singapore, might be worth considering. ASBFEO explained that it had focused on Canada because the system, which took in both personal and corporate insolvency, assumed an 'honest debtor', and had a strong focus on providing business owners with an opportunity for a 'fresh start'.[78]

3.85 Mr Hannan suggested that a comprehensive review should consider the types of insolvency appointments available in Australia, and the possibility of:

> …Chapter 11 type proceedings, the UK voluntary arrangements procedures, prepacks or something like the system available in Canada under their Companies Creditors Arrangements Act for larger companies.[79]

3.86 Mr Barnden, CAANZ, argued that since the Harmer reforms, when Australia was regarded as a 'world leader' in insolvency reform, Australia had fallen off the international pace:

> Other jurisdictions have implemented different types of restructuring and turnaround, and we should be looking at the world and also our backyard about what is available and how business has changed—both digitally and in the types of entities being used, whether it's trusts, partnerships or corporations. In implementing insolvency and reconstruction—because we want to put in there that we want to save businesses—legislation needs to be best fitted for the current market and the environment not only now but in the future.[80]

3.87 Professor Taylor drew the committee's attention to the complexity of the Australian liquidation regime compared to that in place in New Zealand.[81] Mr Murray supported this point, suggested 'we tend to overcomplicate things in Australia in comparison with New Zealand'.[82]

3.88 King & Wood Mallesons argued that a holistic review of Australia's insolvency laws should consider, among other things:

> …the experience of reforms and [restructuring and insolvency] procedures implemented in relevant foreign jurisdictions, focusing specifically on the US, UK and Singapore, where in our view there are important learnings for prospective reform in Australia.[83]

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78 Ms Ekaterina Grazhdannikova, Analyst, Policy and Advocacy, ASBFEO, *Committee Hansard*, 13 December 2022, p. 33.

79 Mr Neil Hannan, *Submission 54*, p. 1. Insolvency pathways are considered further in chapter 7.

80 Mr Andrew Barnden, member, registered liquidator and trustee in bankruptcy, Chartered Accountants Australia and New Zealand, *Committee Hansard*, 28 February 2023, p. 39.

81 Professor Lynne Taylor, Private capacity, *Committee Hansard*, 1 March 2023, p. 30.

82 Mr Michael Murray, Private capacity, *Committee Hansard*, 1 March 2023, p. 23.

83 King Wood & Mallesons, *Submission 45*, p. 1.

3.89 TMA highlighted how Australia might learn for other jurisdictions that are viewed as 'international leaders in restructuring and turnaround,' such as the United States and United Kingdom. Those jurisdictions, TMA submitted:

> …have designed and continue to develop and reform systems to promote corporate turnaround. TMA considers that it is important that reforms of this nature are considered as a part of a broader roots and branch review (discussed in more detail below) to ensure that Australia remains a leading jurisdiction for investment on an international stage.[84]

3.90 SCoLA, in support of its call for a comprehensive review, argued that Australia needed to ensure its insolvency regime remained internationally competitive:

> Australia is in a global race for capital and insolvency law plays a foundational role in making a capital market attractive to international capital flows. Our fellow OECD members and other developed nations (in particular Singapore) have been active in reviewing and updating their insolvency and restructuring laws. Australia needs to ensure that our insolvency and restructuring laws are attractive to international creditors or Australian companies will face higher costs of capital and the community will suffer from businesses failing when they could have been saved.[85]

3.91 Other inquiry participants contended that Australia's insolvency system was sound by international standards. For example, Treasury advised that in the World Bank Ease of Doing Business report, last published in 2019, Australia ranked 20th out of 190 countries for the category 'resolving insolvency'.[86]

3.92 It might also be noted that the Productivity Commission's 2015 report found that returns to creditors in Australian liquidations, while low, and the time taken to wind companies up, while long, were not inconsistent or generally worse than results seen internationally.[87]

3.93 Mr Gothard, KPMG, drew on his personal experience in suggesting that Australia's corporate insolvency system compared well internationally:

> There are many countries around the world, and I've experienced several of them, where a liquidation of a company or a restructuring of a company could take 10 or 15 or 20 years. That does not help anybody in any way. And for us to be able to have a system in place like voluntary administration, which can take a very complex situation, devise a restructuring plan, have it approved by creditors and have the business out of the process within 12

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84 Turnaround Management Association of Australia, answers to questions on notice, 23 December 2022 (received 10 Februrary 2023), p. 9.

85 SCoLA, answers to questions on notice, 23 December 2022 (received 17 February 2023), p. 3.

86 Treasury, answers to questions on notice, 13 December 2022, Treasury001 (received 10 February 2023), p. 1.

87 Productivity Commission, Inquiry Report No. 75, *Business Set-up, Transfer and Closure* (September 2015), p. 23.

> months or 18 months, is really quite an achievement on the international scale of things.[88]

3.94 KPMG submitted that while there was some room for improvement, Australia's insolvency laws 'operate efficiently and cost effectively compared to international systems'. KPMG further cautioned that international approaches would not always reflect community expectations, including 'who should bear the risk of a company's failure, the powers of creditors to influence outcomes which impact their return and the level of independent oversight applied'.[89] It reasoned:

> International approaches to insolvency and restructuring differ according to social purpose, economic goals, court systems and other jurisdictional legislation. While it is useful to learn from experiences in other jurisdictions, each country's insolvency system is necessarily bespoke to its community standards and historical legal construct and therefore it should not be assumed that insolvency laws adopted in other countries can be easily imported into the Australian framework.[90]

Other recent calls for a comprehensive and holistic review

3.95 Calls for a comprehensive review received by this committee add to similar calls elsewhere. Notably, this includes the November 2021 statutory review of the insolvent trading safe harbour undertaken for the government by an independent panel. The Safe Harbour Review characterised Australia's insolvency laws as an 'impenetrable quagmire that is scary, complex and unknown'.[91] It noted that calls for a holistic review of Australia's insolvency laws was a 'consistent theme' in its report, and set out 'some compelling reasons for a comprehensive review of Australia's insolvency laws from an economic, legal and social perspective'.[92] Like participants in this inquiry, the Safe Harbour Review emphasised the economic and social change that had occurred since the Harmer Review,[93] and highlighted the risks of addressing issues in one area of the law without considering the system holistically.[94] It also suggested a review

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88 Mr Peter Gothard, Leader, Asia Pacific Restructuring Services, KPMG, *Committee Hansard*, 21 February 2023, p. 53.

89 KPMG Australia, *Submission 55*, p. 13.

90 KPMG Australia, *Submission 55*, p. 12.

91 The Treasury, *Review of the insolvent trading safe harbour – Final report* (March 2022), p. 79 (emphasis in original).

92 The Treasury, *Review of the insolvent trading safe harbour – Final report* (March 2022), p. 79.

93 The Treasury, *Review of the insolvent trading safe harbour – Final report* (March 2022), p. 85.

94 The Treasury, *Review of the insolvent trading safe harbour – Final report* (March 2022), p. 79. The safe harbour provisions are considered in chapter 7.

should consider the different challenges faced by SMEs compared to larger companies, noting a 'one size model' may not fit all.[95]

3.96 Also in 2021, the then President of the ALRC, the Hon Justice Sarah C Derrington AM, expressed support for 'a comprehensive review of Australia's insolvency laws to ensure they are "simple, efficient and effective"'. Justice Derrington set out how the ALRC would undertake such an inquiry, 'and how it might be guided by the novel analysis methods developed by the ALRC during its current inquiry into the law on financial services and corporations'.[96]

Committee view

3.97 In the committee's assessment, Australia's corporate insolvency system is overly complex, difficult to access, and creates unnecessary cost and confusion for both debtors and creditors.

3.98 Tellingly, few parties seem satisfied with the system as it stands. Unsecured creditors are understandably frustrated by stubbornly low returns in insolvency processes. Debtors, particularly smaller businesses, regard opportunities for restructure as lacking and system costs as excessive. Insolvency practitioners and other observers consider the system is not appropriately resourced to achieve its purposes. A very large number of stakeholders and experts, meanwhile, appear to agree with the Safe Harbour Review's assessment of the system as an 'impenetrable quagmire'.

3.99 While reforms introduced following the Harmer Report were, as one witness put it, 'cutting-edge' at the time, the committee is concerned that Australia's insolvency system may no longer reflect modern business practice or sufficiently meet business needs. This is particularly the case for smaller and medium-sized businesses. It also appears that the insolvency system has not kept pace with changes in the Australian and global economy since the Harmer Report, including but not limited to the shift from fixed assets to intangibles and increasing levels of secured debt. The committee also notes evidence suggesting Australia may have also fallen off the international pace in terms of insolvency reform.

3.100 Since the post-Harmer Report reforms of the early 1990s, a great number of changes have been made to corporate insolvency law. Many of these reforms have made valuable contributions to the corporate insolvency system; indeed, assessed individually, they overwhelmingly appear worthwhile and sensible.

95 The Treasury, *Review of the insolvent trading safe harbour – Final report* (March 2022), p. 85.

96 The Hon Justice Sarah C Derrington, 'The Changing Face of Law Reform in Australia: Commentary on the ALRC's Inquiry Into Insolvency, its Contribution to the Current Legal Framework and the Need for a New Review Given the Passage of Over 30 Years,' ARITA Expert Series: Insolvency – Series 1, 11 November 2023, available at https://www.fedcourt.gov.au/digital-law-library/judges-speeches/justice-s-derrington/s-derrington-j-20211111 (accessed 3 May 2023).

Moreover, it almost goes without saying that the law should respond to changing circumstances, and seek improvements where failings are identified. However, the committee agrees that the approach to corporate insolvency law reform in recent years has been, at times, 'piecemeal' in nature, with reforms attending to parts of the insolvency system without always having regard to the whole. This has added to the complexity and, in places, inconsistency in the system, making it harder and more costly for all to navigate. The committee also notes how failings in one area—for example, the apparent extent of insolvent trading and lack of enforcement in response—creates pressures throughout other parts of the system.

3.101 Even where relatively modest changes to the law might be worthwhile (and elsewhere in this report some such changes are recommended) specific amendments to the law are unlikely to resolve the fundamental issues set out in this chapter. The committee has concluded that, as a first step to addressing the shortcomings of the corporate insolvency system, there is a need for an independent and comprehensive review that addresses the system as a whole.

3.102 As will be explained further in chapter 5, the committee is of the view that a holistic review should have regard to both corporate and personal insolvency.

3.103 The committee considers that the comprehensive review should begin as soon as practicable. The committee suggests that tasking an existing body (supplemented with other specialist skills) would enable the comprehensive review to proceed in a timely way.

Recommendation 1

3.104 The committee recommends that as soon as practicable the government commission a comprehensive and independent review of Australia's insolvency law, encompassing both corporate and personal insolvency. The committee is also recommending that the government progress several other near-term actions as identified in the executive summary.

3.105 The next chapter in this report will consider what a comprehensive review might look like, including its structure, scope, and processes. Chapter 5 then considers, among other things, the data required to support a comprehensive review.

Chapter 4
A comprehensive review: structure, scope and process

4.1 This chapter follows directly on from recommendation made in the previous chapter—that the government commission a comprehensive and independent review of the insolvency system in Australia—and considers the possible structure, process, and scope of such a review. In turn, this chapter considers:

- who might be given the task of undertaking the review;
- likely research and consultation processes; and
- international examples of reform processes that might help inform the conduct of an Australian comprehensive review.

4.2 This chapter also considers how long a review might take, and how the conduct of a comprehensive review might relate to the need to progress certain reforms in a timely manner and thus independent of—and possibly in advance of—a comprehensive review.

4.3 Finally, this chapter considers the appropriate scope and coverage of a comprehensive review, and the extent to which this should be set out in a review's terms of reference.

Review structure and process

Who should conduct a comprehensive review?

4.4 Some inquiry participants offered recommendations as to how a comprehensive review might be conducted, including which body would be best tasked with undertaking such a review.

4.5 Not surprisingly, the Harmer Report was offered as a potential review model, with the ALRC nominated by many as a good choice to conduct the review. ARITA noted the ALRC's ongoing work in relation to the Corporations Act, while suggesting that economic expertise might be added to the ALRC for the purposes of an insolvency review:

> Given the review is likely to touch on administrative, commercial and economic matters, it may be appropriate for the Attorney General to appoint suitable persons as part-time Commissioners pursuant to section 7(d) of the ALRC Act. If financial or economic staff resources were required, we are sure these could be seconded from the [Productivity Commission]...[1]

[1] ARITA, *Supplementary Submission 36.1*, p. 21.

4.6 Some witnesses noted that a comprehensive review might build on the ALRC's ongoing inquiry into the simplification of the legislative framework for corporations and financial services regulation. However, it was generally acknowledged that a holistic review of insolvency law would be broader, given the ALRC's current inquiry is a review of legislative structure rather than of policy settings.[2]

4.7 Mr Murray and Professor Harris also suggested either the ALRC or the Productivity Commission could lead a review, subject to those bodies being able to draw on both legal and economic expertise:

> 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; again though, as long as it can access other relevant disciplines.[3]

4.8 Other witnesses suggested a comprehensive review could be undertaken by a body with economic and/or legal expertise, which could be either the Productivity Commission or the ALRC, a combination of the two, or a body similar to the former Corporations and Markets Advisory Committee (CAMAC) which was abolished in 2018.[4]

4.9 Government agencies and departments, such as ASIC and Treasury, suggested that if the government were to decide to conduct a comprehensive review, the choice of agency or body tasked with undertaking a review would depend on what the government was seeking to achieve and the review terms of reference. At the same time, they acknowledged a review would likely be a multidisciplinary exercise, requiring both legal and economic expertise.[5]

4.10 Mr Tom Dickson, Treasury, suggested that the choice between the ALRC and the Productivity Commission might be a 'false dichotomy':

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2 Mr Tom Dickson, Acting First Assistant Secretary, Market Conduct Division, Treasury, *Committee Hansard*, 1 March 2023, p. 52; Australian Institute of Company Directors, *Submission 44*, p. 2.

3 Mr Michael Murray and Professor Jason Harris, answers to written questions on notice, 22 December 2022 (received 10 February 2023), p. 3. Also see Mr Michael Murray, Private capacity, *Committee Hansard*, 13 December 2022, pp. 38–39.

4 Australian Institute of Company Directors, *Submission 44*, p. 2; MinterEllison, *Submission 4*, p. 2; SCoLA, answers to questions on notice, 23 December 2022 (received 17 February 2023), p. 3; Law Council of Australia, Business Law Section, answers to written questions on notice, 23 December 2022 (received 14 Februrary 2023), p. [13].

5 Mr Warren Day, Chief Operating Officer, *Committee Hansard*, 1 March 2023, p. 33; Ms Jenna Priestly, Assistant Secretary, Commercial and Copyright Law Branch, Attorney-General's Department, *Committee Hansard*, 1 March 2023, p. 51.

> If you wanted to expand the opportunities that you have to nail what you might consider to be a once-in-a-lifetime review, you might want to think about not confining yourself to those two agencies. Starting with the capability, because each does have advantages, for instance the Productivity Commission does have excellent expertise in relation to thinking about things through an economic lens. We know the ALRC is excellent in its capabilities in relation to looking at law reform too. In an ideal world you would be able to take advantage of the various disciplines and not be confined.[6]

Committee view

4.11 The committee agrees that a comprehensive review would require expert understanding of the legislative frameworks, case law and regulatory arrangements that apply to both corporate and personal insolvency law, including appropriate expertise in relation to international frameworks. Equally, a comprehensive review should have access to expert knowledge and capability in respect to the economic and financial imperatives of corporate insolvency.

4.12 Whether the comprehensive review is conducted by the ALRC, the Productivity Commission, or a made-for-purpose body, is secondary in the committee's view to the overriding need for a review to be supported by experts reflecting the multidisciplinary nature of the undertaking. It may be appropriate for a review to be led by multiple commissioners to reflect this multidisciplinary character. Subject to the government having regard to these considerations, the committee considers the question of who should conduct a comprehensive review should be left to the government.

Likely consultation processes and the importance of robust data

4.13 Some witnesses pointed to the processes a comprehensive review would likely need to undertake, including: research and data-driven analysis on the state of Australia's insolvency laws; comparison to other jurisdictions; written submissions and hearings; engagement with interested members of the public and stakeholders, such as professional associations, industry bodies, academics and other experts; and the preparation of consultation papers and draft recommendations.[7]

4.14 Both Treasury and AGD underlined the importance of broad and in-depth consultation and consideration of the perspectives of various stakeholders connected to the insolvency system. AGD advised that any review:

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6 Mr Tom Dickson, Acting First Assistant Secretary, Market Conduct Division, Treasury, *Committee Hansard*, 1 March 2023, pp. 51, 55.

7 For example, see MinterEllison, *Submission 4*, p. 2–3; Turnaround Management Association of Australia, answers to questions on notice, 23 December 2022 (received 10 Februrary 2023), p. 11.

> …would need to take a fresh look at what the industry needs right now—… broad stakeholder consultation would be critical, particularly if you're considering a root-and-branch review with an intention of some form of harmonisation, given the two different roles that the systems play. You wouldn't want to exclude consideration of one system in light of the other, so it would need to be very carefully balanced to ensure that outcome.[8]

4.15 During the inquiry, it was observed that part of the challenge of assessing if the corporate insolvency system is meeting its objectives, and if not why not, was imperfect data on insolvency. For example, the Business Law Section of the Law Council of Australia (BLS LCA) submitted that an extensive review of the insolvency regime 'would need to include material data gathering and analysis'. The paucity of data on some issues, as highlighted in much of the evidence to the committee, presented a real challenge.[9]

4.16 As noted in a 2017 IMF Working Paper, *The Use of Data in Assessing and Designing Insolvency Systems*, 'measuring the effectiveness and efficiency of insolvency procedures begins with establishing the desired objectives, or outcomes of an insolvency system'.[10] The IMF's paper, while explaining the importance of a proper empirical foundation in assessing an insolvency system, argues that the value of such data is contingent on a clear understanding of the system's objectives. The IMF's reasoning would support a comprehensive review starting with a consideration of the principles and objectives of insolvency law (as per recommendation 2 of this report), before in turn identifying what data gaps might exist. This point is considered further in chapter 6.

International examples of insolvency law reform processes

4.17 Other inquiry participants pointed to exercises in insolvency law reform in other countries, including comprehensive review and reform processes that Australian policymakers could potentially draw on or learn from.

4.18 The BLS LCA noted that a number of Australian private practice lawyers had participated in some of these international processes:

> In any root and branch review of Australian insolvency law, it is important that any inquiry utilise the resource of the extensive experience of Australian practitioners and academics in these international processes.[11]

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8 Ms Alice Linacre, First Assistant Secretary, Courts, Tribunals and Commercial Division, Attorney-General's Department, 1 March 2023, pp. 51–52.

9 Mr Christopher Pearce, Chair, Insolvency & Restructuring Committee, Business Law Section, Law Council of Australia, *Committee Hansard*, 14 December 2022, p. 27.

10 International Monetary Fund, *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, p. 3

11 Law Council of Australia, Business Law Section, answers to written questions on notice, 23 December 2022 (received 14 Februrary 2023), p. [15].

4.19 Deloitte pointed to the Singaporean implementation of 'significant reforms which consolidated their personal and corporate insolvency laws into a single piece of legislation which had the objective of simplifying and modernising their insolvency framework'.[12]

4.20 Mr Murray and Professor Harris wrote that it was always valuable to consider reform processes undertaken in comparable jurisdictions. They highlighted broad-ranging reviews in Singapore, India and the United States, along with 'broad scale' insolvency law reforms in recent years in the European Union and United Kingdom.[13]

4.21 The AIIP suggested that a 'comprehensive and thorough examination of corporate insolvency in Australia' should have regard to international examples, including the United States and Singapore:

> In Singapore a major overhaul of its restructuring and insolvency legislation was the culmination of a process that was ongoing for approximately 10-years, including participation by a cross section of stakeholders with relevant specialist skill to review the existing law to determine its effectiveness relative to consideration of the fundamental policy questions on what the key goals of our insolvency law should be, and what sorts of processes are needed in order to achieve these goals.[14]

Could a comprehensive review inadvertently slow necessary reforms?

4.22 In its examination of calls for a comprehensive review, the committee sought to understand the potential investment of time and resources that might be required and weigh the value of a review against the risk such a comprehensive and complex exercise might delay or distract from more timely and potentially easier-to-achieve reforms.

4.23 The Harmer Report followed a lengthy process, with the review taking the ALRC approximately five years to complete, from 1983 to 1988. It took a further five years for the most important resulting reforms to be legislated and implemented.[15]

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[12] Deloitte, *Submission 32*, p. 7.

[13] Mr Michael Murray and Professor Jason Harris, answers to written questions on notice, 22 December 2022 (received 10 February 2023), pp. 2–3.

[14] Association of Independent Insolvency Practitioners, answers to questions on notice, 23 December 2022 (received 23 February 2023), p. 3.

[15] A summary of the review timeline is provided in Mr Michael Murray and Professor Rosalind Mason, answers to questions on notice, 1 March 2023 (received 16 March 2023), pp. 1–2. Mr Murray and Professor Mason also provided a copy of an article by Professor Mason, *Insolvency Academics Contributing to the Review of Insolvency Laws: An Australian Perspective*, Nottingham Insolvency and Business Law e-Journal (2015), which provides, among other things, an account of the progress and other background on the Harmer Report.

4.24 Mr Dickson, Treasury, noted that Productivity Commission reviews typically took 12 to 18 months, while ALRC processes were commonly multiyear exercises. How long an insolvency comprehensive review would take, he added, would very much depend on its terms of reference and what the government was seeking to achieve.[16]

4.25 For its part, SCoLA suggested a three-year timeframe for a comprehensive review would be appropriate. This would allow sufficient time for a 'series of discussion papers, public and private consultations and broad engagement with stakeholders (not just lawyers and insolvency practitioners)'.[17]

4.26 The BLS LCA suggested that while a comprehensive review would be a multiyear process, it did not have to take as long as the Harmer Report. The process might be expedited, it argued, if a properly resourced review was instructed to:

> …not only to settle on particular proposed policy positions but to engage in the legislative drafting process so as to cut short any delay associated with a further consultation process.[18]

4.27 ARITA suggested that given clear guidance by the government as to the objectives of a comprehensive review, it could be completed within 12 months:

> We would expect that there would be consultation with the relevant professional bodies and other stakeholders, with a draft published after eight or nine months to which stakeholders would be given six to eight weeks to respond.[19]

4.28 Asked if he supported a comprehensive review, insolvency lawyer Mr Ben Sewell identified the tension between the value of a broad-ranging review and the need for ongoing responses to address current issues with the law:

> Yes and no. Yes, because of problems with the purposes and the objectives of insolvency in Australia. I think it'd be good to clear that up. But then, on the other hand, I don't want to unnecessarily delay the reform process, because I think it's more a continual process.[20]

4.29 A number of witnesses argued the case for a comprehensive review, while at the same time suggesting other aspects of insolvency law which might be addressed more immediately. Mr Winter, ARITA, while very firmly calling for a

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16 Mr Tom Dickson, Acting First Assistant Secretary, Market Conduct Division, Treasury, *Committee Hansard*, 1 March 2023, p. 55.

17 SCoLA, answers to questions on notice, 23 December 2022 (received 17 February 2023), p. 3.

18 Law Council of Australia, Business Law Section, answers to written questions on notice, 23 December 2022 (received 14 Februrary 2023), p. [14].

19 ARITA, *Supplementary Submission 36.1*, p. 21.

20 Mr Ben Sewell, Private capacity, *Committee Hansard*, 28 February 2023, p. 62.

comprehensive review, noted that such a review and implementation of any resulting reforms could take many years:

> That's why we say throughout our submission that there are some low-hanging fruit, if you like, that parliament can address straightaway—things like implementing the recommendations of the safe harbour report, fixing trusts, fixing small business restructuring et cetera. We can do that quickly, but the bigger review piece is a multiyear task for the ALRC and then for government to draft.[21]

4.30 Various inquiry participants pointed to specific examples of aspects of insolvency law that might be addressed in the short term, even while a larger comprehensive review proceeded. Professor Hargovan, for example, suggested that a ban on the auto ejection of trustees upon insolvency (a topic considered in chapter 10) might be one such change that could be addressed separate to a comprehensive review.[22] As another example, he pointed to certain procedural efficiencies that might be relatively easily achieved in relation to the operation of voluntary administration.[23]

4.31 Associate Professor Wellard similarly pointed ‘to some quick fixes’, including to ‘long-standing errors, technical errors in the legislative drafting of the Insolvency Law Reform Act suite of reforms’ that could be addressed outside a comprehensive review.[24] Professor Mason also agreed with the general proposition that in addition to a comprehensive review, there was a category of reforms that could be introduced in the shorter term to improve the current system.[25]

4.32 Other examples, too numerous to mention here, were provided by inquiry participants of reforms that might be pursued relatively quickly and outside of a presumably lengthy review and reform process. These other examples are raised at points throughout the rest of this report.

4.33 Asked if there were some reforms that should be progressed now, even were a comprehensive review to proceed, SCoLA reiterated its concerns (set out in the previous chapter) about the risks of piecemeal reforms:

> We recommend against short term quick fixes and suggest that reforms be considered holistically as part of a root and branch review. The history of

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21 Mr John Winter, CEO, ARITA, *Committee Hansard*, 14 December 2022, p. 11. As noted above, a subsequent response to a question on notice from ARITA suggested a larger review process could be completed within 12 months.

22 Associate Professor Anil Hargovan, Executive Member, SCoLA, *Committee Hansard*, 1 March 2023, pp. 14–15.

23 Associate Professor Anil Hargovan, Executive Member, SCoLA, *Committee Hansard*, 1 March 2023, p. 16.

24 Associate Professor Mark Wellard, Private capacity, *Committee Hansard*, 1 March 2023, p. 15.

25 Dr Rosalind Mason, Private capacity, *Committee Hansard*, 1 March 2023, p. 25.

> insolvency law (and indeed, much of the history of corporate law) in Australia is replete with small changes designed to address particular concerns of specific stakeholders and unfortunately often without adequate public consultation. This has resulted in a bloated insolvency law that is filled with errors and inconsistencies and a system that fundamentally does not meet its stated goals. We have an insolvency system that we cannot afford and that produces no returns to general creditors in almost every case in circumstances where even the insolvency practitioners are not getting paid for their work in perhaps as much as 30-40% of their appointments. This is a system that no stakeholders are happy with and needs a fundamental rethink to provide a modern insolvency law that is fit for purpose, efficient and effective.[26]

4.34 However, Professor Brand, the Society of Corporate Law Academics (SCoLA), responding to the question of how to balance the need for action on pressing matters against the value of a comprehensive review, allowed that both processes might proceed at once:

> They're not mutually exclusive. That's the beauty of it. You will have already heard lots of evidence about lots of detail that can be tweaked relatively easily and uncontroversially, which will improve things, fix things and allow unintended consequences to be removed.
>
> But we were leaders in insolvency regulation in the early nineties when I was in insolvency practice, as a practitioner. The advice that we're getting from our expert committee is that we are well off the pace now. There are a number of common law jurisdictions around the world which have done clever things which are working well. We've got the capacity to get back up to a much more ideal model—a much more front-end-of-the-curve model, which could pay significant dividends for the economy as a whole.[27]

4.35 When it was put to Professor Brand that a comprehensive review would take significant time, she indicated that the investment of time and resources would be worth it over time:

> The thing is: insolvency is so big and so significant that you can give it as much time as it needs, and it will pay off. It will give you a dividend. But maybe not in your term [of Parliament].[28]

4.36 Like Professor Brand, ARITA acknowledged the challenges of a comprehensive reform process, but argued the benefits would justify this effort:

> We understand that the development of such a framework will take significant effort on behalf of policymakers and stakeholders alike. But law reform is the ordinary business of governments—ordinary business, in this case, that has been neglected for decades. The benefits of undertaking this

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26 SCoLA, answers to questions on notice, 23 December 2022 (received 17 February 2023), p. 10.

27 Associate Professor Vivienne Brand, President, Society of Corporate Law Academics (SCoLA), *Committee Hansard*, 14 December 2022, p. 41.

28 Associate Professor Vivienne Brand, President, SCoLA, *Committee Hansard*, 14 December 2022, p. 40.

> reform will include more businesses surviving periods of financial difficulty; more efficient allocation of labour and capital; less dislocation of employment; reduced compliance and transaction costs; greater creditor recovery; more effective identification of unlawful activity and, therefore, a reduction of the social cost of such activity; reduced administrative costs to governments; and reduced risk of interruption of nationally significant goods and services markets and less distress for individual members of the community.[29]

4.37 Asked how government might conduct a comprehensive review while at once pursuing more pressing reforms, Treasury cautioned that the capacity of stakeholders to provide input to reform processes was finite. Even in pursuing reforms that might be considered relatively minor, careful consideration should be given to how pressing those reforms were:

> One thing that [Treasury is] acutely conscious of is the impost on stakeholders' time when it comes to reform processes. If we were doing a change that you could consider to be relatively minor, if you're changing the law, then you're necessarily needing to consult with people to make sure that that law is going to work as it's intended to. It means engaging with a range of stakeholders who then need to, in some cases, consult with their membership, write briefings, prepare reports, prepare advice and lodge submissions. Even for what you might consider to be relatively minor reforms, there could be quite a material impact on stakeholders. If you're doing a root-and-branch review, my suspicion is that, from a stakeholder point of view, they actually might prefer to spend that time, those precious hours or days that they have, focusing on that once-in-a-lifetime opportunity.[30]

Committee view

4.38 The committee is mindful that a comprehensive review and any resulting reform process would likely require a considerable investment of time and other resources, both by the government and key stakeholders. The committee is firmly of the view that this investment will be worth it, given the importance of a robust, fit-for-purpose insolvency framework.

4.39 While a comprehensive review may delay some reform actions, the committee notes the value in generally progressing reforms as part of a holistic process. The committee again observes the problems that can arise when reforms are progressed in a reactive and piecemeal fashion (as discussed in the previous chapter). Nonetheless, at points through this report this committee has identified some reform actions that should be progressed independent of a comprehensive review. These more immediate potential reforms would address clear and broadly recognised failings in the current law. The committee is

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29 Dr Warren Mundy, Special Adviser, ARITA, *Committee Hansard*, 14 December 2022, p. 3.

30 Mr Tom Dickson, Acting First Assistant Secretary, Market Conduct Division, Treasury, *Committee Hansard*, 1 March 2023, p. 53.

satisfied that these recommended reform actions—the 'low hanging fruit' of corporate insolvency law reform—will help realise a balance between the need for a considered, holistic review and reform process, and timely responses to shortcomings in the law.

4.40 The committee also notes that the work of a comprehensive review could be progressed in stages. This would allow the review to recommend reforms and, where the government and parliament agree those recommendations, for reforms to be implemented while the review continues. This approach would be consistent with that taken in the ALRC's ongoing Review of the Legislative Framework for Corporations and Financial Services Regulation, which complements ongoing work by Treasury to simplify relevant legislation.

4.41 The committee considers that the government should set a clear timetable for a comprehensive review. While it should be left to government to determine this timetable, the committee suggests a final report within three years of the review's commencement would likely be achievable and appropriate.

Review scope and content

4.42 This part of the chapter considers the appropriate scope and content of a comprehensive review.

Articulating the objective of a comprehensive review

4.43 Ms Linacre, AGD, observed that it was important to define the problems a comprehensive review was intended to address, and not do 'a root and branch [review] for the purpose of doing a root and branch [review]'.[31] She suggested that, should this committee make a recommendation for a comprehensive review, it should provide guidance as to its purposes:

> I would just say again that the terms of reference would be really critical. We talk about a root-and-branch review in general terms, but what that review is seeking to achieve and what you're trying to get out of it is quite critical in determining who would be undertaking it. Are you trying to look at the economic impact of the system and determine on that basis whether law reform is appropriate? That may lead you down one path. But if you've determined law reform will be an appropriate mechanism to manage harmonisation for the experience of stakeholders, that may be different. I think these are things that the committee will need to consider in terms of why you are recommending a review and what its purpose [is].[32]

4.44 Likewise, Ms Lawrence, CAANZ, told the committee that while a comprehensive review would be warranted:

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[31] Ms Alice Linacre, First Assistant Secretary, Courts, Tribunals and Commercial Division, Attorney-General's Department, 1 March 2023, p. 52.

[32] Ms Alice Linacre, First Assistant Secretary, Courts, Tribunals and Commercial Division, Attorney-General's Department, 1 March 2023, p. 55.

> …the caveat is that it has to have a purpose. Just reviewing legislation won't achieve structural change. Is the review to bring the two insolvency regimes together? Is it to align insolvency better with the natural business life cycle? Is it with a view to bringing in the nuances that you yourself have referred to and understanding that what a small business needs, what a microbusiness needs and what a larger business needs are quite different? So we do support a review, but we'd like to understand the purpose of that review before it commences.[33]

4.45 The committee considered the extent to which terms of reference for a comprehensive review should refer to specific areas of reform. The BLS LCS observed that the Harmer Report terms of reference were 'short and very broad'. The terms of reference simply referred to:

> …the law and practice relating to the insolvency of both individuals and bodies corporate, in particular—

4.46 The BLS LCA noted that while there might be a need to be more specific than the Harmer Report terms of reference, care should nonetheless be taken 'not to box in any subsequent inquiry unnecessarily'.[34]

Key issues for consideration by the comprehensive review

4.47 As set out in the remainder of this report, there are a range of issues that the committee has determined should be considered as part of a comprehensive review, including:

- re-examining the principles, purposes, and objectives of the insolvency system (recommendation 2);
- the harmonisation of the personal and corporate insolvency systems – as discussed in chapter 5 (see recommendation 3);
- the need for improved insolvency data – as discussed in chapter 6 (see recommendation 4);
- the current system of insolvency pathways, and reforms to specific pathways – as discussed in chapter 7 (see recommendations 5, 6 and 8);
- the requirements for the registration of small business restructuring practitioners – as discussed in chapter 8 (see recommendation 10);
- issues relating to the remuneration of insolvency practitioners – as discussed in chapter 8 (see recommendation 12);
- the independence requirements for insolvency practitioners – as discussed in chapter 8 (see recommendation 13);
- issues associated with of 'untrustworthy pre-insolvency advisors' – as discussed in chapter 8 (see recommendation 14);

33 Ms Jill Lawrence, Senior Policy Advocate, Chartered Accountants Australia and New Zealand, *Committee Hansard*, 28 February 2023, p. 43.

34 Law Council of Australia, Business Law Section, answers to written questions on notice, 23 December 2022 (received 14 February 2023), p. [13].

- options for funding the administrations of assetless companies, including reforms to the Assetless Administration Fund and the creation of a public liquidator for corporate insolvency – as discussed in chapter 9 (see recommendation 17);
- statutory reporting obligations that apply to insolvency practitioners – as discussed in chapter 10 (see recommendation 18);
- the operation of the insolvent trading regime and its impact on the broader corporate insolvency framework – as discussed in chapter 10 (see recommendation 19);
- overall economic and social benefits and costs of ATO relief to potentially insolvent companies in hard economic times, in the context of the impacts on the purposes of the insolvency system – as discussed in chapter 10 (see recommendation 20);
- the relative priority of employees, liquidators and secured creditors, including in relation to circulating assets under Section 561 of the Corporations Act – as discussed in chapter 11 (see recommendation 21);
- unfair preferences and voidable transactions – as discussed in chapter 13 (see recommendation 25); and
- improving the insolvency process for trusts – as discussed in chapter 14 (see recommendation 26).

Committee view

4.48 The committee notes that the Harmer Report was provided with very broad terms of reference, and evidence suggests this ensured the ALRC was not 'boxed in' or prevented from following the evidence.

4.49 Nonetheless, the committee considers that it will assist both a review and those who wish to engage with it if the government sets out in the terms of reference key matters to be addressed. This could be done without necessarily limiting the review to those matters. Those key matters, as the committee views them, are set out over the course of the remaining chapters.

Consideration of the purposes of insolvency law in a comprehensive review

4.50 Mr Neil Hannan submitted that it was 'essential' that any comprehensive review of Australia's insolvency law consider what legal predisposition the system should take. A review, he explained, should examine:

> …the purpose of and the framework surrounding our insolvency system and the natural tensions that exist within the same between the interests of the debtor and the interests of the creditors. Such a review would then have to look at whether as a matter of public policy our system should have a predisposition toward restructuring with a view of saving business or liquidation and receivership which allows creditors to achieve a maximum return.
>
> Any change toward a restructuring predisposition would require an assessment of what rights secured creditors should have in a restructuring

> or liquidation and the extent to which their current rights should be restricted…[35]

4.51 SCoLA wrote that a comprehensive review should:

> …consider why we have insolvency law, what goals it can and should aim for and how best to achieve those goals. This should include whether Australia should have a unified insolvency statute (as many other countries have), whether there should be a single insolvency regulator and what the balance between public and private work within insolvency should be (eg should there be a government liquidator?).[36]

4.52 SCoLA added that:

> …one of the first tasks of a root and branch review should be to determine what the goals of an effective modern insolvency law should be. These goals need to be realistic and achievable. There is little point in designing and insolvency regime around unsecured creditor rights and powers if unsecured creditors rarely receive any financial return in insolvencies and hence are rationally apathetic.[37]

4.53 Mr Murray and Professor Harris envisaged a comprehensive review as a staged process:

> …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.[38]

4.54 TMA submitted that a comprehensive review should address the adequacy of the current objectives of the system, and proceed accordingly:

> In our view, this is a key consideration of any review, that is to ensure that the aims and intention of the legislation are clear up front. Further, in our view, this would include consideration of how businesses can be more effectively turned around, with jobs saved, suppliers keeping business and the consequential positive effects on the economy of saving businesses from liquidation.[39]

4.55 Some inquiry participants argued that the government should clearly articulate what it considered the purposes of insolvency law in the terms of reference given to a comprehensive review. Mr Michael Brennan (Offermans) indicated

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35 Mr Neil Hannan, *Submission 54*, p. 1.

36 SCoLA, answers to questions on notice, 23 December 2022 (received 17 February 2023), p. 4.

37 SCoLA, answers to questions on notice, 23 December 2022 (received 17 February 2023), p. 4.

38 Mr Michael Murray and Professor Jason Harris, answers to written questions on notice, 22 December 2022 (received 10 February 2023), p. 1.

39 Turnaround Management Association of Australia, answers to questions on notice, 23 December 2022 (received 10 Februrary 2023), p. 12.

that while he was not opposed to a root-and-branch review, the government would need to first be clear on what it expects from the insolvency system:

> I'm not averse to a root-and-branch review. Given the last one was 30-odd years ago, I think it's well time for us to do it again. The key is understanding what the government wants of the insolvency system. When we talk about the bandaid solution of different bits and pieces that have happened to our legislation over time, it's because the goalposts shift marginally or because of an event like COVID where we try to be all things to all people. That's really why we need to have government direction on what it wants out of the insolvency process.[40]

4.56 Treasury was asked whether a comprehensive review should itself consider the purposes of the insolvency system, or whether this should be a separate pre-review process that would then inform the review terms of reference. Mr Dickson, Treasury, indicated that there would be pros and cons for each approach:

> If you were to establish the objectives of the system and those objectives were agreed by government first then the review team that comes after that has an easier time of thinking about how those objectives would be achieved. I'm really thinking from the perspective of the review team itself. I imagine the review team that then, in contrast to that, was given both the task of setting an objective and then figuring out how to achieve that objective—if it didn't get the first part of that exercise correct itself then it would potentially find itself off course.[41]

Committee view

4.57 The committee recognises that the outcomes of a comprehensive review, and resulting recommendations for reform, will be very much shaped by how the principles and purposes of insolvency law are defined.

4.58 The committee considers that an early task of a comprehensive review should be to consider and report on the appropriate principles and objectives of insolvency law. This would serve as a clear, transparent foundation for the remainder of the review's work, and provide for early and extensive engagement with interested stakeholders and members of the public.

4.59 The committee would expect that a comprehensive review would, in the ordinary conduct of its work, consult with government and seek to understand its views on the objects of insolvency law. It may also be appropriate for the review, after presenting a report on the purposes of insolvency law, to provide the government with an opportunity to respond and affirm or vary the report's findings and recommendations. Moreover, while it is not suggested that the

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40 Mr Michael Brennan, Liquidator and Bankruptcy Trustee, Offermans, *Committee Hansard*, 21 February 2023, p. 44.

41 Mr Tom Dickson, Acting First Assistant Secretary, Market Conduct Division, Treasury, *Committee Hansard*, 1 March 2023, p. 52.

government should seek to pre-define and lock in those purposes in the review terms of reference, the government might still convey a view of those purposes in initiating a review. The committee notes that the ALRC Review of the Legislative Framework for Corporations and Financial Services Regulation provides an example of a review that has proceeded in multiple stages, with the government responding to an early report, while further work continues on the review.

4.60 The committee would also expect that a comprehensive review would have regard to the evidence put in this inquiry, and summarised in this report, as to the purposes of insolvency law.

Recommendation 2

4.61 The committee recommends that the comprehensive review, as part of its early work, consider and report on the appropriate principles and objectives of insolvency law. The committee further recommends that the government respond quickly to this first report of the comprehensive review to allow the comprehensive review to continue with further stages of work in a timely way.

Chapter 5
Harmonisation of corporate and personal insolvency

5.1 This chapter considers the effects of the division between personal and corporate insolvency law, and whether this division reflects the needs of modern Australian business. A central concern in this chapter is the complexity this division can create for small and medium businesses, where the boundaries between personal and corporate debt are often poorly defined.

5.2 In turn, this chapter assesses calls for greater harmonisation of insolvency law, including the implementation of a unified insolvency law administered by a single insolvency regulator.

Overview of the division between corporate and personal insolvency

5.3 The legislative, regulatory and judicial division of personal and corporate insolvency is summarised in *Keay's Insolvency*:

> The insolvency of individuals is governed by the *Bankruptcy Act 1966* (Cth), including Sch 2 of the *Bankruptcy Act*, and the rules, and the *Bankruptcy Regulations 2021* (Cth). This regime is administered and regulated by the Australian Financial Security Authority (AFSA), which houses the government trustee, the Official Trustee in Bankruptcy, the Official Receiver and the Inspector-General in Bankruptcy, along with the Personal Property Securities Register. The relevant courts are the Federal Court of Australia and the Federal Circuit and Family Court of Australia, with the state and territory Supreme Courts having only incidental jurisdiction.
>
> Corporate insolvency is governed by the *Corporations Act 2001* (Cth), including Sch 2 of the Corporations Act, and the rules, and the *Corporations Regulations 2001* (Cth), with the regime regulated by the Australian Securities and Investments Commission (ASIC), among its many other responsibilities. Significant corporate insolvency jurisdiction is conferred specifically on the "Courts" set out in s 57AA of the Corporations Act, being the Federal Court of Australia, the Supreme Courts of the States and Territories. The Federal Circuit and Family Court has no direct corporate insolvency jurisdiction. However, the Corporations Act also gives jurisdiction to "courts" more generally, being any courts, including lower district and county courts.[1]

5.4 Put simply, whether the insolvency process of a business is governed by the personal or corporate insolvency regime depends on the legal form of that business, rather than its economic form.[2] An incorporated company has the

1 Murray and Harris, *Keay's Insolvency*, p. 6.

2 Murray and Harris, *Keay's Insolvency*, p. 9.

benefit of limited liability, meaning 'in the event of business failure, members are not personally liable for the debts of the business and only stand to lose their paid-up share capital'. Incorporated companies are subject to the corporate insolvency regime.[3] Where a business is set up as a sole trader or a partnership[4], there is no legal separation between the business owners and the business, meaning the personal insolvency system may be relevant, even when debts are business-related.[5]

5.5 Australian Bureau of Statistics (ABS) figures show that Australian businesses, which in absolute terms are overwhelmingly small and medium enterprises (SMEs), are about evenly split between companies, on the one hand, and sole traders and partnerships on the other.[6]

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3 Australian Securities and Investments Commission (ASIC), *Submission 29*, p. 8. Trusts are dealt with as part of the insolvent administration of the trustee—if the trustee is natural person, the Bankruptcy Act applies, whereas for a corporate trustee the Corporations Act applies. Although, as discussed further in chapter 12, there is a lack of 'legislative guidance as to how trust assets, liabilities and stakeholders are left to be dealt with as part of the bankrupt person's or insolvency company's estates'. Law Council of Australia, Business Law Section, answers to question on notice Law Council of Australia, Business Law Section, answers to written questions on notice, 23 December 2022 (received 14 February 2023), p. 32.

4 The Society of Corporate Law Academics (SCoLA) advised: 'Insolvent partnerships are regulated by the Partnership Acts in each state and territory that provide rules for dealing with debts owed to external creditors and debts owed between partners. Not all partners may be insolvent even if the firm is insolvent on an accounting basis. Individual insolvent partners for non-partnership debts are regulated by the *Bankruptcy Act 1966* (Cth) while corporate insolvent partners for non-partnership debts are regulated by the *Corporations Act 2001* (Cth).' SCoLA, answers to question on notice SCoLA, answers to questions on notice, 23 December 2022 (received 17 February 2023), p. 7. The Business Law Section of the Law Council of Australia (BLS LCA) explained that over the years there have been conflicting decisions in the case law about when and how the Corporations Act priorities regime, as opposed to provisions in state-based legislation, applies to the winding up of partnerships between corporate partners. See BLS LCA, answers to question on notice, 23 December 2022 (received 14 February 2023), pp. 33–34.

5 Australian Financial Security Authority (AFSA), *Supplementary Submission 7.1*, p. 4.

6 Mr Michael Murray and Dr Rosalind Mason, *Submission 17*, p. 2. In terms of actively trading businesses in the Australian economy, at the end of financial year (FY) 2021–22, there were approximately 1.052 million companies, 798,000 sole proprietors, 232,000 partnerships, and 487,000 trusts. See ABS, 'Counts of Australian Businesses, including Entries and Exits,' Table 10, www.abs.gov.au/statistics/economy/business-indicators/counts-australian-businesses-including-entries-and-exits/jul2018-jun2022. Using ABS definitions, 97.5 per cent of businesses are considered small by employment size (less than 20 employees), 2.3 per cent medium (20 to 199 employees) and 0.2 per cent large (200+ employees). By turnover, 98 per cent of Australian businesses would meet the common Australian Taxation Office definition of turnover of $10 million or less, with the overwhelming majority of those in fact being less than $2 million turnover. Australian Small Business and Family Enterprise Ombudsman (ASBFEO), *Contribution to Australian Business Numbers*, August 2022, www.asbfeo.gov.au/sites/default/files/2022-08/Contribution%20to%20Australian%20Business%20Numbers_August%202022%20_4.pdf.

5.6 If a company director has provided a personal guarantee for company debts, they are also personally liable for those debts, and subject to the Bankruptcy Act and the personal insolvency regime.[7]

5.7 The division between the personal and corporate insolvency systems appears to derive from historical circumstance, rather than being reflective of any specific policy rationale or intent. Mr Gavin McCosker, ASFA, explained:

> Bankruptcy was previously a courts-based process and relies on a federal head of power under the Constitution, whereas corporate insolvency relies on referred powers from the states under the Corporations Act regime. That's just one of the historical factors leading to the current situation.[8]

5.8 Mr Michael Murray and Professor Rosalind Mason similarly advised that the division in insolvency law was 'not based upon policy but on a constitutional quirk at federation based on a limited view of the federal power in respect of corporations, since discounted'.[9]

5.9 The Department of the Treasury (Treasury) agreed that the division in insolvency law might be attributed to historical factors, rather than any deliberate policy rationale in the first instance.[10] While not disagreeing, Ms Zoe Irwin, from Treasury, also referred to 'more scope for complexity in the corporate space' relative to personal insolvencies, providing some current logic for maintaining separate systems.[11] On notice, Treasury confirmed that personal insolvencies typically involve much smaller amounts than corporate insolvencies (see Figure 4.1 below), which is likely relevant to complexity.

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7 AFSA, *Supplementary submission 7.1*, p. 13.

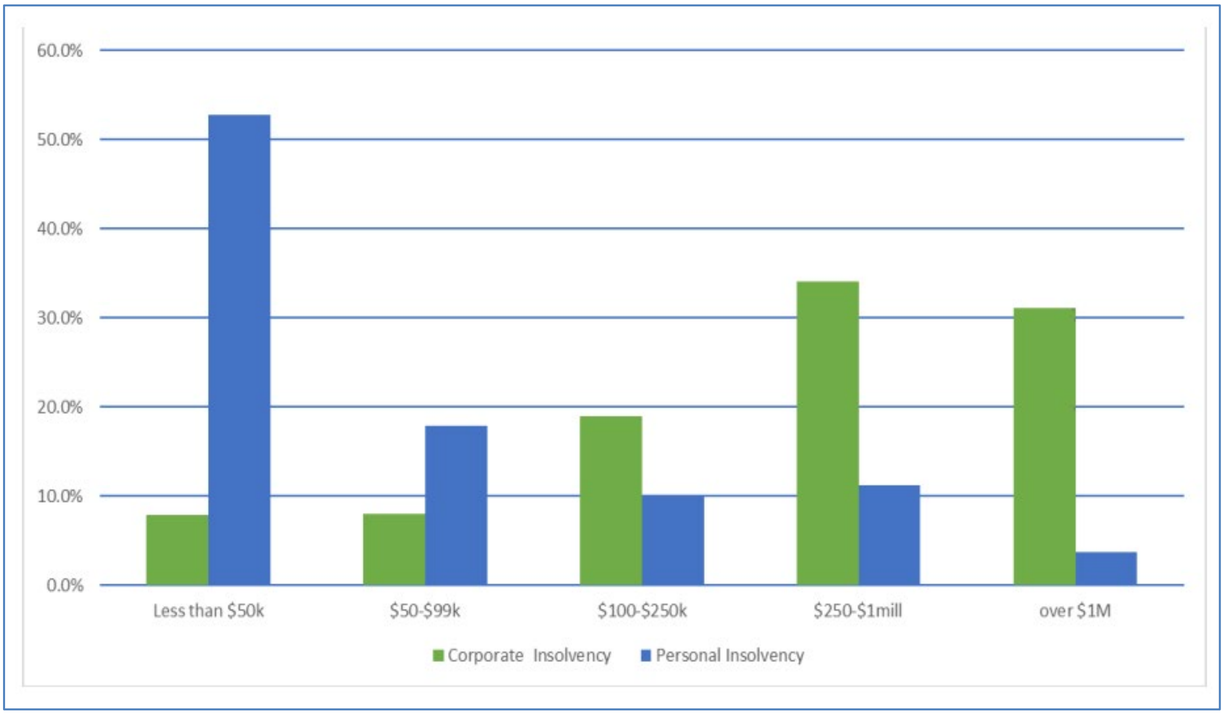
8 Mr Gavin McCosker, Deputy Chief Executive, AFSA, *Committee Hansard*, 13 December 2022, p. 51.

9 Mr Michael Murray and Dr Rosalind Mason, *Submission 17*, p. 6. For a more detailed explanation of this point, see SCoLA, answers to questions on notice, 23 December 2022 (received 17 February 2023), p. 7.

10 Mr Tom Dickson, Assistant Secretary, Corporations, Treasury, *Committee Hansard*, 13 December 2022, p. 10.

11 Ms Zoe Irwin, Acting Director, Financial Reporting and Insolvency Unit, Treasury, *Committee Hansard*, 13 December 2022, p. 10. On this question of the relative complexity of corporate and personal insolvency, also see Murrays Legal, 'The Respective Complexities Of Corporate And Personal Insolvency,' 15 May 2023, https://murrayslegal.com.au/blog/2023/05/15/the-respective-complexities-of-corporate-and-personal-insolvency.

Figure 4.1: Comparison of estimated total liabilities in corporate and personal insolvency



Source: Treasury, answer to question on notice (Treasury013), received 22 March 2023, p. [2].

5.10 Professor Mason made the point that the differences in treatment of individuals in bankruptcy and directors of insolvent companies had deep historical origins. This, she argued, underlined the need for a comprehensive review with proper regard to the structure of the modern Australian economy:

> The bankruptcy law has been around since the 1200s, and it began with worrying about absconding individuals, whereas our corporate insolvency provisions were introduced through the Corporations Act, which came about in the 1800s, for different reasons. That just underpins for me the importance of Australia looking at insolvency as a whole—it having arisen out of historical circumstance—with a more policy-driven, data-driven and thought-through approach to looking at this aspect of the cycle of business—and for individuals, given that we are very much reliant on the credit economy.[12]

Business-related debt in personal insolvency

5.11 While personal insolvency relates to individuals, the committee heard that the debts involved are often business-related. ASFA explained that the personal insolvency system includes:

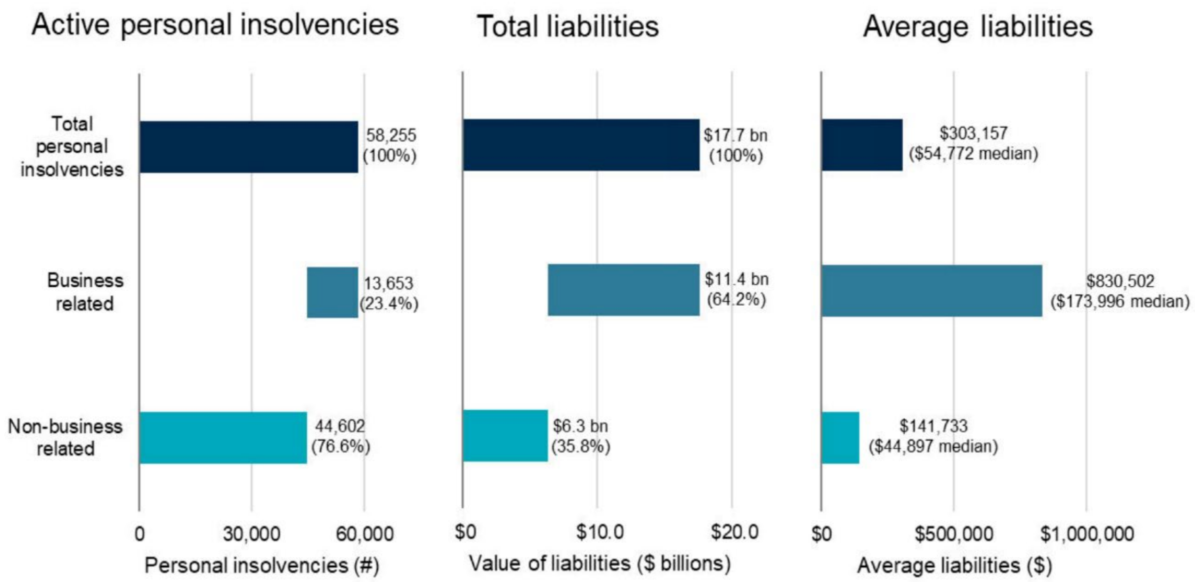
> …individuals and business-related insolvencies such as sole traders and partnerships. This may include company directors and/or secretaries who have given personal guarantees. […]

12 Dr Rosalind Mason, Private capacity, *Committee Hansard*, 1 March 2023, p. 24.

> In 2021-22 we had active regulatory oversight of $17.7 billion in liabilities, of which $11.3 billion was business-related debt, with $10 billion addressed through bankruptcy. Business-related personal insolvencies have accounted for close to 38% of all bankruptcies since 2007. This has ranged from around 6,000 – 9,000 bankruptcies over the decade or so prior to COVID.[13]

5.12 While approximately two-thirds of the total system debt in the personal insolvency space is business-related (that is, $11.4 billion of $17.7 billion), AFSA also advised that only 23.4 per cent of active personal insolvencies are business-related. Average debt for a business-related personal insolvency is $830,502, approximately 5.8 times larger than the average debt in a non–business–related insolvency ($141,733) (see Figure 4.2, below).[14]

Figure 4.2: Distribution of debtor liabilities by business-related personal insolvencies



Source: AFSA, Supplementary submission 7.1, p. 13.

Does the division of insolvency systems reflect business practice?

5.13 A range of inquiry participants argued the division of personal and corporate insolvency is inconsistent with the operating reality of many SMEs, where the lines between personal and business debt were often unclear.

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13 AFSA, *Supplementary submission 7.1*, p. 4. Bankruptcy accounts for approximately 50 per cent of administrations and 75 per cent of the liabilities for which AFSA has regulatory oversight; the other main type of personal insolvency administration, a debt agreement, accounts for approximately 48 per cent of administrations and 18 per cent of liabilities (the balances here being made up of the far smaller categories of deceased estates and personal insolvency agreements). Debt agreements are much less likely than bankruptcies to be business-related, with only approximately 7 per cent of debtors and 10 per cent of liabilities business-related. For detail, see AFSA, *Supplementary submission 7.1*, p. 14.

14 AFSA, *Supplementary submission 7.1*, p. 13.

5.14 Mr Bruce Billson, of the Australian Small Business and Family Enterprise Ombudsman (ASBFEO), explained that for small businesses, the interconnections between business and personal interests had implications for how those businesses engaged with the insolvency system:

> The law basically says we've got the oil of an enterprise and the water of an individual. In the space we operate in, virtually everything is salad dressing—it's a combination. There are 2.5 [million] actively trading enterprises and about 950,000 are incorporated. […] The vast majority aren't incorporated. There's a range of other structures and many of them inherently have that blend, that mash together, of business interest and personal interest. Even if you are incorporated, some of the broader policy settings force that anyway. Just under half of all small businesses accessing finance for their business have their home on the line, so there's a finance practice to create that interconnection.[15]

5.15 Where a business uses a partnership structure, further complexity can arise. Dr Sulette Lombard observed some of the confusion that occurs when companies that were operating in partnership with one another are liquidated, and whether the Corporations Act or the Bankruptcy Act applies:

> The answer to that question has far-reaching consequences. If we say that it's the Corporations Act, we have the super priority for employee claims, for example. If we say, 'No, it's not the Corporations Act distribution principles that apply,' but we use the partnership legislation and Bankruptcy Act then none of that will apply—section 561 and the super priority, for example. We have court cases with differing opinions. In some instances, the court has said, 'Corporations Act,' and in the others it has said, 'No, it's not; it's the Bankruptcy Act.' So there's uncertainty.
>
> In my mind, it seems odd that you have companies that are being liquidated, but they're not subject to the distribution rules under the Corporations Act. And we have this other bizarre thing in the Corporations Act called the part 5.7 body, which says that a part 5.7 body is defined as a partnership et cetera that will consist of more than five members. So, if you have a partnership with more than five members, potentially it will be subject to the Corporations Act. But if it's not more than five members—say, if it's three or four members—it's not subject to the Corporations Act. That doesn't seem right.[16]

5.16 The Society of Corporate Law Academics (SCoLA) noted that while the committee’s inquiry was into corporate insolvency, for many Australian

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15 Mr Bruce Billson, Ombudsman, Australian Small Business and Family Enterprise Ombudsman, *Committee Hansard*, 13 December 2022, p. 28.

16 Dr Sulette Lombard, Private capacity, *Committee Hansard*, 21 February 2023, p. 4. Dr Lombard also pointed to a recent Western Australian case, Woodhouse v Francis [No 2] [2022], as illustrating the confusion and inconsistencies around distribution rules that can arise as a consequence of the separation of the corporate and personal insolvency laws. Dr Sulette Lombard, Private capacity, *Committee Hansard*, 21 February 2023, p. 7.

businesses the Corporations Act was not relevant (or solely relevant) to their experience of insolvency:

> The majority of micro, small and medium businesses (MSMEs) are conducted as sole traders or partnerships, not companies, and so these will come within the Bankruptcy Act 1966 (Cth) and not the Corporations Act 2001 (Cth). Any changes that are aimed at addressing MSME insolvency need to take this into account. Even if an MSME is conducted using a company form it is likely that the company's affairs may overlap with the individual owner/manager's affairs. The use of personal guarantees by company directors and shareholders for the debts of the company is widespread throughout the economy. There is little point in seeking to save a company in financial distress if in so doing the business owner will be sent into bankruptcy. When a small business goes into insolvency, the current law requires that different people be appointed as corporate liquidators and personal bankruptcy trustees, which just increases the level of cost and complexity involved in what is likely a small asset pool of personal and corporate assets.[17]

5.17 Small businesses, AFSA wrote, 'frequently lack the resources and expertise to effectively understand and navigate complex and, in particular for small creditors, costly insolvency systems'.[18]

> The failure of a small business, incorporated or not, has a financial impact on the owners or (if incorporated) the directors of that business, as well as the creditors. These consequences can lead to subsequent personal insolvency of a business's owners, directors and/or its creditors.[19]

5.18 The Australian Banking Association (ABA) acknowledged some of the complexities that arise from having two separate insolvency regimes when debtors were subject to both regimes. It noted that the *Banking Code of Practice* (Banking Code) makes allowance for this, and provides that business assets should generally be realised before pursuing a guarantor for individual assets (typically, their residence):

> There are certainly steps that have been taken over the last few years where the instances of guarantors losing their home have been reduced because secured creditors are far more focused on recovery against the business assets rather than the individual assets. Notwithstanding that, there are definitely cost complexities [from] having the two regimes separate—that is, having a voluntary administrator or receiver deal with the business assets, and, if a demand is made against the guarantor to settle their obligation and

17 Society of Corporate Law Academics, *Submission 37*, pp. 1-2. A similar point is made in Mr Michael Murray and Dr Rosalind Mason, *Submission 17*, pp. 1-2. On notice, SCoLA explained that there have been cases in Australia that 'have allowed bankruptcy trustees to also take appointments as liquidators of associated companies, particularly where there is an overlap between the business and financial affairs of the individual and the company'. SCoLA, answers to questions on notice, 23 December 2022 (received 17 February 2023), p. 2.

18 AFSA, *Supplementary submission 7.1*, p. 15.

19 AFSA, *Supplementary submission 7.1*, p. 15.

> action is taken, that would follow the personal insolvency regime. There definitely is an opportunity to consider that in the future—whether that's the right way of dealing with that or whether actually there is an opportunity to combine those where, at the heart of it, there is only one individual party.[20]

5.19 The Australian Restructuring Insolvency and Turnaround Association (ARITA) argued that the division between personal and corporate insolvency was the primary cause of unnecessary complexity in system. This was, it contended, especially the case for SMEs, leading to excessive cost, reduced incentives and likelihood of business turnaround, and low returns to creditors.[21]

5.20 Mr Michael Brereton, ARITA, emphasised the challenges SME business owners face as a result of the division between corporate and personal insolvency:

> At the moment you have this complicated scenario where many small-business owners have to deal with both a registered liquidator that's administered by ASIC and the bankruptcy trustee that's administered by AFSA. It's very, very complicated. It makes it extremely complicated for those individuals in the SME space and generally in small business for them to try and work out how to navigate their way through financial difficulty while having to deal with two different practitioners administered by two different bodies. It's just extremely complicated.[22]

5.21 Elsewhere, ARITA argued:

> By separating personal from corporate insolvency, and failing to address trusts and partnerships at all, the regime as a whole fails to recognise the underlying legal and economic relationships within most Australian businesses.[23]

Prior calls for and steps toward harmonisation

5.22 Previous reviews have considered the potential benefits of greater harmonisation of personal and corporate insolvency law, up to and including the unification of the two systems under a single law. Notably, the Harmer Report suggested that despite apparent advantages to a unified insolvency law, it was not a matter of 'major significance' or high priority:

> The integration of individual and corporate insolvency into a single Act may be more efficient and result in cost savings through the use of common procedure. A single statutory scheme, controlled by one government, would also allow better control of policy and changes to the legislation could be made more expeditiously. On the other hand, there are many areas peculiar

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20 Mr Ross McNaughton, Group Head of Credit Restructuring, Assurance and Model Risk, Westpac (appearing with Australian Banking Association), *Committee Hansard*, 28 February 2023, p. 7.

21 Australian Restructuring Insolvency and Turnaround Association (ARITA), *Supplementary Submission 36.1*, p. 3.

22 Mr Michael Brereton, President, ARITA, *Committee Hansard*, 14 December 2022, p. 3.

23 ARITA, *Supplementary Submission 36.1*, p. 20.

> to individuals and corporations which may make complete fusion difficult, if not impossible. The issue of which courts would exercise jurisdiction would also need to be resolved. There does not appear to be any overriding need for unity. Substantive reforms in particular areas of insolvency law are more important. However, it is desirable to promote uniformity of the substance of the provisions relating to individual and corporate insolvency.[24]

5.23 This committee's 2004 'stocktake' of corporate insolvency, acknowledged that a merger of the two systems would be a 'protracted and difficult exercise,' and declined to make a 'firm recommendation' on the matter. It nonetheless concluded that a possible merger should remain an option for government consideration. It recommended that the government 'ensure, particularly when contemplating changes to the law, that the two streams of Australia's insolvency laws, personal bankruptcy and corporate insolvency, harmonise where possible'.[25]

5.24 The Senate Economics References Committee 2010 inquiry into liquidators and administrators also addressed the potential benefits of harmonisation of personal and corporate insolvency law. It recommended that the government commission the Australian Law Reform Commission (ALRC) to inquire into the opportunities to harmonise insolvency laws.[26] The government noted the recommendation, while indicating that it did not consider an ALRC review necessary, given other 'significant work' being progressed by relevant government agencies to achieve greater harmonisation.[27]

5.25 In its 2015 review, the Productivity Commission again considered the merits of unifying corporate and personal insolvency within a single legislative and regulatory structure. The Productivity Commission concluded that the benefits of doing so would be marginal. Appearing before this inquiry,

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24 Australian Law Reform Commission, Report No. 45, *General Insolvency Inquiry*, Summary of Report (1988), pp. 2, 14. Several major government reviews in the 1990s again considered the potential harmonisation of corporate and personal insolvency, largely with a view to merging the registration and regulation of insolvency practitioners. See Treasury, *Review of the Regulation of Corporate Insolvency Practitioners: Report of the Working Party*, June 1997, pp. 66–69, available at treasury.gov.au/sites/default/files/2019-03/full-16.pdf.

25 Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: a Stocktake* (June 2004), pp. 227–228. The government responded by noting that AFSA (then the Insolvency and Trustee Service Australia (ITSA)) and ASIC had entered into a Memorandum of Understanding and would continue to consult on the development of insolvency policy.

26 Senate Economics References Committee, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework,* September 2010, p. 149.

27 Government response to the Senate Economics References Committee report, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework,* www.aph.gov.au/~/media/wopapub/senate/committee/economics_ctte/completed_inquiries/2008_10/liquidators_09/govt_response/govt_response_liquidators_pdf.ashx.

Mr Michael Brennan, Productivity Commissioner, questioned if enough had changed since 2015 to justify a different conclusion. He suggested changes in economic activity—for example, increases in platform work and the gig economy—were unlikely 'big enough to warrant a change of view'. He noted the sizable commitment of time and resource likely required to achieve such a reform, underlining the need for caution:

> I think there's the question about whether or not the intermediate step of just trying to get greater consistency between the two regimes is a better solution than trying to bring it all together under one act and a single regulator.[28]

Insolvency Law Reform Act 2016 (ILRA)

5.26 Some steps toward greater harmonisation of the personal and corporate insolvency frameworks were taken with the ILRA. In addition to other reforms, the ILRA 'introduced into corporate insolvency many of the processes of bankruptcy law—the registration and misconduct processes, voting mechanisms, the replacement of liquidators and more'.[29]

5.27 ARITA noted the then government's effort toward greater alignment of the Corporations Act and Bankruptcy Act through the ILRA, but added:

> …before the legislation had even commenced, we saw a drifting apart of the requirements as each regulator needed amendments to cater for their particular approaches.[30]

5.28 As Mr Murray and Professor Mason noted, as part of its development of the ILRA the then government contemplated, but ultimately decided against, aligning the requirements placed on non-compliant directors with those of non-compliant personal insolvents.[31]

International trends, comparisons and best-practice guidelines

5.29 Internationally, there has been a growing focus on the need for insolvency law to recognise the intermingling of personal and corporate finances for SMEs. For example, the World Bank's *Principles for Effective Insolvency and Creditor/Debtor Regimes* refers to the need for a simplified insolvency regime for SMEs. Simplified regimes should allow 'all personal and business debts of a natural person [to] be included in simplified insolvency proceedings'. A simplified insolvency system should also 'address, including through procedural

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28 Mr Michael Brennan, Chair, Productivity Commission, *Committee Hansard*, 13 December 2022, pp. 17-18.

29 Murray and Harris, *Keay's Insolvency*, p. 7; Attorney-General's Department, answer to question on notice (AGD005), 22 December 2022 (received 7 February 2023), p. 1.

30 ARITA, *Submission 36*, p. 36.

31 Mr Michael Murray and Professor Rosalind Mason, answers to questions on notice, 1 March 2023 (received 16 March 2023), pp. 2-3.

consolidation or coordination of linked proceedings, the treatment of personal guarantees provided for business needs of the MSE [micro to small enterprise] debtor'.[32]

5.30 The United Nations Commission on International Trade Law (UNICTRAL) has also recommended that:

> States should ensure that all debts of an individual entrepreneur are addressed in a single simplified insolvency proceeding unless the State decides to subject some debts of individual entrepreneurs to other insolvency regimes, in which case procedural consolidation or coordination of linked insolvency proceedings should be ensured.[33]

5.31 Like witnesses to this inquiry, UNICTRAL noted that for 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.[34]

5.32 The committee also received evidence about other countries pursuing harmonisation of corporate and personal insolvency law. For example, Deloitte advised that in 2020 Singapore:

> …implemented significant reforms which consolidated their personal and corporate insolvency and restructuring laws into a single piece of legislation which had the objective of simplifying and modernising their insolvency framework.[35]

5.33 A single insolvency law and insolvency regulator is standard in many other common law countries, including Canada, the United States, and now, as noted above, Singapore.[36] Mr Tom Dickson, Treasury, noted that Australia appeared

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32 World Bank, *Principles for Effective Insolvency and Creditor/Debtor Regimes*, 'Part C: Legal Framework or Insolvency, subsection C19: Simplified Insolvency Proceedings,' (2021), pp. 30–31.

33 United Nations, *UNCITRAL Legislative Guide on Insolvency Law, Part 5: Insolvency law for micro- and small enterprises* (2022), p. 51.

34 United Nations, *UNCITRAL Legislative Guide on Insolvency Law, Part 5: Insolvency law for micro- and small enterprises* (2022), p. 51. See also: Mr Michael Murray and Dr Rosalind Murray, *Submission 17*, p. 8.

35 Deloitte, *Submission 32*, p. 7.

36 Mr Michael Murray and Professor Jason Harris, answers to written questions on notice, 22 December 2022 (received 10 February 2023), p. 2.

to be an 'outlier in that we have separate corporate and personal insolvency systems'.[37]

A single insolvency system?

5.34 The committee received a range of evidence suggesting that the bifurcation in personal and corporate insolvency was problematic and should be addressed.

5.35 ARITA noted that the Harmer Report had recommended against unification of insolvency laws. However, ARITA argued that changes to the economy since, including the growing complexity of small business and the rise of the gig economy, and changes in statute and case law, created a strong case for reform now. ARITA further suggested the Productivity Commission's 2015 review had only briefly considered the possibility of unifying the two systems before recommending against it.[38]

5.36 While acknowledging the work involved in the creation of a single insolvency law, ARITA submitted that 'at a conceptual level the bringing together of the two frameworks may not be too difficult'.[39] To demonstrate the point, it provided a diagram showing the structural similarities between the two regimes (as reproduced below at Figure 4.3).

5.37 ARITA also argued that 'bringing the regimes together would facilitate a common, consistent set of definitions, a common approach to priorities for business insolvency, a single approach to professional regulation and a single regulator'.[40] ARITA further suggested that the ALRC's current review of the legislative framework of the corporations and financial services regulation meant 'now is an ideal time to remove insolvency from the Corporations Act and develop a fit for purpose, unified insolvency law'.[41]

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37 Mr Tom Dickson, Assistant Secretary, Corporations, Treasury, *Committee Hansard*, 13 December 2022, p. 10.

38 ARITA, *Submission 36*, p. 36.

39 ARITA, *Submission 36*, p. 36.

40 ARITA, *Submission 36*, p. 36.

41 ARITA, *Submission 36*, p. 34.

Figure 4.3: Comparison of structures of corporate and personal insolvency systems

Source: ARITA, Submission 36, p. 37.

5.38 As noted previously, SCoLA argued that the division of corporate and personal insolvency is not reflective of how smaller businesses in Australia are structured and financed, and submitted:

> A modern insolvency law needs to acknowledge the special characteristics of MSMEs and provide streamlined and flexible options for addressing their financial problems. *We recommend consideration be given to forming a single insolvency regulator under a uniform Insolvency Act, which is what exists in most common law countries.*[42]

5.39 Mr Murray and Professor Mason addressed their submission primarily to the less harsh obligations and duties placed on non-compliant directors relative to those applying to non-compliant bankrupts.[43] Mr Murray explained that the obligations on a director to assist a liquidator in providing books and records and a statement of assets and liabilities was a somewhat 'reactive obligation which requires enforcement by the liquidator or by ASIC'. In contrast, in bankruptcy 'there's a severe and immediate consequence of a bankrupt not having prepared their statement of affairs or provided their books and records'.[44] Mr Murray explained that where small business directors had personal liabilities in respect of their corporate business operations and the company itself had separate liabilities, the director could be exposed to two sets of obligations:

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42 Society of Corporate Law Academics, *Submission 37*, pp. 1–2 (emphasis in original).

43 Mr Michael Murray and Dr Rosalind Mason, *Submission 17*, p. 1.

44 Mr Michael Murray, Private capacity, *Committee Hansard*, 1 March 2023, p. 23.

> …if the director is bankrupt, there's one set of obligations in respect of the liquidator and there's another set of obligations, which are quite different, in respect of the trustee. As a matter of principle, we see that as requiring attention, as being an example, I think, of many other such inconsistencies between corporate and personal insolvency which we say should be remedied in any root-and-branch review.[45]

5.40 Mr Murray and Professor Mason acknowledged the challenges of unwinding 'the settled approaches' of personal and corporate insolvency. Nonetheless, they contended that addressing this 'would be necessary for any "holistic" or "root and branch" insolvency law reform'.[46]

5.41 Discussing the potential purposes of a comprehensive review, Ms Jill Lawrence, of Chartered Accountants Australia and New Zealand (CAANZ), explained the priority for CAANZ's members would be:

> …the ability to look through corporate insolvency to personal insolvency for the small businesses. That reflects their business operating model, in which, to even start, a lender will demand that you put up personal guarantees, such as by putting your house on the line. Yet, if the business fails, that registered liquidator is unable to look through to the personal assets. You have to go through the two insolvency systems.[47]

5.42 MinterEllison questioned the split in insolvency systems and submitted that improvements could be realised through 'harmonisation and simplification [of the] various insolvency laws relating to companies, individuals, trusts and partnerships'. To this end, it recommended:

> …the conduct of a further, more comprehensive and holistic review of Australia's corporate and personal insolvency laws, with a view to making meaningful recommendations to harmonise and simplify those laws.[48]

5.43 MinterEllison added that the referral of power since the Harmer Report from the states to the Commonwealth to legislate with respect to corporations means it is no longer necessary to 'maintain any legislative schism' with respect to personal and corporate insolvency:

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45 Mr Michael Murray, Private capacity, *Committee Hansard*, 1 March 2023, p. 23. Also see Michael Murray and Rosalind Mason, 'Harmonising the responsibilities of directors of insolvent companies with those of bankrupts', *Insolvency Law Bulletin* (February 2023), p. 79, provided to committee as an attachment to a response to questions on notice, Mr Michael Murray and Professor Rosalind Mason, answers to questions on notice, 1 March 2023 (received 16 March 2023).

46 Michael Murray and Rosalind Mason, 'Harmonising the responsibilities of directors of insolvent companies with those of bankrupts', *Insolvency Law Bulletin* (February 2023), p. 80, provided as part of Mr Michael Murray and Professor Rosalind Mason, answers to questions on notice, 1 March 2023 (received 16 March 2023).

47 Ms Jill Lawrence, Senior Policy Advocate, Chartered Accountants Australia and New Zealand, *Committee Hansard*, 28 February 2023, p. 39.

48 MinterEllison, *Submission 4*, p. 1.

> If Australian insolvency legislation is to be rewritten, consideration should be given to whether such legislation should be contained within a single enactment encompassing all of the current matters legislated for in the Corporations Act, [*Cross-Border Insolvency Act 2008*] and Bankruptcy Act in an appropriately structured and streamlined manner.[49]

5.44 A range of other inquiry participants also argued that the unification of corporate and personal insolvency law should be the focus of a comprehensive review.[50]

A single insolvency regulator?

5.45 A range of witnesses also recommended the establishment of a unified regulator for corporate and personal insolvency, for the most part as a corollary to broader recommendations for a unified insolvency law.

5.46 Like the idea of a unified insolvency law, the possibility of a single insolvency regulator has been raised previously. In 2010, the final report of the Senate Economics References Committee inquiry into liquidators and administrators recommended the 'the corporate insolvency arm of ASIC be transferred to the ITSA [as AFSA was then known] to form the Australian Insolvency Practitioners Authority'.[51] That inquiry was focused on the conduct and regulation of insolvency practitioners, and less so on the regulation of the insolvency regime in its totality. Nonetheless, the committee did point to the 'opportunity to treat insolvency matters more holistically', and noted the committee's view:

> …that corporate insolvency in Australia needs more priority and prominence in the regulatory framework. This will not be achieved through more funding and responsibilities for the same overburdened agency [ASIC].[52]

5.47 The government rejected the recommendation, pointing to the upfront costs of merging the regulators. The government also observed that the regulation of personal and corporate insolvency involved broader policy considerations than those addressed in the committee's report. The government responded that the:

> …removal of the responsibility for regulation of corporate insolvency from the corporate regulator would be expected to result in corporate insolvency losing its important connections with others parts of ASIC, for example in relation to major corporate administrations, regulation of insolvent trading

49 MinterEllison, *Submission 4*, p. 2.

50 Associate Professor Mark Wellard, Private capacity, *Committee Hansard*, 1 March 2023, p. 11; Dr Sulette Lombard, Private capacity, *Committee Hansard*, 21 February 2023, pp. 3–4; SV Partners, *Submission 50*, pp. 4, 6; DyeCo Solvency & Turnaround, *Submission 13*, p. 2; Australian Institute of Credit Management, *Submission 9*, p. [9].

51 Senate Economics References Committee, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework,* September 2010, p. 148.

52 Senate Economics References Committee, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework,* September 2010, p. 148.

> and of director and corporate misconduct that may have been engaged in leading up to, or during, an insolvency event.[53]

5.48 Some witnesses to this inquiry not only questioned the need for separate regulators for corporate and personal insolvency, but also argued that a specialist regulator would be better suited to the regulatory task than ASIC. The Institute of Public Accountants submitted that in its view:

> …ASIC's remit is too broad, and ASIC simply does not have the resources or the inhouse expertise to adequately regulate the corporate insolvency sector. Also, there is no compelling reason why corporate insolvency and personal bankruptcy should not be jointly dealt with. […]
>
> Our recommendation is that the insolvency function (both corporate and personal bankruptcy) should be moved to a specialist regulator which has the powers, resources, and expertise to regulate the entire sector. This should include the power to arbitrate between parties and to make determinations on the day to day actions currently carried out by the Courts. In this way it could vastly reduce legal costs and be more timely in its processes. This would present a significant benefit for many small businesses and make the practice of insolvency more attractive for professionals.[54]

5.49 ARITA, alongside its call for a unification of insolvency law, called for a new specialist insolvency regulator with responsibility for both corporate and personal insolvency matters. It noted that the United Kingdom took this approach with its Insolvency Service.[55] ARITA was critical of how ASIC has performed its regulatory task in relation to insolvency, and suggested AFSA had proven more effective, particularly in terms of its regulatory engagement performance. For this reason, ARITA recommended the proposed new regulator be modelled on AFSA.[56]

5.50 ARITA acknowledged a new agency would involve some cost to the Commonwealth, but added:

> …we do not think these will be any greater than those encountered with other administrative re-organisations regularly undertaken by the Commonwealth, such as those that occurred after the last election. Further, there is a real opportunity to create an organisation focused on insolvency and turnaround matters.
>
> Whilst ARITA is firmly of the view that a single insolvency law is the best option available to the Australian economy, even if that law reform option was not chosen, there remains merit in a single agency being responsible for both personal and corporate insolvency law. The merit of this is self-evident:

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53 Government response to the Senate Economics References Committee report, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework*.

54 Institute of Public Accountants, *Submission 62*, p. 10.

55 ARITA, *Submission 36*, p. 38.

56 ARITA, *Submission 36*, pp. 70–77.

> greater efficiency, better engagement, removal of duplication of agencies and lower costs to the community.[57]

5.51 Even setting aside the question of different regulatory regimes for personal and corporate insolvency, the BLS LCA suggested the spread of regulators across the corporate insolvency landscape added cost and complexity to the system:

> …it is broadly difficult to understand why the corporate insolvency regime is administered by so many different regulators in so many different respects. The PPSR [Personal Property Securities Register], for example, is overseen by AFSA, the personal insolvency regulator, rather than ASIC. Necessarily enough, practitioners need to deal with other arms of government, such as the ATO, but is unclear why many them need to be in different departments. The administration of the FEG [Fair Entitlements Guarantee] regime has been moved between the Department of Jobs and Small Business, the Attorney-General's Department and then back to the Department of Employment and Workplace Relations in its short life. Those disparate regulators contribute to the time and cost inefficiencies associated with the regime.[58]

5.52 While calling for a broader harmonisation of corporate and personal insolvency law, the BLS LCA submitted that whether or not this occurred it would be:

> … sensible to consider that all insolvency matters, including corporate and personal insolvency, personal property security matters, the FEG regime and other relevant matters are dealt with by a single competent regulator under a single department.[59]

5.53 The committee also received evidence from a range of other witnesses in support of a single insolvency regulator, in varying degrees with a view to a broader harmonisation of insolvency law.[60]

5.54 ASIC detailed a range of considerations that would likely be relevant in the instance the integration of personal and corporate insolvency regulators and regulation was considered, including:

- whether the integration would be coupled with changes to the personal and corporate insolvency regimes;
- would efficiencies in overall workload be achieved, and what would be the impact on resource demands;
- would Registered Liquidators and Registered Trustees remain as two separate regulated populations;

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57 ARITA, *Submission 36*, p. 38.

58 Law Council of Australia, Business Law Section, *Submission 30*, p. 52. Also see Mr Christopher Pearce, Chair, Insolvency & Restructuring Committee, Business Law Section, Law Council of Australia, *Committee Hansard*, 14 December 2022, p. 32.

59 Law Council of Australia, Business Law Section, *Submission 30*, p. 52.

60 Deloitte, *Submission 32*, p. 12; DyeCo Solvency & Turnaround, *Submission 13*, p. 9; Australian Institute of Credit Management, *Submission 9*, p. [8]; Condon Advisory Group, *Submission 61*, p. 3.

- would the single regulator include an official liquidator function in relation to corporate insolvency, funded by government, and what would this mean for the insolvency profession;
- would there still be a need to provide funding through the Assetless Administration Fund;
- would the regulator be responsible for investigating all misconduct related to corporate insolvency, 'and, in the event the regulator is not ASIC, how would this relate to ASIC's jurisdiction'; and
- other administrative and funding considerations.[61]

5.55 Noting the complexities involved, ASIC submitted that any new model would need to deliver clear benefits compared to the status quo.

5.56 ASIC cautioned that while some international jurisdictions have a single insolvency regulator for corporate and personal insolvency, direct comparisons were difficult given that in comparable jurisdictions with a single regulator:

- the regulator is not required to supervise the conduct of insolvency professionals in their jurisdiction, as that is managed by a professional body which acts as a registration and disciplinary body;
- the regulator is instead responsible for overseeing the professional body, rather than the regulated population; and
- the government insolvency services provided by an 'official trustee' (or equivalent) are generally performed as a last resort.[62]

5.57 AFSA did not address recommendations for a single insolvency regulator. However, it explained that it already 'maintains system surveillance' of the intersections between, on the one hand, personal insolvency and personal property securities (which it also regulates), and, on the other, corporate insolvency. This surveillance includes engagement with ASIC, along with relevant policy agencies and peak bodies.[63]

A single policy department?

5.58 While making the case for a broader reform process to address the division of corporate and personal insolvency law, Mr Murray and Professor Mason acknowledged 'the legal difficulties of unwinding a hundred years of not having a joint system'.[64] They suggested a 'soft law' pragmatic alternative, which could be pursued independent of any comprehensive review. This:

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61 ASIC, *Submission 29*, pp. 59–60.

62 ASIC, *Submission 29*, p. 60.

63 AFSA, *Submission 7*, p. 1.

64 Mr Michael Murray, Private capacity, *Committee Hansard*, 1 March 2023, p. 29.

> … would be to move personal insolvency policy and AFSA to Treasury, which would assist in comparing and aligning personal and corporate insolvency law in regulating debtor and director conduct …[65]

5.59 Asked about the possibility of consolidating responsibility for insolvency policy within a single department, the Attorney-General's Department advised that nothing in the current arrangements precluded effective policy engagement between departments. It added:

> Notwithstanding the interaction of personal and corporate insolvency, each system performs a particular function and has a different focus. The benefits of any consolidation of the two policy systems must be carefully considered. This would include an analysis of policy, regulatory and legislative impacts of any consolidation.[66]

5.60 It might be noted that prior to 1996 corporate insolvency was dealt with by the Attorney-General's Department, along with bankruptcy.[67]

Views from a personal insolvency perspective

5.61 Evidence received by the committee would suggest that reforms, including steps toward greater harmonisation of corporate and personal insolvency, might also find support from stakeholders working in personal insolvency.

5.62 AFSA noted that its stakeholders would appear to support a reform process:

> Our stakeholder engagement and system surveillance activities suggest a program of significant legislative reform will be supported. There is an appetite to:
>
> - streamline requirements for people struggling with small amounts of debt to allow practitioner and regulatory activity to focus on significant risks to the credit system and allow debtors and creditors to swiftly return their focus to more productive economic activities
> - enhance access to quality pre-insolvency advice to increase a person's chances of managing their financial obligations and making informed decisions best suited to their needs and raise awareness of fee-free advisors such as Financial Counsellors

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65 Mr Michael Murray and Dr Rosalind Mason, *Submission 17*, p. 8; Mr Michael Murray and Dr Rosalind Mason, *Committee Hansard*, 1 March 2023, p. 25. Also see Michael Murray and Rosalind Mason, 'Harmonising the responsibilities of directors of insolvent companies with those of bankrupts', *Insolvency Law Bulletin* (February 2023), p. 80, provided as part of Mr Michael Murray and Professor Rosalind Mason, answers to questions on notice, 1 March 2023 (received 16 March 2023).

66 Attorney-General's Department, answer to question on notice (AGD008), 1 March 2023 (received 21 March 2023), p. 1; Treasury, answer to question on notice (Treasury011), 1 March 2023 (received 22 March 2023), p. [1].

67 Treasury, answer to question on notice (Treasury006), 22 December 2022 (received 10 February 2023), p. 1; Attorney-General's Department, answer to question on notice (AGD005), 22 December 2022 (received 7 February 2023), p. 1.

- expand the range of tools available to monitor and dissuade system misuse to reduce the harm it causes to individuals and the economy.

We are alert to calls to rebalance the interests of debtors and creditors, and harmonise personal and corporate insolvency laws, regulations and administrative frameworks.[68]

5.63 Associate Professor Mark Wellard, while acknowledging the committee's focus on corporate insolvency, also suggested that Australia's 'personal insolvency legislation is long overdue for a broad, technical review and amendment'.[69]

Ministerial roundtable on personal insolvency, March 2023

5.64 On 2 March 2023, the Attorney-General convened a roundtable with a number of key stakeholders in the personal insolvency sector to consider, among other things, any critical reforms needed in relation to the Bankruptcy Act. In advance of the roundtable, the department noted that it expected issues arising out of the roundtable may be considered alongside this committee's report.[70]

5.65 A public summary of the roundtable confirmed that discussion included potential harmonisation across the corporate and personal insolvency systems, and the difficulties for small businesses engaged in both corporate and personal insolvency proceedings.[71]

Arguments against the unification of insolvency law

5.66 Some inquiry participants contended that the costs of pursuing a unification of corporate and personal insolvency law were not justified, or otherwise raised issues that would need to be carefully considered before a decision was made to merge the two systems.

5.67 For its part, the Association of Independent Insolvency Practitioners (AIIP) suggested the conclusion of the Harmer Report—that unification was not a 'major issue' needing attention—remained relevant today.[72] Ashurst similarly suggested the conclusions reached in both the Harmer Report and the Productivity Commission's 2015 report were still apposite.[73]

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68 AFSA, *Supplementary submission 7.1*, p. 23.

69 Associate Professor Mark Wellard, *Submission 51*, p. 2.

70 Ms Jenna Priestly, Assistant Secretary, Commercial and Copyright Law Branch, Attorney-General's Department, *Committee Hansard*, 1 March 2023, p. 53; and Ms Alice Linacre, First Assistant Secretary, Courts, Tribunals and Commercial Division, Attorney-General's Department, 1 March 2023, p. 53.

71 Attorney-General's Department, *Ministerial Roundtable on Personal Insolvency: summary*, 22 March 2023, www.ag.gov.au/legal-system/publications/ministerial-roundtable-personal-insolvency-summary (accessed 4 May 2023).

72 Association of Independent Insolvency Practitioners, answers to questions on notice, 23 December 2022 (received 23 February 2023), p. 3, p. 5.

73 Ashurst, answers to questions on notice, 23 December 2022 (received 15 February 2023), p. 4.

5.68 Ashurst suggested that if unification were to be considered, then it might be noted that Chapter 5 of the Corporations Act was not only concerned with the circumstances of insolvent companies:

> So, the provisions dealing with schemes of arrangement, receivership and members' voluntary liquidation are relevant for the administration of the affairs of solvent companies.[74]

5.69 In response to ARITA's argument that the financial affairs of small businesses and their owners or shareholders are often intertwined, Ashurst wrote:

> That is undoubtedly the case. However, with respect, the Submission ignores a fundamental consideration which, in the ordinary course, informs the decision to incorporate a company to conduct the "family business"; limited liability. If the family business fails and the primary objective of insolvency law is to provide for a rehabilitation and restructuring, an insolvency professional who is acting on or advising about the possibility of the insolvency administration of both the family company and its shareholders is in a position of conflict when addressing the issue; to what extent, if at all, should the shareholders' assets be made available to satisfy the claims of the company's creditors?[75]

5.70 The Productivity Commission noted that any consideration of unifying corporate and personal insolvency would need to weigh the fact that the majority of bankruptcies were not related to business factors. Should a decision be made to merge the personal and corporate insolvency frameworks, there 'would need to be substantially different arrangements for those situations' not related to business activity.[76]

Committee view

5.71 The committee acknowledges that the circumstances and needs of the insolvent business and the insolvent individual with non-business related debts are likely to be quite different. At the same time, the committee agrees that the division in insolvency law does not correspond with the operating reality for many Australian businesses, and can greatly increase the costs and complexity they encounter in insolvency. This is especially the case for many smaller businesses, where directors who have given personal guarantees may find themselves having to navigate two systems and two regulators.

5.72 These difficulties underline the need for a review that, like the Harmer Report, address both personal and corporate insolvency in the same process. The committee reiterates it view, as set out in chapter 3, that a meaningful

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[74] Ashurst, answers to questions on notice, 23 December 2022 (received 15 February 2023), p. 5.

[75] Ashurst, answers to questions on notice, 23 December 2022 (received 15 February 2023), p. 5.

[76] Ms Rosalyn Bell, Acting Head of Office, Productivity Commission, *Committee Hansard*, 13 December 2022, p. 25.

comprehensive review should have regard to both aspects of insolvency law, even allowing that this committee's focus was on corporate insolvency.

5.73 The committee considers harmonisation and simplification of insolvency law to be worthy, high-level guiding reform objectives.

5.74 'Harmonisation' can, however, mean many different things. The options suggested in this inquiry ranged from the relatively modest (for example, co-locating policy responsibility for corporate and personal insolvency in a single Commonwealth department) to fundamental changes to the law. The most far-reaching proposed change, of course, was the design and implementation of a single legislative scheme administered by one specialist insolvency regulator.

5.75 The committee has formed a preliminary view that the unification of insolvency law under a single insolvency regulator would potentially deliver significant benefits. At the same time, the committee notes that the development and implementation of such a law would be a lengthy, resource-intensive and complex undertaking. The committee has given this issue careful consideration over the course of this inquiry and taken evidence from a wide range of eminent scholars, leading practitioners and lawyers, peak bodies, commercial entities, regulators and other thought leaders on the topic. Still, the committee acknowledges that it may yet have only 'scratched the surface', and the implications of such reforms requires further consideration. The committee is particularly mindful that, in this inquiry, it did not consider the issue in any great depth through the lens of personal insolvency.

5.76 As such, the committee considers the harmonisation of insolvency law, including the design and implementation of a single insolvency law and regulatory scheme, should be a priority issue for examination in a comprehensive review. It would likely be appropriate for a review to not only undertake extensive research and consultation on this issue, but to publish detailed issue and options papers. This would provide ample opportunities for all interested experts and stakeholders to provide input to the process.

Recommendation 3

5.77 The committee recommends that the comprehensive review consider and make recommendations on options to enhance public interest objectives and the effectiveness of, and interaction between, the personal and corporate insolvency systems.

Chapter 6
Data and benchmarks for analysis and review

6.1 Inadequate data availability for analysis to support insolvency policy and legislative decisions has been a long-standing issue. While some improvements have been made over the years, evidence to this inquiry suggests that significant challenges remain. This chapter summarises:

- the consideration of insolvency data by previous inquiries and reviews;
- existing data on corporate insolvency made available by the Australian Securities and Investments Commission (ASIC);
- general observations about the need for better insolvency data;
- specific data that submitters and witnesses have suggested is needed for the comprehensive review and other reforms; and
- an overview of three international analysis frameworks.

Historical consideration of data availability

6.2 Inadequate access to insolvency data is a long-standing issue that has been identified in previous inquiries and reviews.

6.3 The 1988 Harmer Review noted that one of the major handicaps that impeded its work was the difficulty in obtaining pertinent statistical information about corporate insolvency in a readily available and intelligible form.[1]

6.4 In 2004, this committee noted the need for more data on the operation of corporate insolvency laws, particularly for voluntary administrations. The committee observed the contrast with better data availability for personal insolvency. The committee recommended (Recommendation 58) that the government support a research program into the impact of insolvency procedures, if necessary by providing a specific allocation for such research by ASIC, professional associations and commissioned researchers. The committee also recommended that the law should authorise the collection of statistical data by ASIC.[2]

6.5 The government at the time supported Recommendation 58 in principle and noted that the collection of statistical data by ASIC through forms approved by

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[1] Australian Law Reform Commission (ALRC), *General Insolvency Inquiry*, Report No 45, Vol 1, 1988, p. 20.

[2] Parliamentary Joint Committee on Corporations and Financial Services. *Corporate Insolvency Laws: a Stocktake*, 30 June 2004, pp. xxxiii, xxxvi and 225.

it pursuant to Section 350 of the Corporations Act or prescribed forms is currently permitted by the law.[3]

6.6 In 2010, the Senate Economics References Committee (Economics Committee) inquiry into Liquidators and Administrators opened its chapter on the need for better data by stating that one of the frustrations of its inquiry was the lack of adequate data to identify the policy problems.[4] The Economics Committee inquiry also noted the paucity of corporate insolvency data relative to personal insolvency data. The Economics Committee suggested that improving corporate insolvency data gathering and dissemination should be a benefit of its proposal to bring regulation of all insolvency practitioners under a single body.[5]

6.7 In 2014, the Productivity Commission observed a lack of detail regarding the circumstances of company failures in the returns submitted to the regulator by external administrators.[6]

6.8 In 2022, Professor Jason Harris noted the lack of comprehensive data on how voluntary administration works and how stakeholders perceive the procedure, significantly hindering practical policy analysis.[7]

6.9 Despite being an issue of long-standing concern, evidence to this inquiry, as explained below, clearly suggests the lack of readily accessible and appropriately comprehensive data on corporate insolvency is yet to be properly addressed.

Existing data on the state of the insolvency system

6.10 This section presents a summary of evidence provided to the committee in relation to existing data on corporate insolvency. The information provided here does not purport to be a thorough audit of all relevant data sources (a task more appropriate for a comprehensive review, as discussed at Chapter 4). The following sections discuss data that is available from ASIC and the Australian Financial Security Authority (AFSA).

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3 Australian Government, *Government Response to the Report of the Parliamentary Joint Committee on Corporations and Financial Services: Corporate insolvency laws: A stocktake,* [p. 23].

4 Senate Economic References Committee, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework*, 14 September 2010, p. 117.

5 Senate Economic References Committee, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework*, 14 September 2010, p. 148.

6 Productivity Commission, *Business Set-up, Transfer and Closure*, No. 75, 30 September 2015, p. 52.

7 Professor Jason Harris, *Promoting an optimal corporate rescue culture in Australia: the role and efficacy of the voluntary administration regime*, PhD Thesis, Adelaide Law School, April 2022, p. 32.

6.11 The Attorney-General's Department advised that it does not collate data on insolvencies.[8] The Department of the Treasury (Treasury) indicated that it had collated bespoke data on an ad-hoc basis for policy development and advice to governments.[9] Other agencies, such as the Australian Taxation Office (ATO) and the Fair Entitlements Guarantee (FEG) recovery program, may also hold relevant data.

ASIC's corporate insolvency statistics

6.12 ASIC publishes three types of statistics, which are summarised below:

- weekly insolvency statistics (Series 1 and 2);
- external administrators' and receivers' reports (Series 3.1, 3.2, and 3.3); and
- registered liquidator demographics (Series 4 and 4A).[10]

Series 1—Number of companies entering insolvency for the first time

6.13 ASIC Series 1 insolvency statistics provide weekly data on the number of companies entering external administration or controller appointments for the first time. Series 1 includes tables and charts indicating, among other things, the Australian Company Number (ACN) and organisation name; the state (or territory) of incorporation, and principal place of business; the initial type of appointment, the start date of the appointment and relevant financial year; and the person or company appointed.[11]

Series 2—All insolvency appointments over a company

6.14 ASIC Series 2 insolvency statistics provide weekly data on the total number of external administration and controller appointments recorded, including the first, subsequent and transitional appointments. A company can be the subject of multiple forms of external administration or controller appointment at any time and can progress from one type to another. Hence, Series 2 statistics can include a company more than once. To accurately track trends in corporate business failures, ASIC prefers Series 1 statistics as they give a more precise measure of the number of companies subject to a formal appointment.[12]

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8 Attorney-General's Department, answers to questions on notice, 22 December 2022 (received 7 February 2023)

9 Department of the Treasury (Treasury), answers to questions on notice, (two separate sets) 22 December 2022 (received 10 February 2023).

10 Australian Securities and Investments Commission (ASIC), *How to interpret ASIC's corporate insolvency statistics*, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/how-to-interpret-asic-s-corporate-insolvency-statistics/ (accessed 12 April 2023). See also ASIC, *Submission 29*, pp. 40–47.

11 ASIC, *How to interpret ASIC's corporate insolvency statistics*.

12 ASIC, *How to interpret ASIC's corporate insolvency statistics*.

Series 3.1 – 3.3—External administrators' and receivers' reports

6.15 ASIC Series 3 insolvency statistics are based on reports provided to ASIC when the external administrator or receiver suspects:

- that a relevant person may have committed an offence in relation to the company, been negligent or otherwise engaged in misconduct, or
- in the case of a liquidation, the company may be unable to pay its unsecured creditors more than 50 cents in the dollar.[13]

6.16 There are three data series available in Series 3:

- Series 3.1: Reports identifying causes of failure, available assets, liabilities, employee entitlements, creditors, remuneration, and possible misconduct (categorised by industry and region).
- Series 3.2: Reports identifying selected industries showing the five industries with the highest number of external administrators' reports lodged (by region).
- Series 3.3: Reports providing time series data comparing causes of failure, available assets, liabilities, employee entitlements, creditors, remuneration, and possible misconduct as a time series by financial year.[14]

Series 4 & 4A—Registered liquidator demographics and lists

6.17 ASIC Series 4 insolvency statistics provide quarterly and monthly data on registered liquidator demographics, including by region (for new, ceased, and current total registrations), gender, age, years of registration, and firm size.[15] Series 4A also identifies if the liquidator is suspended voluntarily or otherwise, or if there are any current conditions on a liquidator's registration (excluding industry-wide conditions), such as being restricted in the type of appointments that a person may be appointed to undertake.[16]

Series 5 – Members' voluntary liquidation statistics

6.18 ASIC Series 5 insolvency statistics provide quarterly data on the number of solvent companies entering into external administration. Series 5 includes similar charts and tables to Series 1.[17]

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13 ASIC, *How to interpret ASIC's corporate insolvency statistics*.

14 ASIC, *How to interpret ASIC's corporate insolvency statistics*.

15 ASIC, *How to interpret ASIC's corporate insolvency statistics*.

16 ASIC, *How to interpret ASIC's corporate insolvency statistics*.

17 ASIC, *How to interpret ASIC's corporate insolvency statistics*, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/how-to-interpret-asic-s-corporate-insolvency-statistics/ (accessed 14 June 2023).

AFSA insolvency data

6.19 AFSA collects and collates data on personal insolvencies, including business-related personal insolvencies. Much of this data is protected personal information and cannot be made publicly available except in aggregate. Business-related data is collected from individuals completing a bankruptcy form which captures data on whether insolvent individuals are directors of an incorporated company at the time of their insolvency.[18] However, in many instances, there is a lack of root cause information—for example, whether a sole trader or partnership becomes insolvent due to being a creditor in a corporate insolvency process. Hence, gaining insights to strengthen regulation and support earlier intervention in the credit or insolvency system is difficult. [19]

6.20 AFSA publishes a range of data-based reports at regular intervals, including:

- monthly and quarterly personal insolvency statistics;
- regional personal insolvency statistics;
- annual administration statistics;
- practitioner supervision statistics;
- enforcement statistics;
- personal insolvency compliance reports; and
- debts in business-related personal insolvencies.[20]

6.21 At the beginning of the COVID-19 pandemic, AFSA provided additional fortnightly aggregations of personal insolvency statistics. These statistics tracked numbers by type of administration and industry if the insolvency was business-related. The frequency of the statistics and the additional information provided valuable insights into how the pandemic impacted the economy. From April 2022, AFSA released statistics monthly. AFSA also includes a range of data-based information in its annual reports.[21]

6.22 AFSA also noted that:

- Professional associations, academics, statisticians, and other government agencies use AFSA statistics to support policy choices and research.
- AFSA has established relationships with insolvency researchers and is a member of the Insolvency Academics Network.
- AFSA regularly considers what sort of research it can partner with experts and academics on to use data held by AFSA.[22]

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18 Australian Financial Security Authority (AFSA), *Supplementary Submission 7.1*, p. 24.

19 AFSA, *Supplementary Submission 7.1*, pp. 24–25.

20 AFSA, *Supplementary Submission 7.1*, pp. 24–25.

21 AFSA, *Supplementary Submission 7.1*, p. 25. Historical and discontinued releases of aggregated data by AFSA are available on data.gov.au.

22 AFSA, *Supplementary Submission 7.1*, p. 25.

General observations about the need for better insolvency data

6.23 Submitters and witnesses suggested that more and better-quality data was needed to inform policy and legislative decisions on insolvency. This section summarises general suggestions received by the committee, while the following section identifies specific data types that have been suggested for collection.

6.24 Ms Catherine Robinson emphasised the importance of better data access for ensuring confidence in the insolvency system as a whole:

> Along with best practice regulation, one aspect of building confidence in the system, which many submissions and indeed this committee have already addressed, is the issue of data provision. While data is only one story of the regulator's performance, to stakeholders it is the only snapshot we see of how our insolvency system is regulated. Being transparent and publishing and speaking to this data consistently is critical to not guessing if ASIC is under-resourced or inactive or whether there are low or high levels of misconduct in the profession.[23]

6.25 Mr Michael Murray also addressed the need for improved data and suggested that both regulators and professional bodies would be sources or collectors of such data. Mr Murray also noted the new possibilities for data collection and analysis arising out of the recently introduced director identity requirements and broader technological innovations:

> Certainly the regulators, in terms of their collection of a lot of information. But I've also said rather bluntly that the professional bodies—in other words the practitioners themselves—hold a lot of the core data as to how the insolvency system works and, if the professional bodies could be enlisted to take part in that data collection, that would be very valuable. I think we are on the cusp of much better data collection when we have the director identity number … I have got great faith—I hope it's not misplaced—in terms of artificial intelligence and information technology, which the government seems to be gearing up for.[24]

6.26 Professor Anil Hargovan, from the Society of Corporate Law Academics (SCoLA), suggested that ASIC held a 'treasure trove' of documents and data on the insolvency system, which could provide 'rich and fertile ground' for both academic research and policymakers. In connection with improving the availability and accessibility of this data, Professor Hargovan also emphasised that a proposed comprehensive inquiry would require a strong evidence base that properly reflected current realities.[25]

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[23] Ms Catherine Robinson, Private capacity, *Committee Hansard*, 1 March 2023, p. 11.

[24] Mr Michael Murray, Private capacity, *Committee Hansard,* 1 March 2023, p. 24.

[25] Associate Professor Anil Hargovan, Executive Member, Society of Corporate Law Academics (SCoLA), *Committee Hansard*, 1 March 2023, p. 18.

6.27 Asked what assistance and information ASIC could provide in contribution to a comprehensive review, ASIC responded that in addition to providing many of the insolvency statistics it already releases, there is:

> …probably a whole lot of other information about our own experiences in relation to enforcing and applying the laws we've got at the moment. Obviously, we have a lot of practitioner information and feedback we would give, so I can see that there's a range of things we'd be able to contribute to that … I think we'd also be able to provide better detail about how some of these more recent—I'll use the word 'innovations' have gone and what they've actually provided in an Australian context.[26]

6.28 Asked about the accessibility of ATO data on insolvency to academics and other experts, the ATO responded that while it held 'a lot of data', for privacy reasons little was made publicly available. At the same time, the ATO indicated that de-identified, aggregated data could be provided on notice to the committee.[27] Although the ATO did not say so directly, it could be reasonably inferred, then, that similar information might be available to a body conducting a comprehensive review.

6.29 Treasury noted some of the inherent challenges in collecting quality data about the insolvency system in the context of whether the system is properly meeting its objectives, and in reference to a potential comprehensive review:

> …in this space one of the things you may be asking businesses to do is to hang out all of their dirty laundry at once. Businesses don't necessarily want to declare that they're a bit wobbly. They don't necessarily want to declare that they're taking advantage of the safe harbour. There is going to be a natural constraint on our ability to have precise data to inform policy. It's going to require more judgement based on incomplete information. That's the challenge.[28]

6.30 The Association of Independent Insolvency Practitioners (AIIP) indicated that more or different data would be needed to assess the efficiency of insolvency regulators. There is an absence, it noted, of statistical data and relevant criteria to measure insolvency regulators' current and ongoing efficiency.[29]

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26 Mr Warren Day, Chief Operating Officer, ASIC, *Committee* Hansard, 1 March 2023, p. 33.

27 Ms Jillian Kitto, Assistant Commissioner, Lodge and Pay Enforcement, Australian Taxation Office (ATO), *Committee* Hansard, 1 March 2023, p. 33.

28 Mr Tom Dickson, Assistant Secretary, Corporations, Treasury, *Committee Hansard*, 13 December 2022, p. 11.

29 Association of Independent Insolvency Practitioners (AIIP), answers to questions on notice, 23 December 2022 (received 23 February 2023).

6.31 Mr Ben Sewell explained that he suspected the large number of section 533 misconduct reports[30] to ASIC overstated the level of misconduct (he suggested there were somewhere in the order of 8000 per year, from a total of 10 000 appointments). In many cases, Mr Sewell told the committee, these reports might relate to wind-ups where the directors have been 'completely overwhelmed, rather than people that are dishonest or doing the wrong thing'. However, the reports are confidential, so Mr Sewell noted he could not confirm whether this was the case:

> The data issue is a big one, in that this is a very opaque area. It's been opaque across my career. What I would say you are forced to rely on is the opinions of people who have a viewpoint of the industry, and that's obviously guided by their position and bias and a lot of other things. So, if there is genuine misconduct in 88 per cent of these processes, I think that should be reviewed.[31]

6.32 It is worth reiterating that concerns about corporate insolvency data availability are long-standing and have been well-ventilated in other forums. A recent articulation of the problem and how it might be addressed was provided by Mr Murry and Professor Harris. In answer to a question on notice they provided a copy of a 2019 letter from a group of academics (many of whom contributed to this inquiry) to the Office of the National Data Commissioner as part of a review on data sharing and release reforms.[32] In that letter, the group of academics argued that more affordable corporate insolvency data is needed to assist with research projects that help inform and shape national public policy debates. Data relating to personal insolvency, they suggested, is better but could also be improved. The group of academics observed that:

> Insolvency law reform and policy lacks empirical data on the most basic outcomes of the corporate regime – assets, realisations, recoveries, costs,

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30 Section 533 of the Corporations Act requires the liquidator to lodge a report with ASIC where they suspect an officer or employee of a company in liquidation, or a member or contributory, 'may have been guilty of an offence in relation to that company'.

31 Mr Ben Sewell, Private capacity, *Committee Hansard*, 28 February 2023, p. 61.

32 Associate Professor David Brown, Adelaide Law School; Professor Jenny Buchan, School of Taxation and Business Law, University of New South Wales (UNSW); Professor Ellie Chapple, School of Accountancy, Queensland University of Technology (QUT); Dr Jennifer Dickfos, Senior Lecturer, Griffiths Business School; Associate Professor Timothy Fisher, School of Economics, The University of Sydney; Professor Jason Harris, Sydney Law School; Professor Suzanne Le Mire, Adelaide Law School; Dr Sulette Lombard, Senior Lecturer, Flinders University Law School; Associate Professor David Morrison, TC Beirne School of Law, University of Queensland; Michael Murray, Adjunct Professor, QUT Faculty of Law; Dr Rob Nicholls, Senior Lecturer, School of Taxation and Business Law, UNSW; Dr Beth Nosworthy, Senior Lecturer, Adelaide Law School; Professor Ian Ramsay, Melbourne Law School; Catherine Robinson, Lecturer, University of Technology Sydney (UTS) Faculty of Law; Dr Allison Silink, Senior Lecturer, UTS Faculty of Law; Mark Wellard, Senior Lecturer, UTS Faculty of Law.

> 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.[33]

6.33 The group of academics noted that while some data are freely available, the other corporate insolvency data held by ASIC can only be obtained by paying significant fees. The group of academics noted that university researchers find it challenging to obtain funding to pay for search and download fees to access information contained on public registers, severely limiting the scope and significance of research that can be undertaken. They argued that a more effective, efficient and economical way to obtain access to data is needed.[34]

6.34 The group of academics contrasted the data release processes of AFSA and ASIC, noting that AFSA had a more open and collaborative approach:

> 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. [35]

6.35 The Business Law Section of the Law Council of Australia (BLS LCA) suggested that the Australian Law Reform Commission (ALRC) (or other appropriate body tasked with a review) might be left to consider data requirements itself. The BLS LCA noted the ALRC compilation of relevant data as part of its Review of the Legislative Framework for Corporations and Financial Services Regulation.[36]

Specific areas where better data may be useful

6.36 This section identifies specific data that submitters and witnesses suggested would be useful. To assist further work in this area, the committee has briefly summarised the issues and then set out its understanding of the data that would be needed. The suggestions are collated in a box at the end of the section.

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[33] Mr Michael Murray and Professor Jason Harris, answers to questions on notice [Various], 22 December 2022 (received 10 February 2023), p. 16, Attachment B: Academics letter to Office of the National Data Commissioner, *Response to Discussion Paper and Privacy Impact Assessment about Data Sharing and Release reforms*, October 2019, p. 1.

[34] Academics letter to Office of the National Data Commissioner, *Response to Discussion Paper and Privacy Impact Assessment about Data Sharing and Release reforms*, October 2019, pp. 1–2.

[35] Academics letter to Office of the National Data Commissioner, *Response to Discussion Paper and Privacy Impact Assessment about Data Sharing and Release reforms*, October 2019, p. 2.

[36] Business Law Section, Law Council of Australia (BLS LCA), answers to question on notice, 23 December 2022 (received 14 February 2023).

Efficiency of the insolvency system

6.37 Mr Murray and Professor Harris drew attention to the inefficiencies of the insolvency system associated with liquidators having to undertake activities with both private and public purposes. The efficiency of the system, they argued:

> … is qualified by the unfunded cost of administrations, the unrecognised public interest work performed by insolvency practitioners, and the unnecessary complexity of the system'.[37]

6.38 Mr Salman Shah (in an article provided by Mr Murray and Professor Harris) argued that the extent of the 'debt justice' problem—the need to balance the different interests of creditors, debtors and the public—was difficult to assess given the lack of sufficient data:

> Data from the Australian Financial Security Authority regarding personal insolvencies shows that only 16.84% of all estates finalised in 2021–22 paid a dividend and unsecured creditors recovered only 2.23% of their total claims in all finalised estates in 2021–22. These numbers simply beg the question: what was the quantum recovered in the 83.16% of estates which did not pay a dividend in 2021–22? Further, in the 16.84% of estates which paid a dividend, what is the ratio between the return to unsecured creditors and the return to the [insolvency practitioners] themselves? As Murray and Harris correctly observe, there is simply insufficient data collected and collated regarding both personal and corporate insolvencies which explains the extent of the inefficiency.[38]

6.39 The BLS LCA also observed that more data was required to determine the extent of unfunded public purpose work undertaken by liquidators.[39] The AIIP observed that in the absence of data, it is difficult to assess whether an Official Receiver for corporations matters will result in efficiencies.[40]

Outcomes of corporate insolvency

6.40 In the aforementioned 2019 letter from a group of academics to the Office of the National Data Commissioner, the authors suggested data is needed on the assets, realisations, recoveries, costs, and returns to creditors across liquidations

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37 Mr Murray and Professor Harris, *Submission 18*, p. 2. The substantive question of the public purposes of the insolvency regime, and who should do that work (that is, insolvency practitioners or otherwise), is considered further in chapters 8 and 9.

38 Salman Shah, 'Centring debt justice in insolvency reform', *Insolvency Law Bulletin*, February 2023, p. 64; see Mr Michael Murray and Professor Jason Harris, answers to questions on notice, 22 December 2022 (received 10 February 2023).

39 BLS LCA, answers to question on notice, 23 December 2022 (received 14 February 2023), p. 22.

40 AIIP, answers to questions on notice, 23 December 2022 (received 23 February 2023).

and administrations.[41] In answers to questions on notice, Mr Murray and Professor Harris argued that those concerns remain relevant today.[42]

6.41 Professor Lynne Taylor, a New Zealand-based academic, added that there might be value in Australia coordinating with the New Zealand Registrar of Companies for potentially valuable comparative data on returns to creditors (while also noting that New Zealand's current data was not as comprehensive as that available in Australia):

> Since 2021 New Zealand liquidators have been required to file quite detailed six monthly and final reports about their remuneration, about returns to creditors. I think it would be absolutely fascinating to be able to do a comparison as to whether ultimately returns to creditors are better in New Zealand's light regulatory system or whether, in fact, Australia's far more onerous regulatory system is the winner.[43]

6.42 Mr Murray and Professor Harris suggested that a comprehensive review will likely require more and better-quality data, including:

- trends in the number of companies that are deregistered by default;
- the extent of assetless company administrations and the value forgone;
- the average net return to creditors from voidable transaction claims; and
- the length, cost, creditor returns, and outcomes of insolvency processes.[44]

6.43 The BLS LCA also identified some types of data that may assist a comprehensive review, including:

- the level of creditor attendance and voting in formal insolvency processes;
- the level of practitioner fees and recovery; and
- the comparative success of foreign jurisdiction's insolvency processes relative to Australia.[45]

6.44 Barrett Walker, a Certified Practising Accountant (CPA) Practice, suggested that a comprehensive review would benefit from information on:

- corporate insolvency and bankruptcy the returns to creditors by category, such as priority creditors, secured and unsecured creditors; and

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41 Academics letter to Office of the National Data Commissioner, *Response to Discussion Paper and Privacy Impact Assessment about Data Sharing and Release reforms*, October 2019, p. 1.

42 Mr Murray and Professor Harris, answers to questions on notice, 22 December 2022 (received 10 February 2023); Attachment B: Academics letter to Office of the National Data Commissioner, *Response to Discussion Paper and Privacy Impact Assessment about Data Sharing and Release reforms*, October 2019, p. 1.

43 Professor Lynne Taylor, Private capacity, 1 March 2023, p. 24.

44 Mr Murray and Professor Harris, answers to questions on notice, 22 December 2022 (received 10 February 2023), p. 23.

45 BLS LCA, answers to question on notice, 23 December 2022 (received 14 February 2023).

- data to indicate whether voluntary administration and other pathways had achieved the benefits that were envisaged when those pathways were introduced.[46]

Unfair preference claims

6.45 Registered liquidator, trustee, and accounting firm Kroll Corporate Finance and Restructuring argued for improved data capture and reporting to address the debate (See Chapter 13) on whether the law ought to be amended to limit or extinguish preference claims available to a liquidator in a winding up. The data needed may include:

- the book values and realisations of unfair preference claims;
- the direct costs of recovering unfair preferences; and
- the benefits accrued to ordinary unsecured creditors (if any).[47]

Fair Entitlements Guarantee

6.46 The committee sought information on what data may be available to evaluate the effectiveness of the FEG. The Australian Council of Trade Unions (ACTU) indicated that, at present, there is limited data on the gap between workers' actual entitlements and the level of entitlements covered by the FEG:

> …the ACTU notes evidence given to the Joint Committee by Fair Entitlements Guarantee Branch, Department of Employment and Workplace Relations that it doesn't collect data on gap losses workers experience as a result [of] insolvencies. In our view the FEG branch should, as a matter of course, together with ASIC, other agencies and external administrators, work to collect and publish such statistics to get closer to real-world losses workers experience in insolvencies (noting that other cohorts of workers such [as] dependent contractors often experience total loss because they are unsecured creditors).[48]

Deregistered businesses and companies

6.47 The AIIP suggested that data is needed to analyse the thousands of companies abandoned via deregistration following failure to lodge an annual return. There is no investigation of those companies before deregistration by ASIC.[49]

6.48 On the question of how many businesses are passively deregistered rather than go through an insolvency process Mr Michael Brennan, from Offermans, told the committee:

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46 Barrett Walker, *Submission 64*, pp. 1–2.

47 Kroll, *Submission 47*, pp. 2–3.

48 Australian Council of Trade Unions (ACTU), answers to question on notice [Fair Entitlements Guarantee], 1 March 2023 (received 8 March 2023).

49 AIIP, answers to questions on notice, 23 December 2022 (received 23 February 2023). The substantive issue of deregistration is addressed in Chapter 7.

> I think the problem is that there is a massive amount of data out there, but it's about trying to identify what is the correct data. This is why we've always tracked the ATO debt. If we're looking at, say, the 50-odd thousand businesses that seem to have been taken off the register by ASIC, what we're looking at is how many of those are actually insolvent, as opposed to having ceased to operate.[50]

Insolvent trading safe harbour

6.49 The Treasury *Review of the Insolvent Trading Safe Harbour* observed that data collection from registered liquidators in their Form 908 Annual liquidator return would only capture information where registered liquidators have been appointed either as a safe harbour adviser or as a subsequent administrator or liquidator. The review suggested, provided the cost of collecting data is low, there is utility in using existing forms to garner information from at least one key industry participant. The review suggested there would be utility in a data collection point being included in reports provided by voluntary administrators and liquidators. While this would relate only to safe harbours that have ended in formal appointments, it would allow for further quantitative analysis of the use of the safe harbour in such circumstances and its success in preventing a worse outcome for the company. Such reports would also assist in assessing any difficulties for registered liquidators in pursuing insolvent trading actions.[51]

6.50 KPMG also supported gathering data on the safe harbour, suggesting that there should be a role for ASIC to collect anonymised data on safe harbour engagements so an assessment can be made on the uptake and usefulness of the safe harbour provisions. Data could be collected through Registered Liquidator annual returns or other means. Such data collection could be extended to other parties which play a safe harbour role.[52]

Misconduct and enforcement data

6.51 In a published paper attached to her submission, Ms Robinson identified significant gaps and inconsistencies in reporting enforcement statistics and effective engagement with stakeholders regarding the provision of key data. Ms Robinson observed that ASIC no longer provides a breakdown of the classification of reports of alleged misconduct, and further argued that the omission of this information is concerning, noting:

- It makes it impossible to ascertain whether ASIC's low-level use of enforcement tools is due to a correspondingly low number of conduct-related complaints.

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50 Mr Michael Brennan, Liquidator and Bankruptcy Trustee, Offermans, *Committee Hansard*, 21 February 2023, p. 45.

51 Treasury, *Review of the Insolvent Trading Safe Harbour*, 23 November 2021, pp. 71–72.

52 KPMG, *Submission 55*, p. 7; See also, Institute of Public Accountants, *Submission 62*, p. 6.

- Appropriate information is unlikely to be forthcoming in the short term, given ASIC's position that it will consider publishing this data in the future after data has been collected for subsequent years.
- The lack of transparency also does not allow for a study of trends in enforcement actions. Nor does it allow for an assessment of ASIC's performance compared to AFSA.[53]

6.52 Other suggestions for the collection and publication of misconduct and enforcement data include quantitative and qualitative data on regulatory enforcement.[54]

ASIC's corporate insolvency statistics

6.53 ASIC indicated that it would welcome further information from stakeholders about information or data collection that may assist the public in understanding how the current insolvency regime is working. ASIC indicated that to avoid unnecessarily imposing an administrative burden on parties completing and lodging documents, ASIC is mindful of collecting only information and data that is required by law to be provided or which serves a regulatory purpose and is reasonable to collect.[55]

6.54 ASIC's registry function is being progressively transitioned to Australian Business Registry Services (ABRS) under the modernisation of the business registers program. Under this program, the Registrar will set the data standards and receive much of the data lodged by registered liquidators and other parties relating to companies' external administration and controllership. When the registry transition is complete, the ABRS may be best placed to publish insolvency data.[56]

6.55 The Australian Small Business and Family Enterprise Ombudsman acknowledged the helpful data in ASIC's insolvency statistics and suggested that the following enhancements would assist policymakers and academics to develop more targeted reforms:

> We recommend that ASIC's insolvency data series include the estimated size of the business, the extent of phoenixing activity, outcomes of liquidations (such as returns to creditors), insolvency-related fees per

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53 Catherine Robinson, 'Regulation of Insolvency Practitioners in a Pandemic', *Insolvency Law Journal*, 2020, Volume 28, No. 4, pp. 195 and 202; see *Submission 41*.

54 BLS LCA, answers to question on notice, 23 December 2022 (received 14 February 2023), p. 28.

55 ASIC, answers to questions on notice, 23 December 2022 (received 8 February 2023).

56 ASIC, answers to questions on notice, 23 December 2022 (received 8 February 2023).

liquidation and restructure, and financial positions of deregistered companies (including the cause of company failure).[57]

Collated data suggestions

6.56 For ease of reading, Box 6.1 (below) collates the data suggestions from the previous section.

Box 6.1 Collated data suggestions

Efficiency of the insolvency system

- In estates with some dividends to unsecured creditors, how many cents per $ were recovered and used to cover liquidators' fees and costs compared to how many cents per $ were returned to unsecured creditors?[58]

Corporate insolvency statistics

- Could ASIC corporate insolvency statistics provide an estimated size of the business, the extent of phoenix activity, outcomes of liquidations (such as returns to creditors), insolvency-related fees per liquidation and restructuring, and financial positions of deregistered companies (including the cause of company failure)?
- Could the ASIC insolvency statistics be made more accessible through a portal based on the Office of National Data Commission's Foundational Four practical guidance? [59]

Outcomes of corporate insolvency

- The extent of assetless administrations and the value forgone.[60]
- What are the assets, realisations, recoveries, costs, and returns to creditors, across liquidations and administrations?[61]
- Data to indicate whether voluntary administration and other pathways had achieved the benefits that were envisaged when those pathways were introduced.[62]

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57 Australian Small Business and Family Enterprise Ombudsman (ASBFEO), answers to questions on notice, 22 December 2022 (received 9 February 2023).

58 Salman Shah, 'Centring debt justice in insolvency reform', *Insolvency Law Bulletin*, February 2023, p. 64; see Mr Michael Murray and Professor Jason Harris, answers to questions on notice, 22 December 2022 (received 10 February 2023).

59 ASBFEO, answers to questions on notice, 22 December 2022 (received 9 February 2023).

60 Mr Murray and Professor Harris, answers to questions on notice, 22 December 2022 (received 10 February 2023), p. 23.

61 Academics letter to Office of the National Data Commissioner, *Response to Discussion Paper and Privacy Impact Assessment about Data Sharing and Release reforms*, October 2019, p. 1.

62 Barrett Walker, *Submission 64*, pp. 1–2.

- Length, cost, actual returns, and outcomes from insolvency processes.[63]
- The operation of foreign jurisdiction's insolvency systems compared to Australia.[64]
- Creditor attendance and voting in formal insolvency processes.[65]

Unfair preference claims

- What are the book values of unfair preferences and the ultimate realisations made?
- What are the direct costs of recovering unfair preferences?
- What benefits accrued to ordinary unsecured creditors on recovery of a preference (if any)?[66]

Fair Entitlements Guarantee

- What is the gap between an employee's unpaid entitlements and the level of entitlements covered by the Fair Entitlements Guarantee? [67]

Deregistered businesses and companies

- How insolvent are deregistered businesses and companies?[68]

Insolvent trading safe harbour

- Data on safe harbour utilisation be collected and reported on as part of the reports received from voluntary administrators and liquidators.[69]

International analysis frameworks

6.57 The utility of data is enhanced when there are well-developed principles and frameworks to shape the analysis. Fortunately, multiple frameworks and sets of principles are available. Three are summarised below from the International Monetary Fund, the United Nations, and the World Bank.

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63 Mr Murray and Professor Harris, answers to questions on notice, 22 December 2022 (received 10 February 2023), p. 23.

64 BLS LCA, answers to question on notice, 23 December 2022 (received 14 February 2023).

65 BLS LCA, answers to question on notice, 23 December 2022 (received 14 February 2023).

66 Kroll, *Submission 47*, pp. 2–3.

67 ACTU, answers to question on notice, 1 March 2023 (received 8 March 2023).

68 Mr Michael Brennan, Offermans, *Committee Hansard*, 21 February 2023, p. 45.

69 Treasury, *Review of the Insolvent trading Safe Harbour*, 23 November 2021, p. 90.

International Monetary Fund

6.58 The International Monetary Fund (IMF) observed that Australia is not alone in having insufficient data to support insolvency law reform in the past. The IMF indicated that the use of empirical data in insolvency law analysis has been sporadic:

> For a long time, insolvency legislation, as [with] most legal reforms, has been designed without a proper empirical foundation. Isolated from developments in other areas, insolvency law, and creditor-debtor law in general, is still designed in most countries without the support of detailed data on the actual performance of the system, or the issues experienced in its application.[70]

6.59 The IMF further noted that while there are qualitative assessments of insolvency systems based on compliance with international standards or customized indicators, there are few such assessments based on empirical data. The IMF indicated that while qualitative methods have their use, they should not substitute for reliable quantitative data. The IMF maintained that assessments and design of insolvency regimes should be based on relevant statistics, thereby providing a basis for sound policy decisions.[71]

6.60 The IMF analysed existing sources of data on insolvency proceedings, including general insolvency statistics, judicial statistics, statistics of insolvency regulators and other sources. It proposed methodologies, principles, and a conceptual framework for the use of data to assess the effectiveness and efficiency of insolvency systems. The IMF advocated for the design of special data collection mechanisms and statistics to conduct detailed assessments of insolvency systems and to assist in the design of legal reforms.[72] The IMF noted that measuring the effectiveness and efficiency of insolvency procedures begins with establishing the desired objectives, or outcomes of an insolvency system.[73]

UNCITRAL

6.61 The United Nations Commission on International Trade Law (UNCITRAL) has developed a legislative guide on insolvency law. The *Legislative Guide on*

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70 International Monetary Fund (IMF), *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, pp. 1 and 3.

71 IMF, *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, p. 3.

72 IMF, *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, p. 1.

73 IMF, *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, p. 5.

Insolvency Law (Legislative Guide) (with its various parts adopted between 2004 and 2021) provides a comprehensive statement of the key objectives and principles that should be reflected in a nation's insolvency laws. The Legislative Guide is intended to inform and assist insolvency law reform worldwide, providing a reference tool for national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations. The advice provided aims at achieving a balance between the need to address a debtor's financial difficulty as quickly and efficiently as possible; the interests of the various parties directly concerned with that financial difficulty, principally creditors and other stakeholders in the debtor's business; and public policy concerns, such as employment and taxation.[74]

6.62 UNCITRAL's Legislative Guide has five parts. Parts One and Two, adopted in 2004, deal with insolvency laws generally. Part Three, adopted in 2010, addresses the treatment of enterprise groups in insolvency.[75] Part Four, adopted in 2013, deals with directors' obligations in the period approaching insolvency. Finally, Part Five, adopted in 2021, deals with insolvency law for micro and small enterprises.[76]

6.63 The box below summarises the alignment of Australia's insolvency laws with the UNCITRAL Legislative Guide based on analysis by the United Nations National Coordination Committee for Australia (UNCCA).

Box 6.2 Main findings of the UNCCA analysis of the alignment of Australia's insolvency laws with the UNCITRAL legislative guide

- Australia's corporate (and personal) insolvency laws generally align with UNCITRAL's Legislative Guide.
- However, there are eight areas where Australia's laws do not align:
    (1) Restrictions on insolvency proceedings without sufficient assets to meet the costs of administration.

74 United Nations Commission on International Trade Law (UNCITRAL), *Legislative Guide on Insolvency Law*, uncitral.un.org/en/texts/insolvency/legislativeguides/insolvency_law (accessed 23 April 2023).

75 For more information on enterprise group insolvency, see Kathlene Burke, 'UNCITRAL Adopts the Model Law on Enterprise Group Insolvency', *International Corporate Rescue*, Editorial, Volume 16, Issue 5, pp. 263–264.

76 BLS LCA, answers to questions on notice, 23 December 2022 (received 14 February 2023).

(2) No specific regime for the raising of finance during an insolvency proceeding with priority over existing secured creditors.
(3) No specific regime governing the acceptance or rejection of pre-appointment contracts.
(4) No provisions allowing the assignment of contracts irrespective of terms in the contracts which restrict such assignment.
(5) No special mechanism for insolvency representatives to be remunerated where the assets of the estate are insufficient to meet the costs of the administration.
(6) No specific provisions in its insolvency laws which deal with the treatment of enterprise groups in insolvency.
(7) Insolvent trading laws are more stringent than recommendation 255, which is more aligned to the wrongful trading laws in the United Kingdom.
(8) Contrary to recommendation 283, the Small Business Restructuring process does not reduce formalities for all procedural steps, including for submission of claims, for obtaining approvals and for giving notices and notifications.[77]

(The complete UNCCA analysis is available with the answers to the questions on the notice submitted to this inquiry by the LCA.)[78]

The World Bank

6.64 The World Bank has developed principles for effective insolvency and creditor and debtor regimes which distil international best practices. The principles have been designed as a broad-spectrum assessment tool to assist countries in their efforts to evaluate and improve core aspects of their commercial law systems. The World Bank argues that efficient, reliable, and transparent creditor and debtor regimes and insolvency systems are of key importance for the reallocation of productive resources in the corporate sector for investor confidence and forward-looking corporate restructuring. Furthermore, these systems also play a pivotal role in times of crisis to enable a country and

77 BLS LCA, answers to questions on notice, 23 December 2022 (received 14 February 2023), p. 25.

78 United Nations National Coordination Committee for Australia, Working Group V (Insolvency) Expert Advisory Committee, *Analysis of the alignment of Australia's insolvency laws with each of the 377 recommendations contained in the UNCITRAL's Legislative Guide on Insolvency Law*, submitted with LCA, answers to questions on notice, 23 December 2022 (15 February 2023).

stakeholders to promptly respond to and resolve matters of corporate financial distress on systemic scales.[79]

6.65 The *Principles for Effective Insolvency and Creditor/debtor Regimes* (The Principles) highlight the relationship between the cost and flow of credit (including secured credit) and the laws and institutions that recognize and enforce credit agreements (Part A). The Principles also outline key features and policy choices relating to the legal framework for risk management and informal corporate workout systems (Part B), formal commercial insolvency law frameworks (Part C), and the implementation of these systems through sound institutional and regulatory frameworks (Part D).[80] In 2021, new principles were added to address the needs of insolvent micro and small enterprises (MSEs). MSEs often struggle to navigate an ordinary insolvency process and typically lack the resources to cover the costs and fees of the proceedings.[81]

6.66 Murrays Legal noted that the World Bank recently established a new corporate flagship called *Business Ready* (B-READY) which aims to improve on and replace the Doing Business report. B-READY is intended to address the scarcity of large-scale comparable data on business entry, business location, utility services, labour, financial services, international trade, taxation, dispute resolution, market competition, and business insolvency. B-READY does not appear to cover personal insolvency, the government role, or underfunded and assetless insolvencies. Murrays Legal notes the areas B-READY is intended to cover for corporate insolvency:

> The Business Insolvency topic measures key features of insolvency systems at a regulatory level. It also assesses the institutional and operational infrastructure associated with insolvency proceedings (judicial services), as well as the efficiency of insolvency proceedings in practice across three different dimensions, referred to as pillars. The first pillar assesses the effectiveness of regulation of insolvency proceedings, the second measures the quality of institutional and operational infrastructure for insolvency processes; and the third pillar measures the time and cost required to resolve in-court liquidation and reorganization proceedings. Each pillar is divided into categories and then subcategories.[82]

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79 World Bank, *Principles for Effective Insolvency and Creditor/debtor Regimes*, 2021 Edition, Washington DC, 22 April 2021, pp. 2–3.

80 World Bank, *Principles for Effective Insolvency and Creditor/debtor Regimes*, 2021 Edition, Washington DC, 22 April 2021, p. 3.

81 World Bank, *Principles for Effective Insolvency and Creditor/debtor Regimes*, 2021 Edition, Washington DC, 22 April 2021, p. iv.

82 Murrays Legal, *World Bank's B-Ready Report On Country Business Systems, Including On The Efficiency Of Corporate Insolvency Systems*, 5 May 2023, murrayslegal.com.au/blog/2023/05/05/world-banks-b-ready-report-on-country-business-systems-including-on-the-efficiency-of-corporate-insolvency-

Committee view

6.67 The committee acknowledges that the lack of quality data available for analysis to support insolvency policy and legislative decisions has been a long-standing issue. While some improvements have been made over the years, evidence to this inquiry suggests that significant challenges remain, and submitters and witnesses have identified a range of general and specific requirements for better data.

6.68 The existing data that ASIC provides on corporate insolvency enables an overview, albeit one with some gaps, of the state of insolvency (as shown in Chapter 2). However, even existing data could be improved to better inform policy decisions. An example of this is causes of company failure, which is currently included in Series 3 reports (see paragraph 2.39).

6.69 It is likely that the aggregate level of corporate insolvency across the economy is affected by the business cycle. The impacts of an economic downturn (or period of growth) may not be evenly spread across all sectors, as economic shocks (both positive and negative) will often affect some sectors more than others.

6.70 Another cause of insolvency could be higher rates of risk taking, for example if a sector is undergoing significant change due to innovation. In this context, temporarily elevated rates of insolvency might, in aggregate, reflect a positive overall economic outcome, particularly if new and potentially more productive technologies or business practices are emerging.

6.71 However, the available data does not allow for these propositions to be tested in the Australian context. Policy makers could benefit from higher quality and more granular data in relation to the trends in and causes of insolvency.

6.72 The committee did not, as part of this inquiry, undertake a detailed audit of the available data and data requirements. However, the committee has summarised the suggestions for better data it has received in Box 6.2 to provide a jumping-off point for the proposed comprehensive review.

6.73 The committee also draws attention to the analysis frameworks developed by the IMF, the World Bank, and the United Nations. The committee draws particular attention to the IMF's observation that measuring the effectiveness and efficiency of insolvency procedures begins with establishing the desired objectives, or outcomes of an insolvency system. The committee commends such an approach to the proposed comprehensive review.

systems/ (accessed 22 May 2023); World Bank, *Business Ready (B-READY)*, www.worldbank.org/en/businessready (accessed 7 May 2023).

6.74 Given the long-standing difficulties with obtaining the data required to inform insolvency policy and legislation, the committee makes the following recommendation to assist the proposed comprehensive review.

Recommendation 4

6.75 The committee recommends that the Australian Securities and Investments Commission collect high quality, granular data in relation to insolvency and provide this data in a timely way to relevant government agencies and regulators.

Recommendation 5

6.76 The committee recommends that the proposed comprehensive review of insolvency consult data holders, researchers, industry participants, and public sector organisations to progress the access to and analysis of insolvency data.

Chapter 7
Pathways for insolvency, restructuring, liquidation, and deregistration

Introduction

7.1 This chapter discusses the evidence and suggestions for reform that the committee received on insolvency, restructuring, liquidation, and deregistration pathways. The chapter provides an overview of existing pathways, and considers potential reforms in relation to:

- informal workout with safe harbour or pre-packs;
- small business restructuring;
- voluntary administration;
- simplified liquidation; and
- deregistration.

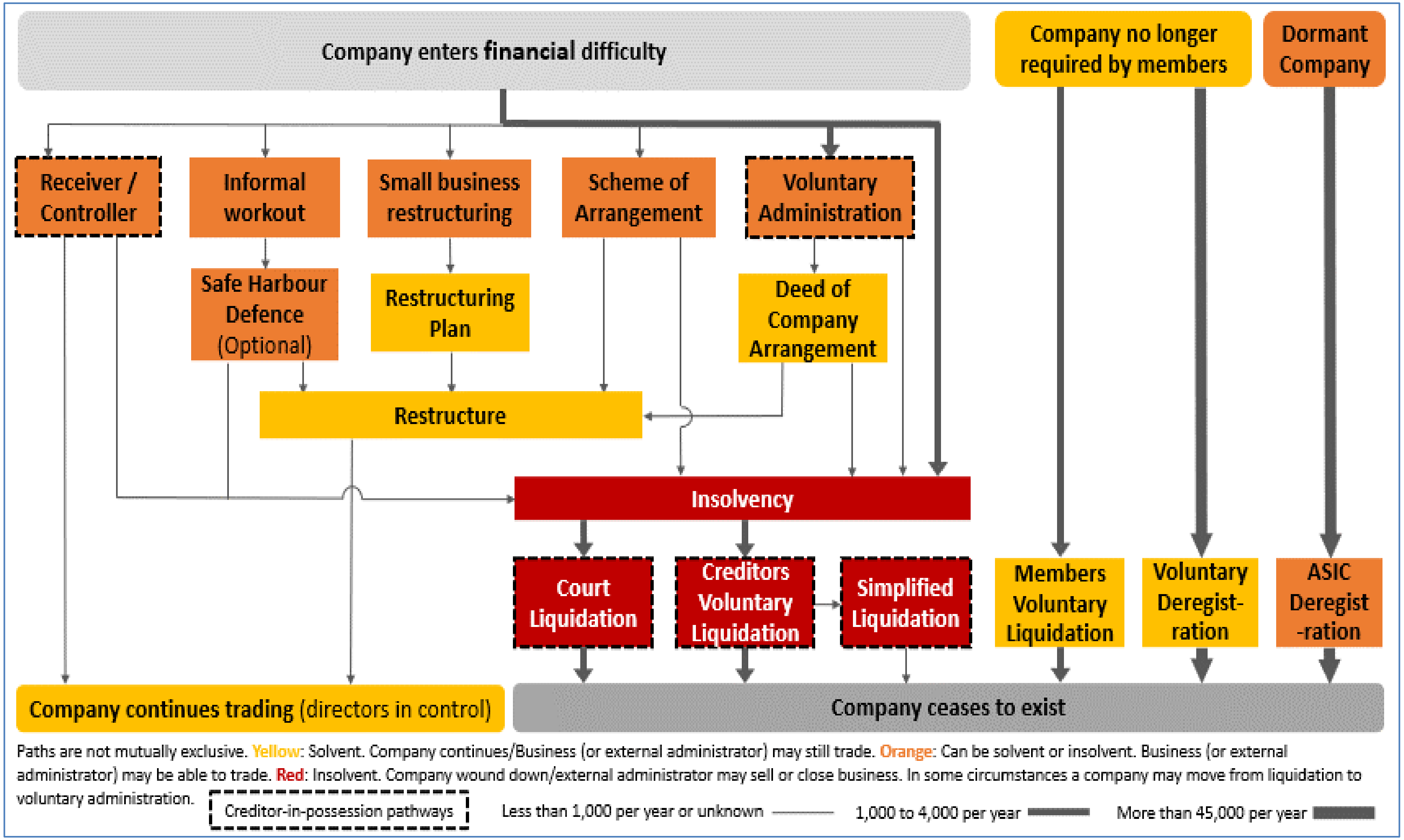
7.2 Suggestions for reforming the liquidation pathways are covered in more detail in other chapters. As the committee received limited evidence on the other pathways (informal workout without safe harbour, schemes of arrangement, and receivership), they are only mentioned briefly in the overview section below.

Overview of pathways

7.3 Since the implementation of the Harmer Report recommendations, there have been significant changes to existing pathways and the addition of new pathways. Figure 7.1 identifies 11 pathways that may be available when a company enters financial difficulty, is no longer required by the members, or is dormant:

- receiver/controller;
- informal workout (including with the option of the safe harbour defence);
- small business restructuring;
- schemes of arrangement;
- voluntary administration;
- court liquidation;
- creditor's voluntary liquidation;
- simplified liquidation;
- members voluntary liquidation;
- voluntary deregistration; and
- Australian Securities and Investments Commission (ASIC) deregistration.

Figure 7.1 Insolvency, restructuring, liquidation, and deregistration pathways



Source: Adapted from Figure 6 of the Productivity Commission Inquiry into Business Set-up, Transfer and Closure, No. 75, 30 September 2015, p. 27. The committee is grateful to ARITA) for checking the accuracy of the diagram. Arrow thickness indicates events per annum (not directly proportional). Data for arrow thickness is from Figure 2.3, Table 7.1 in this report; ASIC) insolvency statistics Chart C1.1.2 3 April 2023 release; ASIC Submission 29, Table 11, p. 42; Thea Eszenyi, 'Is ASIC deregistering more "abandoned companies"? What the data shows', ARITA Journal, July 2022, pp. 40–41; Data was not available on the number of informal workouts and safe harbour.

7.4 The colours in Figure 7.1 indicate the company's insolvency status and the business's ability to trade in each of the pathways. For the orange pathways, the solvency status and ability to trade depend on the circumstances, whereas in the red insolvent pathways, companies may not trade. In the yellow boxes, the company is solvent, and the business may trade.

7.5 Four of the 11 pathways (informal workout with optional safe harbour defence, small business restructuring, schemes of arrangement, and voluntary administration) provide options that may enable the company to restructure. Those pathways allow the debtors to remain in possession, except for the voluntary administration pathway for which creditors take possession. The five pathways shown with dashed boxes in Figure 7.1[1] use a creditor-in-possession model (receiver/controller, court appointed liquidation, creditors voluntary liquidation, simplified liquidation, and voluntary administration). The pathways are not all mutually exclusive. For example, a company might simultaneously use the safe harbour defence and a scheme of arrangement.

7.6 The three categories of arrow thickness indicate (not directly proportional) how often the pathways are used relative to each other. The usage levels of the more common pathways are:

- voluntary deregistration (around 80 000 per year);
- ASIC deregistration (around 47 000 per year);
- creditors voluntary liquidation (around 2000–4000 per year);
- court liquidation around 1600–2300 per year prior to COVID, lower since;
- members voluntary deregistrations (1500 per year);
- voluntary administrations 700–1200 per year (the higher end prior to COVID), with 35 per cent progressing to a deed of company arrangement (DOCA) and most of the remainder to liquidation); and
- receiver controller appointments (around 200–400 per year).[2]

7.7 Figure 7.1 enables consideration of a big-picture view of the system of pathways for insolvency, restructuring, liquidation, and deregistration. The different usage levels of pathways draw out questions about the balance of outcomes and economic incentives between the pathways (without expecting the numbers to be shared equally). For example, during this inquiry, questions have been raised about the number of companies proceeding to deregistration (either voluntarily

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1 The other six pathways (informal workout, small business restructuring, scheme of arrangement, members voluntary liquidation, voluntary deregistration, ASIC deregistration) have various types of debtor-in-possession status. All other boxes should not be assumed to be debtor-in-possession, as not all boxes are pathways.

2 ASIC, *Submission* 29, Table 11, p. 42; Thea Eszenyi, 'Is ASIC deregistering more "abandoned companies"? What the data shows', *ARITA Journal*, July 2022, pp. 40–41; *ASIC Insolvency Statistics*, Series 1, 3 April 2023 release, Chart 1.1.2; Australian Restructuring Insolvency and Turnaround Association (ARITA) *Submission 36*, pp. 83–84.

or by ASIC deregistration) versus the much lower use of pathways that provide opportunities for restructuring.

Description of the individual pathways

7.8 The following text provides a brief description of each of the pathways.

7.9 *Receivership (controllership)* is a process that entitles a secured creditor to appoint a registered liquidator as a receiver to a company. The receiver's role is to take control of the secured assets to repay the secured debt. The loan agreement gives the creditor a right to appoint a receiver under certain conditions.[3] If there are any assets or money left over when the receivership is complete, they are returned to the company (and the control of the company's directors) unless a liquidator or another external administrator is appointed.[4]

7.10 *Informal workouts* occur outside the formal frameworks of the law and rely on the law of contract. In this case, a creditor (or small group of creditors such as financial institutions) will work with a business to restructure the business's liabilities to allow it to continue trading.[5]

- *Safe harbour defence* is an option under an informal workout that sits outside the formal insolvency process but within the *Corporations Act 2001* (Corporations Act). The safe harbour provides a defence for insolvent trading if a director suspects that insolvent trading may occur, and the director ensures the company's books and affairs are in good order and develops a restructuring plan with a qualified professional.[6]

7.11 *A small business restructure* allows eligible businesses to compromise their debts with their creditors' agreement. It also enables business owners to remain in control during the restructuring period it restrictions on eligibility are met. Directors are assisted through the restructuring process by a restructuring practitioner, who must be a registered liquidator.[7]

7.12 *A scheme of arrangement* is a restructuring tool that can be used for either solvent or insolvent companies. It is a proposal to restructure the company that includes a compromise of the rights of one or all stakeholders—creditors, shareholders, or both. The courts oversee the process and require the agreement of all classes

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3 ARITA, *Submission 36*, p. 31.

4 Australian Securities and Investments Commission (ASIC), *Receivership: A guide for creditors*, asic.gov.au/regulatory-resources/insolvency/insolvency-for-creditors/receivership-a-guide-for-creditors/ (accessed 12 May 2023).

5 ARITA, *Submission 36*, p. 31.

6 ARITA, *Submission 36*, p. 31.

7 ARITA, *Submission 36*, p. 31.

affected. Schemes of arrangement are becoming more common, especially for complex restructurings that involve debt-for-equity swaps.[8]

7.13 During August and September 2021, under the Morrison Government, the Department of the Treasury (Treasury) consulted on improving schemes of arrangement to better support businesses. Subsequently, reforms were announced to:

- establish an opt-in automatic moratorium on creditor enforcement;
- enable courts to prevent a class of creditors from inappropriately leveraging a scheme process to force an alternative arrangement; and
- enhance creditor notification requirements.[9]

7.14 However, the reforms in relation to creditors' schemes of arrangement were not implemented prior to the 2022 Federal election.[10]

7.15 *Voluntary administration* aims to rescue a company that is in financial difficulty. A voluntary administrator (registered liquidator) is appointed to take control of the company and manage its affairs until the creditors decide the company's fate. A Deed of Company Arrangement (DOCA) may document an agreement between the administrators and the creditors to settle the firm's debts in a way that allows part or all of the business to be returned to the control of the directors. Voluntary administration can involve a change in ownership.[11]

7.16 *Liquidation* (or winding-up) results in a company being shut down. All the company's assets are sold, and the money raised is used to repay the company's debts. There are three main types of liquidation:

- *Creditors' voluntary liquidation*—is initiated by the company's directors when they are concerned the company cannot pay its debts.
  - *Simplified liquidation*—(a sub pathway under creditor's voluntary liquidation) can be used by a liquidator if the company in a creditor's voluntary liquidation is eligible and not more than 25 per cent of creditors object.[12] A simplified liquidation pathway is a streamlined

8 ARITA, *Submission 36*, p. 31.

9 King & Wood Mallesons, *Submission 45*, p. 2; Department of the Treasury (Treasury), *Submission 34*, pp. 13–14; Treasury, *Improving schemes of arrangement to better support businesses*, Consultation paper, 2 August 2021.

10 King & Wood Mallesons, *Submission 45*, p. 2; Treasury, *Submission 34*, pp. 13–14; Treasury, *Improving schemes of arrangement to better support businesses*, Consultation paper, 2 August 2021.

11 ARITA, *Submission 36*, p. 31.

12 ARITA, *Submission 36*, p. 31; ARITA, *The liquidation process*, https://arita.com.au/ARITA/ARITA/Insolvency_help/The_liquidation_process.aspx (accessed 4 May 2023).

creditors' voluntary winding up for companies that have liabilities less than $1 million.[13]

- *Court liquidation*—starts as a result of a court order, usually made after an application by a creditor of the company.
- *Member voluntary liquidations* (MVLs)—are used to wind up a solvent company voluntarily under the control of a liquidator. The liquidator realises the company's assets, pays all creditors in full, and distributes the surplus amongst the shareholders according to their entitlement, following which the company ceases to exist.[14]

7.17 *Deregistration*—this usually means that a company ceases to exist as a legal entity. Deregistration of a company can be:

- voluntary by agreement of the members if the company meets conditions; or
- by ASIC if the company has ceased trading or has not fees and penalties; or
- a final step following the end of an external administration for liquidation.[15]

Financial distress lifecycle

7.18 The Australian Restructuring and Insolvency and Turnaround Association (ARITA) drew attention to where some pathways sit in the financial distress lifecycle in Figure 7.2. There is a relationship between viability, insolvency, and asset values. Restructuring and turnaround are feasible paths when the realisable asset value is above zero, and the company is solvent. Pathways such as informal workouts, small business restructuring and voluntary administration provide opportunities to avoid the transaction costs and intellectual property destruction that occur with business liquidation. Other benefits potentially include maintaining employment, continuity of service to customers, and greater returns to creditors.[16]

7.19 Where the realisable assets value falls below zero, but the company remains solvent, schemes of arrangement and voluntary administration may be viable. In summary, if a business is to be rescued, or where that is not possible, more money returned to creditors in a liquidation, the directors need to act earlier

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13 ASIC, *Simplified Liquidation*, https://asic.gov.au/regulatory-resources/insolvency/insolvency-for-directors/simplified-liquidation/ (accessed 27 April-2023).

14 ARITA, *Submission 36*, pp. 31, 59; ARITA, *The liquidation process*, https://arita.com.au/ARITA/ARITA/Insolvency_help/The_liquidation_process.aspx (accessed 4 May 2023).

15 ASIC, *Deregistration*, https://asic.gov.au/for-business/closing-your-company/deregistration/ (accessed 28 April 2023); ASIC, *Effects of deregistration*, https://asic.gov.au/for-business/closing-your-company/effects-of-deregistration/ (accessed 24 May 2023).

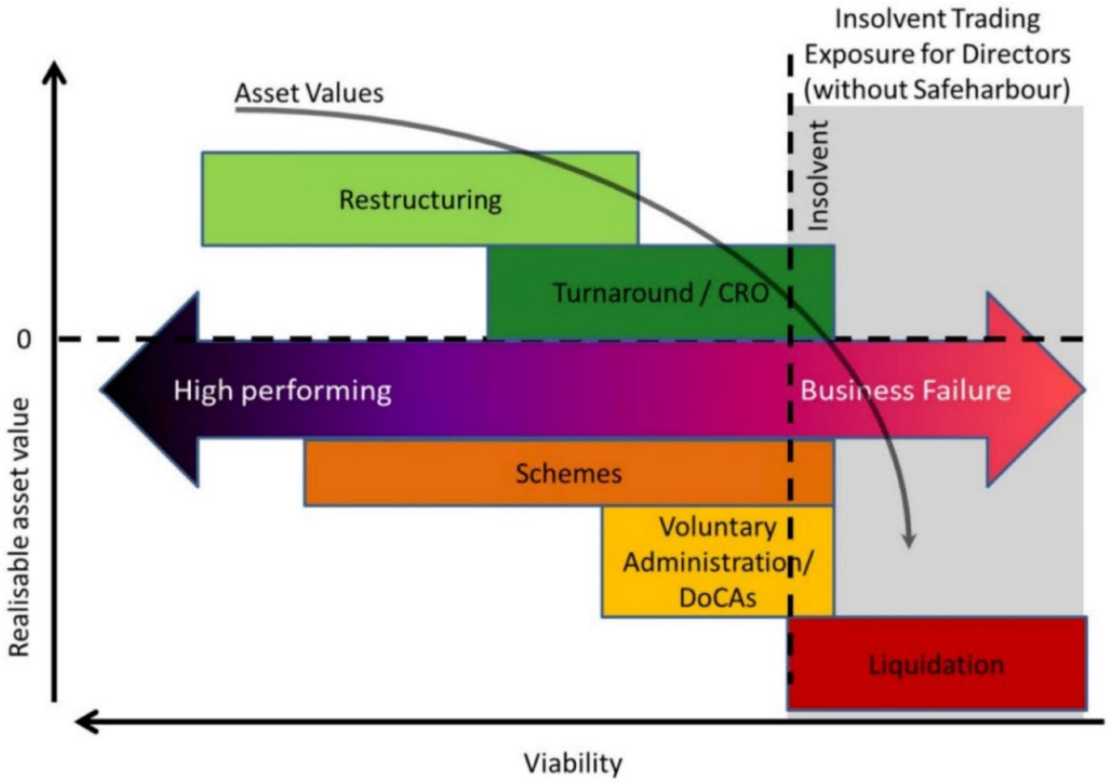
16 ARITA, *Submission* 36, p. 15; *Supplementary Submission 36.1*, pp. 4–5.

when net asset values are higher and provide more opportunities for restructuring.[17]

7.20 Liquidation occurs at the end of the financial distress lifecycle, where:

- the realisable value of assets, if any remain, has diminished;
- the opportunities for restructure, turnaround, or rehabilitation through a voluntary administration or small business restructuring no longer exist;
- the company is likely to be insolvent; and
- the appointment of a liquidator is required.[18]

Figure 7.2 Financial distress lifecycle



Source: ARITA, Supplementary Submission 36.1, p. 4.

Informal workouts, safe harbour, and prepacks

7.21 Informal workouts generally occur outside the regulated corporate insolvency processes and use a range of methods to bring companies back to a viable status. While the committee has not inquired into informal workout methods in detail, the committee did receive evidence on two aspects of informal workouts which are discussed in this section: the regulated safe harbour pathway and the unregulated pre-pack restructuring.

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17 ARITA, *Supplementary Submission 36.1*, pp. 4–5.

18 ARITA, *Supplementary Submission 36.1*, pp. 4–5.

Safe harbour

7.22 Safe harbour, as an option under the informal workout pathway, sits outside the formal insolvency process but within the Corporations Act. It provides a defence for insolvent trading if a director, suspecting that insolvent trading may occur, takes a range of prudent steps to ensure the company's books and affairs are in good order and develops a restructuring plan with the support of an appropriately qualified professional.[19] This section summarises the recent review of the safe harbour provisions and views from inquiry participants.

The safe harbour review

7.23 The safe harbour provisions contained in sections 588GA and 588GB of the Corporations Act commenced in September 2017. Section 588HA of the Corporations Act provided for an independent review to examine and report on the impact of the availability of the safe harbour to directors of companies on the conduct of directors and the interests of creditors and employees of those companies. The Treasury Safe Harbour Review was completed in November 2021.[20]

7.24 Safe harbour uses confidential board decisions and, in most cases, only becomes public if the company enters a formal insolvency process (and even then, there is little public data available). There are good reasons for this: publicising a company's financial distress during a safe harbour can have dire consequences for its liquidity and ongoing ability to trade. As a result, the Safe Harbour Review relied on input received from advisers, directors and other stakeholders as to their experiences of the safe harbour provisions.[21] The Safe Harbour Review:

- noted that there was no ASIC or industry-endorsed best practice guide on how the safe harbour provisions operate in practice;
- considered that the safe harbour protections offer considerable assistance in encouraging an active turnaround market for larger companies; and
- held concerns as to the applicability of the safe harbour for small and medium enterprises (SMEs).[22]

7.25 The Safe Harbour Review made 14 recommendations, aimed at:

- clarifying and simplifying provisions;

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19 ARITA, *Submission 36*, p. 31.

20 Treasury, *Review of the Insolvent Trading Safe Harbour*, 23 November 2021, p. 2; Treasury, *Submission 34*, p. 7.

21 Treasury, *Review of the Insolvent Trading Safe Harbour*, 23 November 2021, p. 4; See also Turnaround Management Association Australia, *Submission 38*, p. 12; Institute of Public Accountants, *Submission 62*, p. 6.

22 Treasury, *Review of the Insolvent Trading Safe Harbour*, 23 November 2021, p. 5.

- improving the safe harbour protections and thresholds for the protections;
- providing easy to understand guidance and definitions;
- clarifying references to advisers, tax and employee entitlement safeguards;
- improving the collection of data on the use of safe harbour from administrators; and
- establishing a holistic in-depth review of Australia's insolvency laws.[23]

7.26 In March 2022, the Morrison Government responded to the Safe Harbour Review, agreeing to nine recommendations, and noting others (recommendations 2, 10 and 12–14), some of which it indicated it might consider further. The March 2022–23 Federal Budget provided $0.8 million to implement the recommendations. The funding was reversed as part of the spending audit in the October 2022–23 Federal Budget pending the outcome of this corporate insolvency inquiry by the committee.[24]

7.27 The Safe Harbour Review also suggested updating Regulatory Guide 217 (*Duty to prevent insolvent trading: Guide for directors*; RG 217). ASIC indicated that it is currently reviewing RG 217 and anticipated consulting on revised guidance in the first half of 2023.[25]

Safe harbour views from submitters and witnesses

7.28 Many inquiry participants considered that the safe harbour was a beneficial reform and supported the implementation of the recommendations of the Safe Harbour Review.[26] Other submitters were in favour of most recommendations or suggested adjusting others.[27] ARITA suggested the recommendations could be implemented soon and did not need to wait for a comprehensive review.[28]

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23 Treasury, *Review of the Insolvent Trading Safe Harbour*, 23 November 2021, pp. 89–90; Australian Institute of Company Directors, *Submission 44*, p. 5.

24 Australian Government, *Government Response to the Review of the Insolvent Trading Safe Harbour*, March 2022, pp. 3–6; KPMG, *Submission 55*, p. 23.

25 ASIC, *Submission 29*, p. 57.

26 Australian Institute of Credit Management, *Submission* 9, p. 6; KordaMentha, *Submission 14*, pp. 5 and 6; Mr Michael Murray and Professor Jason Harris, *Submission 18*, p. 12; Housing Industry Association, *Submission 21*, p. 14; Business Law Section, Law Council of Australia (BLS LCA), *Submission 30*, pp. 40–41; Deloitte, *Submission 32*, p. 7; ARITA, *Supplementary Submission 36.1*, p. 40; ARITA, *Submission 36*, p. 7; Society of Corporate Law Academics (SCoLA), *Submission 37*, p. 4; Turnaround Management Association Australia, *Submission 38*, p. 22; Australian Institute of Company Directors, *Submission 44*, pp. 2 and 5; KPMG, *Submission 55*, pp. 6 and 23; McGrath Nicol, *Submission 67*, p. 5; Association of Independent Insolvency Practitioners, answers to questions on notice, 23 December 2022 (received 23 February 2023).

27 CPA Australia, *Submission 11*, p. 3; DyeCo Solvency and Turnaround, *Submission 13*, p. 7.

28 ARITA, *Supplementary Submission 36.1*, p. 47; *Submission 36*, p. 7; See also Australian Institute of Company Directors, *Submission 44*, p. 2.

7.29 The following paragraphs identify further safe harbour issues and suggestions raised by submitters and witnesses, including relaxing the criteria of access, SME access, the interaction with unfair preference claims, the costs relative to phoenixing, and the potential for creditors to be exploited.

7.30 *Relaxing criteria*: To access the safe harbour defence, companies must pay the entitlements of employees by the time they fall due; and give returns, notices, statements, applications, or other documents as required by taxation laws. Some inquiry participants suggested that the criteria should be relaxed. Other submitters, such as the Australian Council of Trade Unions (ACTU), argued against any loosening of the criteria, suggesting this would encourage sharp practices and increase the likelihood of additional costs of insolvency being externalised on workers, unsecured creditors, and the wider community.[29]

7.31 *SMEs:* Some submitters observed that the cost and other aspects of the safe harbour scheme meant that it was not accessible to many SMEs.[30] The Safe Harbour Review noted that there had been limited utilisation of the safe harbour by SMEs due to the relatively high cost of advice and the intertwining of SME liabilities with personal guarantees provided by directors over other assets, including family property.[31] Mr Allan Eskdale noted that SMEs with minimal capital, poor management, and inadequate systems struggle to meet and maintain compliance with the safe harbour eligibility criteria.[32]

7.32 *Interaction with unfair preferences*: The Safe Harbour Review observed that creditors who assist a debtor during a safe harbour may still be subject to unfair preference claims. Some submitters and witnesses proposed that such creditors should have some protections against unfair preference claims.[33] Chapter 13, discusses those issues in further detail.

7.33 *Incentives for phoenixing*: The Institute of Public Accounts indicated that its members advise that the safe harbour is potentially cost-prohibitive to financially distressed organisations. This makes it less attractive than

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29 *Corporations Act 2001*, Subsection 588GA(4); Mr Russell Morgan, *Submission 2*, pp. 4–5; Australian Banking Association, *Submission* 23, p. 6; Mr Michael Brennan, Offermans, *Submission 73*, p. 8; Australian Council of Trade Unions, *Submission 75*, pp. 7 and 14.

30 Australian Banking Association, *Submission 23*, p. 6; ARITA, *Supplementary Submission 36.1*, p. 6; ARITA, *Submission 36*, p. 43; Australian Institute of Company Directors, *Submission 44*, p. 6; Mr Allan Eskdale, *Submission 60*, p. 13; Institute of Public Accounts, *Submission 62*, p. 6.

31 Treasury, *Review of the Insolvent Trading Safe Harbour*, 23 November 2021, p. 23; see also Australian Institute of Company Directors, *Submission 44*, p. 6; BLS LCA, *Submission 30*, pp. 40–41; CPA Australia, *Submission 39*, p. 9; King & Wood Mallesons, *Submission 45*, p. 7.

32 Mr Allan Eskdale, *Submission 60*, p. 13.

33 Australian Institute of Credit Management, *Submission* 9, p. 6; Southern Steel, *Submission 27*, p. 4; Subcontractor Alliance and Subbies United, *Submission 56*, p. 18; Scanlon Carroll, *Submission 59*, pp. 2 and 5.

phoenixing, which is less expensive, expedient, and is often not scrutinised to the same level as the informal workout with safe harbour pathway.[34]

7.34 *Exploitation of creditors*: Some witnesses raised concerns about the potential for the safe harbour to exploit some creditor groups.[35] The Electrical Trades Union (ETU) noted that safe harbour rules prevent entities from enforcing contractual rights to terminate agreements against companies. The ETU argued that obliging contractors to continue carrying out work for which they may not be paid is a crude and risky tool.[36] The Australian Manufacturing Workers' Union (AMWU) raised concerns about the use of the safe harbour printing and marketing firm Ovato (this case is discussed in Chapter 11). The AMWU made several suggestions to protect employees, including in relation to disclosure, regulatory oversight and appointment of administrators, mechanisms for government intervention, and prohibiting restructures that rely on the Fair Entitlements Guarantee (FEG).[37]

Pre-pack sales and restructuring

7.35 Pre-pack sales and pre-pack restructuring are debtor-in-possession approaches to facilitate continued trading. Creditor-in-possession restructuring through voluntary administration is a public process that can impact business relationships, making it difficult to retain the business's value. An alternative is a pre-pack sale, where an insolvent company sells its business and assets to a buyer before appointing administrators.[38]

7.36 The Business Law Section of the Law Council of Australia (BLS LCA) noted that questions persist over legal issues surrounding pre-pack processes, and in Australia the process remains relatively unregulated. Risks include that a later-appointed administrator or liquidator must investigate and possibly unwind the sale. To comply with independence requirements, the ultimately appointed administrators may not be involved in the sale process before the appointment, which leads to duplication of effort and increased costs. In the United Kingdom (UK), pre-pack administration processes have been regulated to ensure those concerns can be adequately addressed. The BLS LCA recommended that consideration should be given to whether a better-regulated scheme for pre-pack administrations is required as part of the Australian restructuring regime.[39]

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34 Institute of Public Accountants, *Submission 62*, p. 7.

35 Electrical Trades Union, *Submission 49*, p. 3; Australian Manufacturing Workers' Union, *Submission 69*, pp. 1–2.

36 Electrical Trades Union, *Submission 49*, p. 3.

37 Australian Manufacturing Workers' Union, *Submission 69*, pp. 7–8.

38 BLS LCA, *Submission 30*, pp. 46–47.

39 BLS LCA, *Submission 30*, p. 47.

7.37 Narrow Road Capital suggested that where a reasonable sale process has been run before insolvency, and the majority of creditors which are likely to receive a recovery have provided their consent, pre-pack insolvencies should be encouraged. Pre-pack insolvencies allow over-indebted but sustainable businesses to transition to a more appropriate capital structure quickly. Narrow Road Capital observed that care must be taken that pre-packs are not used to phoenix business assets and that directors are still held accountable to creditors.[40]

7.38 The Turnaround Management Association Australia (TMA) suggested that there needs to be consideration of pre-packaged sales and pre-packaged creditors' schemes of arrangement (similar to that introduced in Singapore). The TMA also noted that there are two main types of pre-packs:

- *Pre-pack sales* are common in the UK, where a business sale is negotiated with a buyer before the appointment of administrators. The administrators sign the agreed form of sale documents immediately upon their appointment.
- *Pre-pack restructurings* involve the majority of creditors voting in favour of a restructuring plan before its launch.[41]

7.39 The TMA summarised its view on how pre-packs work:

> In broad terms, a pre-pack is a strategy employed to preserve value through an insolvency or restructuring process by conducting a significant amount of the sale or restructuring work and obtaining the agreement of the required parties to implement the sale or restructuring, before the formal insolvency or restructuring process commences. This allows the formal process to be conducted rapidly with certainty of outcome, reducing broader uncertainty for suppliers and customers who may not realise the company is in significant financial difficulty until after the transaction has been completed and a solution has been implemented.[42]

7.40 Several other inquiry participants suggested pre-pack reforms and adjusting insolvency practitioner independence requirements could be worth exploring.[43]

7.41 ARITA was not in favour of a pre-pack regime, commenting that:

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[40] Narrow Road Capital, *Submission 15*, p. 16.

[41] Turnaround Management Association Australia, *Submission* 38, pp. 7, 24.

[42] Turnaround Management Association Australia, *Submission* 38, pp. 7, 23–24.

[43] See, for example, SCoLA, *Submission* 37, p. 4; Turnaround Management Association Australia, *Submission* 38, p. 7 and 23–24; Mr Ben Sewell, *Submission 12*, p. 29; BLS LCA, answers to questions on notice, 23 December 2022 (received 14 February 2023), pp. 8–9; Mr Murray and Professor Harris, answers to questions on notice, 22 December 2022 (received 10 February 2023), p. 9; Association of Independent Insolvency Practitioners, answers to questions on notice, 23 December 2022 (received 23 February 2023), p. 2.

- Reforms in 2003 effectively removed receivership as an option in the UK. Hence, receivership appointments in the UK are now rare. Pre-pack sales via the UK's administration process effectively replaced receivership appointments. It can leave unsecured creditors without a return, and no say in the process.
- ARITA preferred pre-positioned sales, which directors of a financially distressed business can use to prepare a business for orderly wind-down and present potential sale options to an incoming administrator.[44]

7.42 ARITA indicated that it continued to concur with the recommendations on pre-packs and pre-positioned sales by the Productivity Commission's 2015 Report, which included recommendation 14.3 on making provisions in the Corporations Act for pre-positioned sales. That recommendation has not been implemented.[45]

7.43 Kroll suggested that the tension between the benefits and risks of pre-packs could be managed by using a system like the Takeovers Panel to adjudicate disputes in a commercial manner that is cheaper and faster than court-supervised systems.[46]

Small business restructuring

7.44 From 1 January 2021, a new pathway called Small Business Restructuring (SBR) became available. These changes included a new simplified debt restructuring process for eligible small businesses and a new type of registered liquidator. The SBR pathway leaves the control of the insolvent company in the hands of the directors, rather than the appointed registered liquidator—that is, it uses a debtor-in-possession approach. SBR allows eligible businesses to compromise their debts with their creditors' agreement. Directors are assisted through the restructuring process by a restructuring practitioner.[47]

7.45 To be eligible for the SBR pathway:

- the total liabilities of the company must not exceed $1 million;
- directors must meet restrictions on directors who have previously been involved in insolvency; and
- the company must not have undergone restructuring or been the subject of a simplified liquidation process within the preceding seven years.[48]

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44 ARITA, *Supplementary Submission 36.1*, pp. 46–49.

45 ARITA, *Supplementary Submission 36.1*, pp. 46–49; see also Productivity Commission, *Business Set-up, transfer and Closure*, No. 75, 30 September 2015, pp. 37 and 387–393.

46 Kroll, *Submission 47*, p. 2.

47 ASIC, *Report 756: Review of small business restructuring process*, January 2023, p. 4; ARITA, *Submission 36*, p. 31.

48 ASIC, *Report 756: Review of small business restructuring process*, January 2023, p. 35.

7.46 Small business restructurings occur in two phases:

(a) appointing a registered liquidator as the restructuring practitioner:

(i) directors of a company appoint a restructuring practitioner; and

(ii) a restructuring proposal period of 20 business days commences where the company proposes a restructuring plan; and

(b) entering into a restructuring plan (if creditors approve one).[49]

7.47 The SBR safe harbour provisions differ from the informal workout safe harbour provisions as follows:

- a registered liquidator must be appointed as a restructuring practitioner;
- non-lodgement of taxes and non-payment of employee entitlements do not preclude the appointment of an SBR practitioner, nor the operation of the SBR safe harbour provisions (provided they are paid, in each case, by the time a restructuring plan is proposed to creditors);
- creditors are notified, and *ipso facto* protections apply to impose a moratorium during the planning period; and
- the only consideration in relation to the debts incurred is, as noted above, that the company is restructuring, and that the debt was incurred in the ordinary course of the company's business (or otherwise with the consent of the restructuring practitioner or the court).[50]

ASIC Review

7.48 In January 2023, ASIC completed a review of the SBR pathway, covering 82 appointments. ASIC made the following findings:

- Creditors approved 92 per cent of proposed restructuring plans.
- 65 per cent of accepted restructuring plans were effectuated and 33 per cent were ongoing at the end of the period reviewed.
- 66 per cent of companies with an effectuated restructuring plan appeared to be continuing to operate their business.
- The Australian Taxation Office (ATO) was a creditor in 89 per cent of companies that entered a restructuring plan and was a major creditor (50–100 per cent of the debt) in 79 per cent of those companies.
- The average dividend to creditors was 15.2 cents per dollar.[51]

49 ASIC, *Report 756: Review of small business restructuring process*, January 2023, p. 4.

50 Treasury, *Review of the Insolvent Trading Safe Harbour*, 23 November 2021, p. 16.

51 ASIC, *Report 756: Review of small business restructuring process*, January 2023, pp. 5–6 and 14.

Concerns about SBR implementation

7.49 The SBR pathway was intended to be a cost-efficient way to manage the expected wave of insolvencies following the COVID-19 pandemic. Some concerns have arisen about the low take-up of the SBR pathway.[52] In the first 18 months from the beginning of 2021 to mid–2022, 82 small business restructuring appointments were made.[53] However, usage of the SBR pathway has increased in recent months, with 71 restructuring plans registered in the last quarter of 2022 and a further 70 in the first quarter of 2023.[54]

7.50 Several inquiry participants raised concerns that the SBR legislation was introduced in a rush without adequate consultations, or parliamentary committee consideration.[55] ARITA noted that the SBR legislation was a modified version of the voluntary administration legislation, contributing to the SBR process being too expensive and complex.[56] Mr John Winter, ARITA, suggested the complexity of the SBR pathway was counterproductive to its purpose of being more accessible to SMEs. When it was drafted, he contended:

> … they took [Part] 5.3A of the Corporations Act, which is what looks after voluntary administration, cut and pasted that and called it [Part] 5.3B, added some more and said, 'That's a simplified structure for small business rescue.' Clearly that's not. What you need is four pages of legislation to make it super streamlined and cheap.[57]

7.51 The ATO suggested that 'there were some things that were implemented in the small business restructuring laws that perhaps could be offered as improvements for the broader insolvency regime'. The ATO added:[58]

> We are a creditor in most of those, so we do have first-hand experience of the work that the practitioners do and the plans that are put forward by the

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52 See, for example, BLS LCA, *Submission 30*, p. 24; Deloitte, *Submission 32*, p. 5; Turnaround Management Association Australia, *Submission 38*, p. 14; Mr Murray and Professor Harris, *Submission 18*, p. 9.

53 ASIC, *Report 756: Review of small business restructuring process*, January 2023, p. 4.

54 ASIC, *Series 2 Insolvency Statistics*, 3 April 2023 release, sheet 2.1.

55 See, for example Association of Independent Insolvency Practitioners, *Submission* 20, pp. 3 and, 5; Mr Michael Murray and Dr Rosalind Mason, *Submission 17*, p. 7; BLS LCA, *Submission 30*, p. 20; ARITA, *Submission 36*, p. 43; KPMG, *Submission 55*, p. 20. Mr Michael Brennan, Offermans, *Submission 73*, pp. 26–27; Mr Bruce Billson, Ombudsman, Australian Small Business and Family Enterprise Ombudsman, *Committee Hansard*, 13 December 2023, p. 27; Mr Ben Sewell, Private capacity, *Committee Hansard*, 28 February 2023, p. 60; Associate Professor Mark Wellard, *Committee Hansard*. 1 March 2023, p. 17; Mr Murray, *Committee Hansard*, 1 March 2023, p. 30.

56 ARITA, Submission 36, p. 44.

57 Mr John Winter, Chief Executive Officer, Australian Restructuring Insolvency & Turnaround Association, *Committee Hansard*, 14 December 2022, p. 5.

58 Ms Jillian Kitto, Assistant Commissioner, Lodge and Pay Enforcement, Australian Taxation Office, *Committee Hansard*, 1 March 2023, p. 34.

> directors. We have seen, at this stage anyway, that most of those plans have been accepted by creditors, including the ATO, and it has provided a relatively straightforward mechanism for approval that provides probably greater certainty about outcomes than, for example, a deed of voluntary administration and a deed of company arrangement might do.[59]

7.52 Generally, the concept of the SBR pathway was well received. However, there were many concerns about how it was implemented. ASIC's stakeholder engagement and inquiry participants identified areas for reform, including:

- Many businesses have debts that exceed the threshold of $1 million.
- Some businesses are unable to meet the required:
  - substantial compliance with taxation obligations; and
  - compliance with employee entitlements, including superannuation.
- The SBR pathway is too complex and expensive for some businesses.
- The appointment of a restructuring practitioner may void a company's existing business insurance, and the insurance cover maintained by the registered liquidator does not apply as the directors remain in control.
- In some states, appointing a restructuring practitioner to a company may void licences required to operate a business, such as a builder's licence.
- Banks may cut off facilities for businesses that undertake an SBR process.
- ASIC records show that a company going through an SBR is 'under external administration', which may create confusion about the company's viability.
- High investigative burdens to satisfy the ATO.
- ATO time frames for processing matters do not align with SBR time frames.
- Practitioner hesitancy to implement SBR due to their liabilities and protections afforded to directors.[60]

7.53 While recommending that steps be taken to address the cost and complexity of the SBR pathway, ARITA raised some concerns about raising the SBR debt threshold:

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59 Mr Gary Busby, Senior Insolvency Advisor, Lodge and Pay Enforcement, Australian Taxation Office, *Committee Hansard*, 1 March 2023, p. 34.

60 See for example the following documents and submissions, not all issues are raised in every submission or document. ASIC, *Report 756: Review of small business restructuring process*, January 2023, pp. 4–5; *Submission 29*, p. 46; CPA Australia, *Submission 11*, p. 2; BLS LCA, *Submission 30*, pp. 11 and 25–26; BlueRock, *Submission 8*, pp. 1 and 5; Mr Ben Sewell, *Submission 12*, pp. 3 and 24–25; Association of Independent Insolvency Practitioners, *Submission* 20, pp. 4–5; Australia Credit Forum, *Submission 22*, pp. 2–3 and 7–8; Ashurst, *Submission 26*, pp. 4–5; Deloitte, *Submission 32*, p. 5; Turnaround Management Association Australia, *Submission 38*, p. 14; Australian Institute of Company Directors, *Submission 44*, pp. 4 and 6; KPMG, *Submission 55*, pp. 20–22; BLS LCA, answers to questions on notice, 23 December 2022 (received 14 February 2023), pp. 38–41; Professor Jason Harris, Private capacity, *Committee Hansard*, 13 December 2022, p. 44; Mr Steve Blinkhorn, Director of Legal Affairs, Australian Banking Association, *Committee Hansard*, 28 February 2023, p. 4; Ms Helen Davis, General Manager, Small Business Debt Helpline, *Committee Hansard*, 28 February 2023, pp. 34–45.

> Great care should be taken in raising the threshold … with increased debt comes increased complexity that should not be dealt with in this simplified format. It will also significantly increase the risk of SBRs being used to facilitate illegal phoenixing. We have instead suggested excluding related party creditors from the threshold.[61]

7.54 ARITA provided several other reform suggestions for the SBR pathway:

- Excluding secured creditor debt from the SBR process and preventing secured creditors from enforcing security during the SBR process.
- Recognising the restructuring practitioner as a company advisor and their independence.
- An automatic stay on winding up applications during the SBR process.
- Modifying the SBR process to determine creditor claims before the proposed plan is issued, thereby reducing plan variations.
- Allowing SBR plans to treat related and arm's length creditors differently.
- Limiting plans to the payment of cash by the restructuring practitioner so the restructuring practitioner simply distributes funds as agreed under the plan to reduce complexity and cost.
- Allowing creditors to vote on a plan variation rather than requiring court consideration.[62]

7.55 Commenting on operation of the SBR pathway, Professor Anil Hargovan raised the possibility of a more efficient pathway where the ATO is the main creditor:

> … the ATO in the majority of cases. If that trend were to continue, then there's a case to revisit. Do you really want to put in an external administrator and incur all those expenditures when you are dealing with the ATO most, if not all, of the time. So there's got to be a better way there.[63]

7.56 Asked about criticisms from ARITA regarding SBR and simplified liquidation, and statistics suggesting low uptake of both, Treasury noted:

> It's not intended to replace the insolvency system; it's meant to only cater to a very particular subset of cases. There are eligibility criteria that have been established for those two simplified systems, and those eligibility criteria are important because they're trying to, first of all, enable only simple affairs to be considered because we are stripping out quite a lot of the typical regulatory processes you would go through, and you don't want to end up in a scenario where you are inviting people to misuse and abuse those simplified processes.[64]

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61 ARITA, *Supplementary Submission 36.1*, p. 46; *Submission 36*, p. 43.

62 ARITA, *Submission 36*, pp. 44–45.

63 Associate Professor Anil Hargovan, Executive Member, SCoLA, *Committee Hansard*, 1 March 2023, p. 16.

64 Mr Tom Dickson, Assistant Secretary, Corporations, Treasury, *Committee Hansard*, 13 December 2022, p. 14.

Simplified liquidation

7.57 The simplified liquidation pathway came into effect in January 2021. The simplified liquidation pathway was intended to reduce regulation for small businesses and aims to allow faster and lower-cost liquidation, and thereby increase returns for creditors and employees. The pathway is available to eligible companies in a creditors' voluntary winding up.[65] To be eligible for simplified liquidation:

- the company must be in a creditors' voluntary winding up;
- liabilities must not exceed $1 million;
- the company will not be able to pay its debts in full within 12 months;
- the directors must, within five business days, give to the liquidator a report on the company's business affairs and a declaration the company meets the eligibility criteria for the simplified liquidation pathway;
- directors meet requirements about involvement in previous insolvencies;
- the company has not undergone restructuring or been the subject of a simplified liquidation process in the preceding seven years; and
- the company has given returns, notices, statements, applications and other documents required under the *Income Tax Assessment Act 1997*.[66]

Issues identified by inquiry participants

7.58 From January 2021 to the end of September 2022, the simplified liquidation pathway was used in 59 liquidations, indicating a relatively low usage level compared to liquidations and deregistrations.[67] Many inquiry participants acknowledged the value of the simplified liquidation concept. However, they also argued that uptake of the simplified liquidation pathway was low because the complexity, cost, and efficiency were not much different from the standard liquidation pathway, and the timeframes were much tighter. As a result, there were few incentives for insolvency practitioners or creditors to use simplified liquidation. Hence, many participants suggested the need for further reductions in complexity and cost.[68] Others noted that it might be too early to judge the

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65 Treasury, *Submission 34*, pp. 10–11.

66 ASIC, *Simplified liquidation*, https://asic.gov.au/regulatory-resources/insolvency/insolvency-for-directors/simplified-liquidation/ (accessed 8 May 2023).

67 Treasury, *Submission 34*, p. 11; ASIC, *Submission 29*, p. 51.

68 BlueRock, *Submission 8*, p. 2; Professor Harris, *Committee Hansard*, 13 December 2022, p. 44; DyeCo Solvency and Turnaround, *Submission 13*, p. 3; Mr Murray and Professor Harris, *Submission 18*, p. 9; Association on Independent Insolvency Practitioners, *Submission 20*, pp. 3, 6; Housing Industry Association, *Submission 21*, p. 14; BLS LCA, *Submission 30*, pp. 11 and 26–27; ARITA, *Supplementary Submission 36.1*, pp. 3 and 28; SCoLA, *Submission 37*, p. 3; Mr Neil Hannan, *Submission 54*, p. 2; KPMG, *Submission 55*, p. 22; Financial Counselling Australia and Small Business Debt Helpline, *Submission 58*, p. 2; Ms Vicki Stylianou, Group Executive, Advocacy and Policy, Institute of Public

success of the reforms.[69] Like the SBR reforms, some inquiry participants considered that the rush to implement the simplified liquidation reforms had contributed to ineffective policy settings.[70]

7.59 Mr Michael Murray and Professor Jason Harris suggested that there is a need for a streamlined insolvency procedure for low/no asset companies. However, simplified liquidation can't effectively fulfil that role. Mr Murray and Professor Harris recommend that the simplified liquidation pathway be replaced by an administrative procedure conducted by, or under the supervision and funding of an Official Receiver's office.[71] Professor Harris argued that simplified liquidation is:

> … not simplified enough. It's almost exactly what you have to do in a full creditor's voluntary liquidation, but the time frames are very tight. There's not enough benefit to using the simplified restructuring.[72]

7.60 The Society of Corporate Law Academics (SCoLA) recommended further streamlining of simplified liquidation by removing reporting obligations, shortening the timeframes for completion and making the entry criteria easier.[73]

7.61 ASIC noted that the decision to adopt the simplified liquidation process is made by the registered liquidator, not the directors, in a creditor's voluntary winding up. ASIC suggested that consideration might be given to the directors electing whether the appointment should commence using the simplified liquidation process with the appointed liquidator, then converting it to a full liquidation, if the directors' judgement that the company satisfies the eligibility criteria for simplified liquidation is incorrect.[74]

7.62 Professor Lynn Taylor observed that New Zealand's standard liquidation process is simpler than the Australian simplified liquidation process. Professor Taylor suggested that a streamlined New Zealand liquidation process may be a better option for all low-value Australian liquidations (or even all

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Accountants, *Committee Hansard*, 28 February 2023, pp. 40–41; Mr John Winter, Chief Executive Officer, ARITA, *Committee Hansard*, 14 December 2022, pp. 4–5.

69 See for example, Barrett Walker, *Submission 64*, p. 2.

70 See for example, Association of Independent Insolvency Practitioners, answers to questions on notice, 23 December 2022 (received 23 February 2023); Associate Professor Mark Wellard, Private capacity, *Committee Hansard*, 1 March 2023, p. 17; Mr Michael Brereton, President, Australian Restructuring Insolvency & Turnaround Association, *Committee Hansard*, 14 December 2022, p. 5.

71 Mr Murray and Professor Harris, *Submission 18*, p. 9. Also see Chapter 9 on assetless administrations and the role of the state.

72 Professor Harris, *Committee Hansard*, 13 December 2022, p. 44.

73 SCoLA, *Submission 37*, p. 3.

74 Mr Warren Day, Chief Operating Officer, ASIC, *Committee Hansard*, 1 March 2023, p. 32.

Australian liquidations). Professor Taylor also noted that there are trade-offs, as simpler systems reduce fees and incentives for liquidators.[75]

7.63 The Australian Banking Association (ABA) told the committee that looking at the threshold for access to the pathway might be worthwhile. The ABA suggested a threshold more consistent with the small business definition in the *Banking Code of Practice* is currently $3 million.[76]

7.64 Treasury, when asked about the low uptake of the simplified liquidation pathway and criticisms from witnesses about the conduct of the design and implementation of the reform, responded:

> We are acknowledging that there is feedback we are receiving in relation to that, and we understand that, for instance, the $1 million threshold is one of the sticking points people often raise. The question is whether that $1 million threshold is appropriate, particularly in relation to the liquidation pathway. Another anecdote we've received is that, from the point of view of the liquidator, there's very little incentive for a liquidator to go through the simplified system because the remuneration possibilities in there are low ...[77]

7.65 ARITA proposed the following reforms to bring the simplified liquidation pathway closer to its policy intent:

- The ability to litigate within a simplified liquidation is, by its nature, counterintuitive and should be removed.
- A maximum statutory remuneration of $10 000 is set, removing the need for liquidators to report and obtain approval for remuneration.
- Streamlined reporting obligations, clarifying liquidator investigation requirements and removing the right of creditors to make requests.
- Enable multiple dividends to be paid to priority employee creditors.
- Remove the requirements for ATO approval before a dividend is declared and for proof of debts to be lodged for claims of less than $10 000.
- Offset the removal of creditors' right to request information with a right to seek termination of the simplified process.[78]

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75 Professor Lynn Taylor, *Submission 74*, pp. 4–5.

76 Mr Steve Blinkorn, Director of Legal Affairs, Australian Banking Association, *Committee Hansard*, 28 February 2023, p. 4.

77 Mr Tom Dickson, Assistant Secretary, Corporations, Treasury, *Committee Hansard*, 13 December 2022, p. 15.

78 ARITA, *Submission 36*, p. 47.

Voluntary administration

7.66 This section:

- describes the voluntary administration pathway in Australia;
- covers reform suggestions by inquiry participants; and
- notes views of inquiry participants on calls for a United States (US) Chapter 11-style system.

7.67 Part 5.3A of the Corporations Act, introduced in 1992 implements the recommendations made in the Harmer Report to establish the voluntary administration pathway designed to resolve a company's future.[79]

7.68 An independent registered liquidator (the voluntary administrator) controls the company. This allows the director or a third-party time to find a way to save the company or its business. If it is not feasible for the director or a third party to come up with a plan to save the company or its business, the voluntary administrator aims to administer the company's affairs to obtain a better return to creditors than would result from an immediate liquidation of the company.[80]

7.69 A company's director(s) usually appoints a voluntary administrator after they determine the company is insolvent or likely to become insolvent. Less commonly, a liquidator, provisional liquidator, or secured creditor may appoint a voluntary administrator. After taking control of the company, the voluntary administrator presents a report providing the following three options for a creditors' meeting (after five weeks) to decide the company's future:

- end the voluntary administration and return the company to the directors;
- approve a DOCA through which the company will pay all or part of its debts and then be free of those debts; or
- wind up the company and appoint a liquidator.[81]

7.70 A DOCA is a binding arrangement between a company and its creditors governing how its affairs will be dealt with. The DOCA is generally proposed by the director or any third party, usually in consultation with the voluntary administrator, and is administered by a deed administrator (usually the registered liquidator who was the voluntary administrator).[82] Approximately 35 per cent of voluntary administrations progress to a DOCA.[83]

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79 Professor Jason Harris, *Promoting an optimal corporate rescue culture in Australia: the role and efficiency of the voluntary administration regime*, PhD Thesis, Adelaide Law School, 18 April 2022, pp. 64, 104.

80 ASIC, *Voluntary administration: A guide for creditors*, https://asic.gov.au/regulatory-resources/insolvency/insolvency-for-creditors/voluntary-administration-a-guide-for-creditors/ (accessed 7 May 2023).

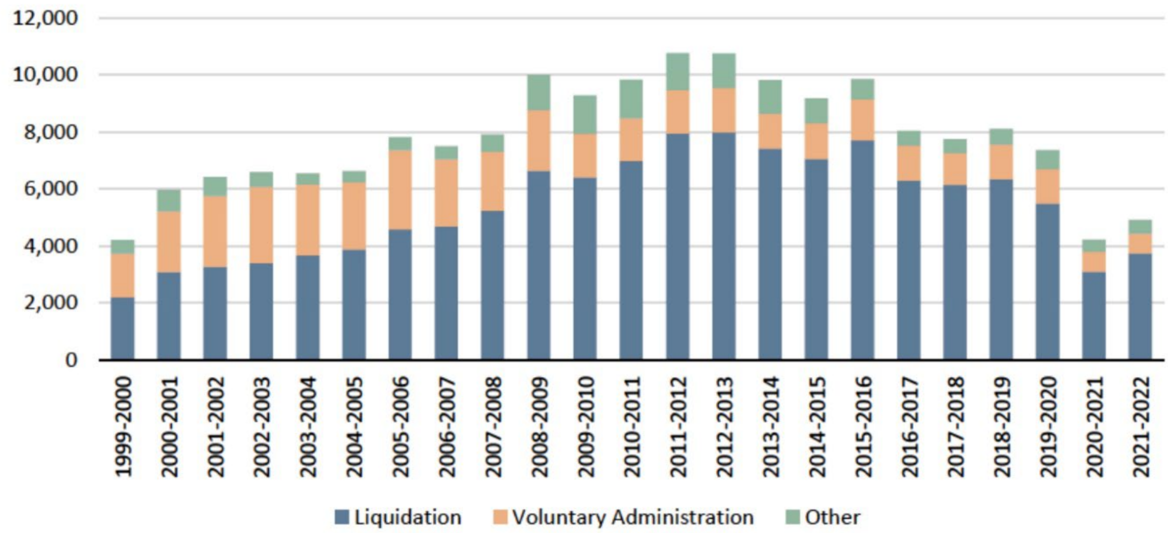
81 ASIC, *Voluntary administration: A guide for creditors*.

82 ASIC, *Voluntary administration: A guide for creditors*.

83 ARITA, *Submission 36*, p. 84.

7.71 The usage of voluntary administration has fallen gradually over the past two decades, as indicated in Figure 7.3.

Figure 7.3 Corporate external administration appointment per financial year



Source: Treasury, Submission 34, p. 4; ASIC Insolvency Statistics Series 1.

Issues identified during the inquiry

Professor Harris's empirical study of voluntary administration

7.72 In his recently completed PhD which provides a detailed empirical study of voluntary administration, Professor Jason Harris made the following observations about the voluntary administration pathway:

> Part 5.3A has operated without major structural amendments for over 25 years. During that time, it has been used to address the financial distress of thousands of MSMEs [micro, small and medium businesses], as well as restructure some of the largest and most complex businesses in Australia. The procedure can work well, and is working well in many instances, but that appears largely to be due to the ingenuity of practitioners and the flexibility of the courts.
>
> Voluntary administration requires a range of tasks to be undertaken and imposes various obligations and potential liability risks for administrators that contribute to a cost structure that makes it unworkable for many (mostly smaller) businesses. These measures can hinder commercial restructuring efforts, but it is also clear that many businesses in financial distress are simply not viable candidates for corporate rescue.
>
> The empirical research discussed in this thesis demonstrate that there are broad levels of support for Part 5.3A as a useful tool to deal with financial distress, but also show that the regime does not provide an optimal framework to facilitate corporate rescue in Australia.[84]

[84] Professor Jason Harris, *Promoting an optimal corporate rescue culture in Australia: the role and efficiency of the voluntary administration regime*, PhD Thesis, Adelaide Law School, 18 April 2022, p. 245.

7.73 Professor Harris made 24 recommendations (the Harris recommendations) to improve the voluntary administration regime so that it better facilitates corporate rescue, including, recommendations 1–6 on improving MSME corporate rescues:

- extending stay against enforcement of related party guarantees;
- greater flexibility on what a restructuring plan can include;
- standard rules for restructuring practitioner remuneration;
- greater flexibility to manage the business and sell some property;
- improving transparency for creditors through information and recommendations from the restructuring practitioner; and
- determine creditor debts and claims at the start of the restructuring period.[85]

7.74 Some inquiry participants also identified areas for reform related to some of Professor Harris's recommendations,[86] for example:

- the unsuitability of the current voluntary administration for SMEs;[87]
- allowing creditors rather than courts to limit administrator liability;[88]
- stand-alone DOCAs;[89]
- transparency around costs;[90] and
- allowing creditors to approve extensions to the convening period.[91]

Other issues identified by inquiry participants

7.75 Other potential areas for reforms suggested by inquiry participants included:

- reforming DOCAs to:
  - release claims against third parties; extinguishing securities or modifying, terminating, remedying or transferring contracts or leases as part of a broader reconstruction; and
  - have more prescriptive mandatory requirements on the priority treatment of administration costs; and;

85 Professor Jason Harris, *Promoting an optimal corporate rescue culture in Australia: the role and efficiency of the voluntary administration regime*, PhD Thesis, Adelaide Law School, 18 April 2022, pp. 224–244.

86 Professor Jason Harris, *Promoting an optimal corporate rescue culture in Australia: the role and efficiency of the voluntary administration regime*, PhD Thesis, Adelaide Law School, 18 April 2022, pp. 224–244.

87 Mr Ben Sewell, *Submission 12*, pp. 3, 17, 22–24.

88 KordaMentha, *Submission 14*, p. 10; BLS LCA, *Submission 30*, pp. 23–24; Turnaround Management Association Australia, *Submission 38*, p. 30; McGrathNicol, *Submission 67*, p. 3.

89 Turnaround Management Association Australia, *Submission 38*, p. 31.

90 Mr Ben Sewell, *Submission 12*, p. 3.

91 KordaMentha, *Submission 14*, p. 10; BLS LCA, *Submission 30*, pp. 23–24; McGrathNicol, *Submission 67*, p. 3.

– improve creditor protections;[92]

- relaxing independence requirements on voluntary administrators associated with pre-appointment work;[93]
- a broader interpretation and application of the failing firm exception should be taken by the Australian Competition and Consumer Commission (ACCC);[94]
- streamlining reporting requirements;
- minimising the need for courts to approve borrowing agreements;
- limiting the time to amend DOCA proposals;
- improving the effectiveness of the *ipso facto* stay regime;
- mechanisms to transfer contracts during restructure;[95]
- conduct of voluntary administrations by ASIC appointed registered liquidators and report to ASIC in the same way they do for liquidations.[96]

7.76 TMA argued that the voluntary administration regime has become procedurally more cumbersome and costly, and is no longer the 'quick, efficient and relatively inexpensive' process envisaged by its authors. TMA said it would be appropriate to empower a new committee of turnaround experts to report on reforms to promote restructuring and turnaround of enterprises capable of being saved without abrogating from the need to protect creditors and maintain insolvency regimes for those entities that cannot be sensibly rescued.[97]

7.77 It was a common view amongst inquiry participants that voluntary administration worked better for larger corporates.[98] For example KordaMentha submitted that:

> In our experience, the Voluntary Administration regime is a very powerful and useful tool. It is flexible and versatile and has been used in very large corporate failures in Australia. It is better suited to medium to large companies from a cost perspective.[99]

92 Turnaround Management Association Australia, *Submission 38*, p. 30.

93 BLS LCA, *Submission 30*, pp. 23–24.

94 KPMG, *Submission 55*, p. 29.

95 KordaMentha, *Submission 67*, p. 3.

96 Australia Council of Trade Unions, *Submission 75*, p. 10.

97 Turnaround Management Association Australia, answers to questions on notice, 23 December 2022 (received 10 February 2023), pp. 10–11; See also *Submission 38*, pp. 29–30.

98 See, for example, KordaMentha, *Submission* 14, pp. 1 and 6; Mr Ben Sewell, *Submission 12*, p. 3; ARITA, *Supplementary Submission 36.1*, p. 55; See also McGrathNicol, *Submission 67,* pp. 2–3; Crouch Amirbeaggi, *Submission 70*, p. 4.

99 KordaMentha, *Submission* 14, p. 6.

7.78 In contrast, Mr Ben Sewell argued that voluntary administration is an expensive (around $50 000 per administration) and a largely unsuccessful restructuring mechanism (only around one per cent of insolvent companies use voluntary administrations to successfully restructure).[100]

US Chapter 11 system

7.79 A US Chapter 11 debtor-in-possession system is often suggested alternative to Australia's voluntary administration system to promote more business rescues and restructuring. The first section of this chapter noted that Australia's corporate insolvency system already has several restructuring pathways, some of which use a debtor-in-possession model. This section briefly summarises views put to the committee by inquiry participants on the US Chapter 11 system.

7.80 Ashurst noted that in a restructuring via a voluntary administration, the market tends to regard the appointment of administrators as an indication of failure and that the company's financial position is terminal. There is a significant risk that liquidation will follow. Ashurst suggested an alternate restructuring mechanism to promote a culture of corporate rehabilitation for businesses of all sizes in the appropriate cases. Ashurst suggested a new debtor-in-possession regime would promote this, and suggested there are numerous international regimes from which to draw useful precedents, such as those in the UK, Singapore and the US.[101]

7.81 Mr Bruce Billson, Australian Small Business and Family Enterprise Ombudsman (ASBFEO), while making a case for an insolvency regime that was more sympathetic to honest failure and genuine prospects for recovery of the business or the business owner, indicated that Chapter 11 was likely not the best way of achieving this in Australia:

> Chapter 11 does shift responsibility and onus, in my mind, a little too far away. It puts the debtor or the business a little too much in control; it's just a calibration. I'd be thinking about something chapter 11-esque without going all the way to chapter 11. The information is that if creditors felt we had a full-blown chapter 11 in Australia they might be less inclined to lend.[102]

7.82 Professor Harris noted that the US Chapter 11 system is not just a set of provisions providing another insolvency pathway. Instead, it is a legal system, with its own federal bankruptcy court and expert judges, premised on it being

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100 Mr Ben Sewell, *Submission 12*, p. 3.

101 Ashurst, *Submission 26*, p. 2; See also Australian Small Business and Family Enterprise Ombudsman, *Submission 31*, p. 7; Mr Neil Hannan, *Submission 54*, p. 1.

102 Mr Bruce Billson, Ombudsman, Australian Small Business and Family Enterprise Ombudsman, *Committee Hansard*, 13 December 2022, pp. 27, 33.

a court-driven system. Hence, there would be significant challenges to adding such a system to Australia's insolvency system.[103]

7.83 The BLS LCA preferred Australia's current voluntary administration system to Chapter 11, noting that the voluntary administration pathway is generally a better system in the Australian marketplace. It serves both large and SME businesses well, although the cost of the process is occasionally a prohibitive factor for micro-businesses. A small number of potential improvements could be made.[104]

7.84 The BLS LCA noted that, in effect, Australia already has a debtor-in-possession model available for large enterprises in the form of schemes of arrangement. Similarly, the Small Business Restructuring pathway provides a debtor-in possession insolvency pathway for small businesses. However, in practice, schemes of arrangement are too expensive for medium enterprises to access, involving millions of dollars in professional expense across lawyers, accountants, and financial advisers. As such, there was merit in considering the introduction of a debtor-in-possession pathway accessible to medium-sized businesses.[105]

7.85 Mr Michael Brennan, Productivity Commission, explained that when people raised the possibility of a Chapter 11 approach in Australia, often that was not so much about Chapter 11 itself but rather the idea that there'd be a greater focus on business recovery, as distinct from getting what you can for the creditors.[106]

7.86 Mr Michael Brereton, ARITA, suggested that one of the strengths of Australia's system was having a skilled and trusted group of liquidators who could in most instances achieve the right outcomes. In contrast, the Chapter 11 process was conducted on the basis that the bankruptcy court supervises everything because they don't trust the debtor in possession.[107]

7.87 Mr Warren Mundy, appearing on behalf of ARITA but able to speak to the Productivity Commission report (given he was a commissioner at the time of that report), noted that when the Productivity Commission did its work:

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103 Professor Jason Harris, 'Episode Thirteen: Insolvency – Over the Horizon', *The BLS Report*, Podcast BLS LCA; See also KPMG, *Submission 55*, pp. 12–13; Mr Andrew Barnden, member, registered liquidator and trustee in bankruptcy, Chartered Accountants Australia and New Zealand, *Committee Hansard*, 28 February 2023, p. 40.

104 BLS LCA, *Submission 30*, p. 22.

105 Mr David Walter, Member, Insolvency & Restructuring Committee, LCA, *Committee Hansard,* 14 December 2022, p. 36; See also Mr Anthony Ryan, Deputy Chair, Insolvency & Restructuring Committee, BLS LCA, *Committee Hansard*, 14 December 2022, p. 35.

106 Mr Michael Brennan, Chair, Productivity Commission, *Committee Hansard*, 13 December 2022, p. 20.

107 Mr Michael Brereton, President, Australian Restructuring Insolvency & Turnaround Association, *Committee Hansard*, 14 December 2022, p. 6.

> … there was significant pressure from within the government, both at an officials level and at an elected level, that the commission should recommend chapter 11 as a model for the future of the bankruptcy law in Australia. The commission examined that, and my discussion with the Department of Justice in Washington was basically: 'Do anything but chapter 11. Just don't go near it. It's big. It's expensive.' I think we all know the challenges that the federal and circuit courts face from time to time. We would need an entirely new court to administer that stuff.[108]

Members voluntary liquidation

7.88 An MVL is not an insolvency administration. An MVL is a method provided for in the Corporations Act to wind up a solvent company voluntarily under the control of a liquidator. The liquidator realises the company's assets, pays all creditors in full, and distributes the surplus amongst the shareholders according to their entitlement. Following that the company ceases to exist. Solvent companies are usually wound up because they no longer have any commercial use or where the members perceive some benefits can be gained. If a company in MVL subsequently turns out to be insolvent, the liquidation converts to a creditors' voluntary liquidation.[109]

7.89 Like a voluntary deregistration, a company in MVL needs to ensure all its debts have been paid, and all tax lodgements are up to date and payments remitted. Data provided by ASIC indicates that there were approximately 1500 MVL appointments each year over the four years to 2021–22.[110]

7.90 ARITA noted that the Corporations Act acknowledges the different nature of an MVL by allowing unregistered individuals to be appointed as liquidators. This differential means unregistered individuals who undertake MVLs do not incur an ASIC industry funding levy, while registered liquidators incur a charge for undertaking the same functions. ARITA argued that the disparity gives unregistered individuals an unfair advantage and that the ASIC industry funding model should remove levies that relate to solvent liquidations.[111] ASIC data indicates that 75 to 78 per cent of liquidators appointed to MVLs were registered liquidators over the four years to 2021–22.[112] ARITA also noted that

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108 Mr Warren Mundy, Special Adviser, ARITA, *Committee Hansard*, 14 December 2022, p. 6.

109 ARITA, *Submission 36*, p. 59.

110 ARITA, *Submission 36*, p. 59; Thea Eszenyi, 'Is ASIC deregistering more "abandoned companies"? What the data shows', *ARITA Journal*, July 2022, p. 40.

111 ARITA, *Submission 36*, p. 60.

112 Thea Eszenyi, 'Is ASIC deregistering more "abandoned companies"? What the data shows', *ARITA Journal*, July 2022, p. 40.

MVLs are not included in public reporting by ASIC of external administrations even though they are an external administration under the Corporations Act.[113]

7.91 ARITA submitted that while MVLs provide an effective method to dissolve a company if it doesn't meet the requirements for voluntary deregistration, some inefficiencies and disparities could be addressed to make the process cheaper and timelier. This could reduce the time taken by several months. ARITA also suggested streamlining the MVL process to enable more companies not qualifying for voluntary deregistration to be correctly wound down more cheaply and quickly through the following MVL reforms:

- Remove the requirement to obtain clearance from the ATO before a distribution is made.
- Remove any provisions that give creditors rights in the members' voluntary liquidation process.
- To ensure competitive neutrality, exclude members' voluntary administrations from any industry levies applied to registered practitioners.[114]

Deregistration

7.92 Deregistration of a company can be:

- Voluntary by agreement of the company members, when the company is not conducting business, has assets worth less than $1000, is not involved in legal proceedings, has no outstanding liabilities, and has paid all fees and penalties payable to ASIC.[115]
- Compulsory, if ASIC believes the company has ceased trading or has outstanding fees and penalties: including:
  - the company has not paid its annual review fee within 12 months;
  - the company has not responded to a company compliance notice; or
  - the company has not lodged any documents in 18 months, and ASIC believes the company is no longer in business.[116]

    (If ASIC initiates deregistration for non-payment of the annual review fee, a significant period will have lapsed before the company is deregistered, during which no creditor has acted to wind up the company. This may indicate that if any creditors exist, the debts are

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113 ARITA, *Submission 36*, p. 72.

114 ARITA, *Submission 36*, pp. 59–60; See also KordaMentha, *Submission 14*, p. 3.

115 ASIC, *Voluntarily deregistering a company*, https://asic.gov.au/for-business/closing-your-company/deregistration/voluntarily-deregistering-a-company/ (accessed 27 April 2023),

116 Thea Eszenyi, 'Is ASIC deregistering more "abandoned companies"? What the data shows', *ARITA Journal*, July 2022, p. 40; ASIC, *Deregistration*, asic.gov.au/for-business/closing-your-company/deregistration/ (accessed 28 April 2023).

minimal and/or they are aware there are little or no assets available to pay costs in a winding up.)[117]

- ASIC initiated, following a liquidator lodging a deregistration request or end-of-administration return to signal that the winding up is complete.
- By other means including automatic deregistration when the affairs of the company are fully wound up; the court orders the deregistration; the strike-off from the register of a registered Australian body after it has ceased to carry on business interstate; or the removal from the register of a registered foreign company after it has ceased to carry on business.[118]

7.93 Voluntary and compulsory deregistrations are more common than other deregistrations and external insolvency administrations, as shown in Table 7.1. Several submitters and witnesses raised concerns that deregistrations may include many insolvent companies, with some suggesting that more checks or investigations are needed to prevent companies using deregistrations to avoid appointing liquidators.[119] ASIC is not required to carry out investigations about a company before deregistering it, and ASIC indicated it may not have the resources to investigate every company's affairs before deregistration.[120] ASIC confirmed that if the ATO has concerns about a company, it has an opportunity to request that ASIC defer a deregistration process for 180 days.[121]

117 ASIC, answers to questions on notice 001, 14 December 2022 (received 8 February 2023).

118 ASIC, answers to questions on notice 001, 14 December 2022 (received 8 February 2023).

119 Discussed in Chapter 3. See, for example, Russell Morgan, *Submission 2*, pp. 1–4; CPA Australia, *Submission 11*, p. 4; Ben Sewell, *Submission 12*, p. 13; DyeCo Solvency and Turnaround, *Submission 13*, p. 7; Mr Murray and Professor Harris, *Submission 18*, pp. 3–4; SCoLA, *Submission 37*, p. 2; SV Partners, *Submission 50*, pp. 4–5; Financial Counselling Australia and Small Business Debt Helpline, *Submission 58*, pp. 2–3; Mr John Winter, Chief Executive Officer, Australian Restructuring Insolvency & Turnaround Association, *Committee Hansard*, 14 December 2022, pp. 10–11.

120 ASIC, answers to questions on notice 001, 14 December 2022 (received 8 February 2023).

121 ASIC, answers to questions on notice 024, 1 March 2023 (received 11 April 2023).

Table 7.1 Company deregistrations

Financial Year	Voluntary Deregistration	ASIC/ABRS Initiated (Unpaid review fees)	ASIC/ABRS Initiated (Form 578)	Other	Total
2016-17	71,020	40,127	5,584	4,825	121,556
2017-18	74,848	44,701	5,252	4,493	129,294
2018-19	80,446	47,916	3,485	5,729	137,576
2019-20	84,929	49,605	2,463	6,370	143,367
2020-21	80,420	47,824	2,319	7,196	137,759
2021-22	82,431	47,767	1,225	6,257	137,680
Total	**474,094**	**277,940**	**20,328**	**34,870**	**807,232**

Source: ASIC, answers to questions on notice 001, 14 December 2022 (received 8 February 2023); See *also: Mr Russell Morgan, Submission 2, p. 4; Thea Eszenyi, 'Is ASIC deregistering more "abandoned companies"? What the data shows', ARITA Journal, July 2022, p. 40.*

7.94 Voluntary or compulsory deregistrations may occur for reasons other than financial difficulty or insolvency. At present, it is not possible to determine what portion of voluntary or compulsory deregistrations that may involve insolvent companies because the necessary data is not available.[122]

7.95 The responsibility for the registration and deregistration of companies will be with the Registrar (of Australian Business Registry Services (ABRS)) in the future. ASIC also notes that since April 2021, ABRS has been operating the registry business (which includes the registration and deregistration of companies) as a delegate of ASIC. At a later stage, the Registrar will assume primary responsibility for these functions under law.[123]

Committee view

System of pathways

7.96 In the first section of this chapter, the committee brought together a picture (Figure 7.1) of the system of 11 pathways for insolvency, restructuring, liquidation, and deregistration. The committee notes that the pathways include several pathways for restructuring and pathways using a debtor-in-possession approach. The committee suggests that it is unlikely that more pathways are needed. Rather, the existing pathways can be improved, and the committee discusses below some of the potential reforms put to this inquiry.

7.97 However, before proceeding to work on the individual pathways, the proposed comprehensive review should consider including an early task or project on a 'big-picture' view of the system of pathways, including:

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122 For discussion of some of the issues see, for example, Mr Michael Brennan (Offermans), *Submission* 73, pp. 8–10; Ben Sewell, *Submission 12*, pp. 13–14; Mr Murray and Professor Harris, *Submission 18*, pp. 3–4; ARITA, *Submission 36*, p. 72.

123 ASIC, answers to questions on notice 001, 14 December 2022 (received 8 February 2023).

- whether the system of pathways is meeting the purposes of the insolvency system and the economy; and
- the appropriate balance of outcomes and economic incentives for the range of stakeholders using the pathways.

Recommendation 6

7.98 The committee recommends that the proposed comprehensive review consider and report on the current system of corporate insolvency pathways from a holistic systems analysis perspective.

Safe harbour defence

7.99 The committee notes that many inquiry participants supported the safe harbour pathway and implementation of the recommendations of the Safe Harbour Review sooner rather than later. Some inquiry participants were not in favour of the informal workout with safe harbour pathway generally and held concerns about transparency of the safe harbour process. The committee notes that significant practical difficulties would arise if the safe harbour process was public, including that wide knowledge of a safe harbour process may lead to stakeholders taking actions that quickly render the company insolvent and unable to be restructured.

7.100 The committee also received evidence about other safe harbour issues, including relaxing criteria to access the protection, SME access, the interaction with unfair preference claims, the costs relative to phoenixing, and the potential exploitation of creditors. The committee has concluded that these issues require more forensic examination than was possible in this inquiry, and therefore highlights them as matters for consideration by the proposed comprehensive review. The committee considers that those issues should not prevent the near-term implementation of the Safe Harbour Review recommendations.

Recommendation 7

7.101 The committee recommends that the government implement recommendations from the Safe Harbour Review, independent and likely in advance of the further review, and consider referring the remainder of safe harbour reform issues identified in this report to a comprehensive review.

Small Business Restructuring (SBR)

7.102 The committee notes that the concept of small business restructuring has been welcomed by many stakeholders. The committee acknowledges that in the context of the pandemic, it was important for the previous Government to progress the SBR reforms relatively quickly. However, stakeholders have identified issues, potentially arising from the rushed legislation and implementation with limited consultation. The committee considers that it should have been possible to improve the consultation process while still legislating in a timely way.

7.103 The committee notes that stakeholders raised concerns that may be worthy of further reform, including too much complexity leading to higher costs, appropriate eligibility criteria, impact on access to insurance and industry licences, loss of access to banking facilities, ATO investigative burdens on practitioners, issues with personal guarantees and practitioners' liabilities.

Simplified liquidation

7.104 The committee observes that while the simplified liquidation pathway has only been in place for a short time, the early indications are that the drafting and implementation were rushed, leading to a potentially ineffective pathway. The committee acknowledges that moving quickly was important during the pandemic. However, appropriate consultation and policy design should still be possible. The committee considers that the simplified liquidation pathway must be sufficiently simpler and cheaper than standard insolvency to incentivise its use.

Voluntary administration

7.105 The committee notes that, on balance, most inquiry participants considered the voluntary administration pathway appropriate and effective. However, since the main provisions were put in place around 30 years ago, reforms have been limited, and in the most recent decade, usage of the pathway has declined. Inquiry participants have provided suggestions for reform that could be considered during the proposed comprehensive review. The committee observes that inquiry participants were generally not in favour of introducing the high complexity and high-cost US Chapter 11 system. The committee further notes that the Australian insolvency system already has several debtor-in-possession pathways.

Members voluntary liquidation

7.106 The committee considers that if the comprehensive review or other reforms to pathways are pursued, it would be appropriate to review and consult on potential improvements to the members voluntary liquidation pathway.

Recommendation 8

7.107 The committee recommends that as soon as practicable the government consider and consult on potential reforms to the:

- **small business restructuring pathway; and**
- **simplified liquidation pathway.**

Recommendation 9

7.108 The committee recommends that the comprehensive review consider the:

- **voluntary administration pathway; and**
- **members voluntary liquidation pathway.**

Deregistration

7.109 The committee notes that many companies are deregistered through voluntary or compulsory deregistration. The committee has heard concerns that some of those companies may be insolvent, even though deregistration is not a pathway properly available to an insolvent company. As no data is available, it is impossible to determine how many of those companies were, in fact, insolvent. The committee considers that it would be beneficial for the proposed comprehensive review to have some information on the solvency status of such companies. The committee suggests that, for this reason, ASIC should collect and analyse on an appropriately sized random sample of deregistrations. The committee suggests that the sample should be large enough to be statistically significant, without placing an undue burden on ASIC's resources.

Recommendation 10

7.110 The committee recommends that the Australian Securities and Investments Commission collect and analyse data from an appropriately sized sample of voluntary and compulsory deregistrations, to provide greater visibility of the solvency status of deregistered companies.

Chapter 8
Administration of liquidations and insolvency

8.1 The impact of insolvency practitioners on Australia's corporate insolvency regime cannot be understated. Upon appointment, insolvency practitioners become custodians of what may be the livelihood, not just of the directors of the immediate business, but also potentially of many others.

8.2 Insolvency practitioners must wear many hats: they may be advisors, accountants, auditors, investigators, debt collectors, litigators, and distributors. They usually enter people's lives at when they are at their most vulnerable and must balance many interests with often scarce resources to share around. This great responsibility is reflected in the requirements that must be met in the registration and conduct of insolvency practitioners, and for good reason.

8.3 Evidence to this inquiry recognised that the complexity and idiosyncrasies of the task of insolvency practitioners deserves further reflection. Primarily, this would help ensure that the current policy settings are optimal for ensuring that this profession can best serve the Australian economy.

8.4 This chapter focuses on five areas in particular:

- registration requirements;
- insolvency practitioner regulation;
- remuneration of insolvency practitioners;
- independence requirements; and
- pre-insolvency advisors.

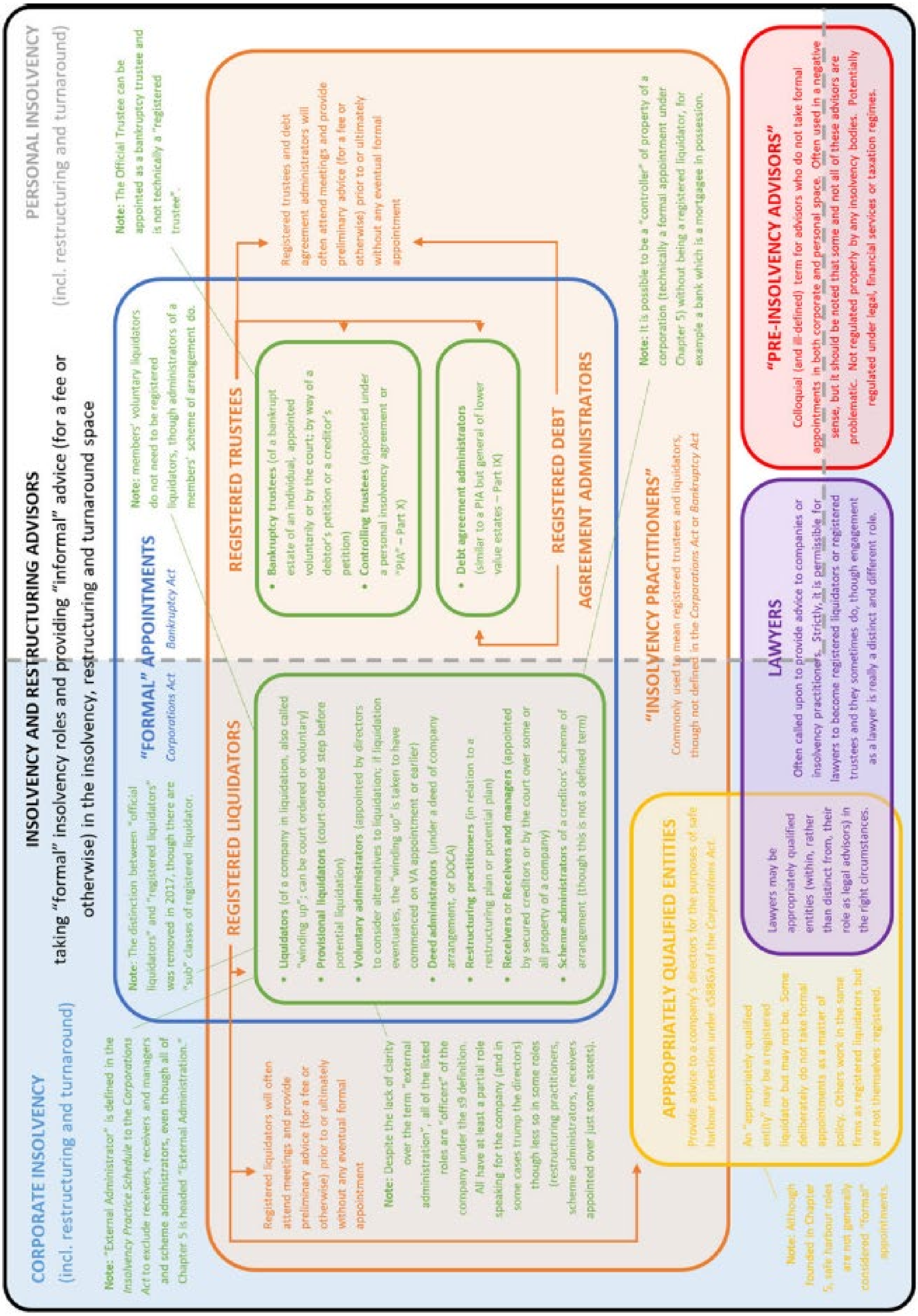
Background

8.5 'Insolvency practitioners' is an umbrella term used to refer to practitioners that specialise in advising on, or being appointed to formal roles within insolvency, restructuring and turnaround processes. While this term is commonly accepted as including liquidators and administrators, it does not have a clear definition, including in statute.[1]

8.6 Figure 8.1 contains a diagram provided to the committee by the Business Law Section of the Law Council of Australia (BLS LCA) that sets out and describes the various insolvency and restructuring advisors in both corporate and personal insolvency.

1 Business Law Section, Law Council of Australia (BLS LCA), *Submission 30*, p. 48.

Figure 8.1 Descriptions of insolvency and restructuring advisors



Source: Business Law Section, Law Council of Australia, Submission 30, Annexure 1.

8.7 Insolvency practitioners appointed to an administration or a liquidation take on a variety of tasks, including those identified in Figure 8.2 below, which was provided by the Australian Restructuring Insolvency and Turnaround Association (ARITA).

Figure 8.2 Responsibilities of insolvency practitioners

Source: ARITA, Submission 36, p. 62.

8.8 Insolvency practitioners, once appointed to an administration or liquidation (other than in small business restructuring), assume control of the company—the subject of the appointment to 'secure and recover its assets'— with the end goal being to either 'maximise the chances of the company or its business continuing in existence and/or maximise the returns to creditors'.[2] In doing so, insolvency practitioners become personally responsible to the company's creditors and may be held personally liable for the company's actions.[3] Insolvency practitioners also have duties to investigate a company's affairs and report to ASIC if necessary.

8.9 The highest level of the insolvency profession is made up of registered liquidators, which practice in corporate insolvency, and bankruptcy trustees, which operate in relation to personal bankruptcy. ARITA told the committee

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2 Australian Securities and Investments Commission (ASIC), *Submission 29*, p. 4.

3 Australian Restructuring Insolvency and Turnaround Association (ARITA), Submission 36, p. 62.

that as at 31 October 2022, there were 652 registered liquidators and 209 registered (bankruptcy) trustees, with a degree of overlap between the two.[4]

8.10 Responsibility for the regulation and supervision of insolvency practitioners in the context of corporate insolvency rests with the Australian Securities and Investments Commission (ASIC), while the Australian Financial Security Authority (AFSA) oversees the personal bankruptcy regime.

Registration requirements of insolvency practitioners

8.11 The registration regime for liquidators is set out in Subdivision B of Division 20 of the Insolvency Practice Schedule (Corporations) (Schedule 2 of the Corporations Act).

8.12 The Schedule provides that applications for registration as a liquidator must be considered by a committee convened for the purposes of considering such applications, to be constituted by representatives of ASIC, a registered liquidator chosen by a prescribed body (which is the Australian Restructuring Insolvency and Turnaround Association (ARITA)), and a person appointed by the Minister.[5] In considering an application, the committee must determine whether, among other things, the applicant has met the prescribed qualification, experience, knowledge and abilities requirements.[6]

Small business restructuring practitioners

8.13 The reforms that introduced the small business restructuring arrangements also introduced a new sub-class of registered liquidators who may only take appointments as restructuring practitioners, with lesser registration requirements than for full registration as a registered liquidator.[7] The committee was informed that as of January 2023, one small business restructuring practitioner had been registered, with six applications for registration having been rejected.[8]

8.14 Two competing views were put to the committee about this. On the one hand, ARITA raised concerns that the lessened requirements 'undermines much of the progress made to increase the competence and capability of the profession through the *Insolvency Law Reform Act 2016*' and 'fail[s] to recognise the specialised expertise of insolvency practitioners'.[9] Given the complexities

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4 ARITA, *Submission 36*, p. 61.

5 Insolvency Practice Schedule (Corporations), s 20–10.

6 Insolvency Practice Schedule (Corporations), s 20–10.

7 Insolvency Practice Rules (Corporations) 2016, section 20-2; ARITA, *Submission 36*, p. 66.

8 Mr Murray and Professor Harris, answers to written questions on notice [Various], 22 December 2022, (received 10 February 2023), p. 5.

9 ARITA, *Submission 36*, p. 67.

associated with the small business restructuring regime, ARITA 'strongly' recommended that equivalent academic requirements be imposed on restructuring practitioners as those on registered liquidators, while experience requirements could remain lessened.[10]

8.15 On the other hand, noting what appears to be a limited take up of this particular category of registration and the high number of rejections relative to the number of applications granted, Professor Harris and Mr Murray proposed expanding the scope of who may serve as a restructuring practitioner to assist in expanding the number of these practitioners.[11]

Gender diversity amongst registered liquidators

8.16 During this inquiry, the imbalance in gender representation amongst registered liquidators was a focus for inquiry participants. Table 8.1 below sets out data adapted from ASIC's submission and its Series 4 data[12] which shows the proportion of female registered liquidators against the total figure.

Table 8.1 Statistics of registered liquidators by gender

Period	Total	Female	Percentage female
2019-2020	633	55	8.7%
2020-2021	649	57	8.8%
2021-22	646	59	9.1%
As at 31 March 2023	651	60	9.2%

Source: Adapted from ASIC, Submission 29, pp. 68–69 and ASIC Series 4 statistics Table 4.4- Registered liquidators–Gender by region, ANNUAL, QUARTERLY, released April 2023, Tab 4.4 *<https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-4-quarterly-registered-liquidator-statistics/>*

8.17 While ASIC noted that there had been a slight increase in the number of female insolvency practitioners over the past 10 years (from five per cent),[13] there was

10 ARITA, *Submission 36*, p. 67.

11 Mr Murray and Professor Harris, answers to written questions on notice [Various], 22 December 2022, (received 10 February 2023), p. 5.

12 Quarterly statistics on the total number of ASIC registered liquidators, together with the number of new and ceased registered liquidators (by region): https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-4-quarterly-registered-liquidator-statistics/.

13 ASIC, *Submission 29*, p. 53.

a shared view amongst inquiry participants that more needs to be done to 'ensure that the profession is more reflective of the community that it serves'.[14]

8.18 The major reason provided for this imbalance is the current qualification requirements for registration as a liquidator with ASIC. The Turnaround Management Association (TMA) explained that the current requirement to demonstrate 4,000 hours of relevant experience within the five years prior to applying for registration is problematic, particularly for applicants that have caring responsibilities or take parental leave.[15]

8.19 KPMG echoed TMA's concerns that the current restrictions are problematic and discourage people with caring responsibilities from coming back into insolvency.[16] It recommended that this requirement be amended to take into consideration career breaks and part time work. KPMG did not express a view as to alternative minimum experience requirements, other than it possibly being a 'significant reduction', but it expressed a willingness to work with the relevant parties to make a recommendation.[17] It supported the development of a competency-based framework to determine the appropriate level of skill required.[18]

8.20 ASIC agreed that the experience requirement 'can be challenging for applicants who have or anticipate having parental leave or carers duties'.[19] It identified that changes that came into effect on 1 January 2021 provide liquidator registration committees with broader scope to consider what may be determined to be relevant work experience. It explained that following the introduction of these measures, some applicants, both male and female, were granted registration despite not having completed 4,000 hours of directly related work experience within the previous five years. These applicants had demonstrated that they were otherwise suitable for registration.[20]

8.21 ASIC pointed out that there is capacity to apply for a variation to these requirements. While acknowledging that there is some capacity to vary these

14 See, for example, ARITA, *Submission 36*, p. 68.

15 Ms Jennifer Ball, Chair, National Board, Turnaround Management Association, *Committee Hansard*, 14 December 2022, p. 49.

16 Mr Gothard, KPMG Australia, *Committee Hansard*, 21 February 2023, p. 48.

17 Mr Heathcote, KPMG Australia, *Committee Hansard*, 21 February 2023, p. 52.

18 Mr Heathcote, KPMG Australia, *Committee Hansard*, 21 February 2023, pp. 47, 52.

19 Mr Warren Day, Chief Operating Officer, ASIC, *Committee Hansard*, 1 March 2023, p. 32.

20 Mr Warren Day, Chief Operating Officer, ASIC, *Committee Hansard*, 1 March 2023, p. 32.

requirements, TMA stated that this is 'very ad hoc, and a lot of women didn't even know that they could actually make that application in the first place'.[21]

8.22 Both ARITA and ASIC suggested that the lack of female representation in the registered liquidator population may be the result of broader systemic issues.[22] ASIC pointed out that the gender imbalance also exists in other jurisdictions (such as the United Kingdom and New Zealand), suggesting that the problem extends beyond the Australian experience requirement.[23] ARITA told the committee that it is seeking to improve diversity and inclusion through its Balance Taskforce, which is initially focusing on gender and age diversity.[24]

Committee view

Small business restructuring practitioners

8.23 The limited number of registrations for small business restructuring practitioners is a cause for reflection. While these reforms have only been in place for two years, the committee is of the view that further consideration of the reasons for this would be beneficial and may lead to improvements in these figures. However, the committee agrees that any changes to this process would have to be undertaken carefully so as to not compromise the integrity and quality of the broader profession.

8.24 The committee is cognisant that the limited number of registrations for the position of a small business restructuring practitioner is likely to be related to the broader criticisms of the small business restructuring pathway. For that reason, the committee is of the view that it is appropriate to reflect on this issue in the course of any wider consideration of the pathway itself.

Recommendation 11

8.25 The committee recommends that the comprehensive review consider the requirements for the registration of small business restructuring practitioners to understand the reasons for the limited number of registrations to date.

Gender diversity amongst registered liquidators

8.26 While many other industries and professions have managed to improve diversity among their ranks, registered liquidators appear to have been locked in a time capsule that was buried decades ago.

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21 Ms Jennifer Ball, Chair, National Board, Turnaround Management Association, *Committee Hansard*, 14 December 2022, p. 49.

22 ARITA, *Submission 36*, p. 68.

23 Mr Day and Ms Eszenyi, ASIC, *Committee Hansard* 14 December 2022, p. 71.

24 ARITA, *Submission 36*, p. 68.

8.27 The fact that female representation amongst registered liquidators has *improved* to one in ten over the past decade is alarming. It appears that we are not alone in facing this issue. There are clearly broader cultural or systemic factors at play, and they must be reflected on and addressed.

8.28 A great place to start is the current experience requirements. These requirements are a significant barrier to anyone with caring responsibilities. They can be changed, and they must if we are to have an insolvency profession that reflects the economy and the country that it serves. While the committee acknowledges that there is capability for flexibility amongst the registration application process, reliance on *ad hoc* decision making is not enough if we are to achieve this goal.

8.29 The committee is of the view that prompt reform of the experience requirements is necessary. This review should consider whether the current requirement to demonstrate 4,000 hours of relevant experience during the previous five years is appropriate and necessary. It should also consider whether this requirement could be revised to allow for greater inclusivity while still ensuring that practitioners are appropriately qualified for registration.

Recommendation 12

8.30 The committee recommends that the government reform the experience eligibility requirements for registered liquidators, to address the inequity of the requirements and the gender imbalance in the population of registered liquidators. Reforms could potentially include:

- **increasing the period over which experience is demonstrated, or**
- **replacing part of the required hours with a competency-based exam.**

Regulation of insolvency practitioners

8.31 ASIC told the committee that it undertakes regulation of insolvency practitioners through various means, including:

- supervision, including:
  - dealing with reports of misconduct lodged with ASIC regarding alleged registered liquidator misconduct;
  - using real-time data to identify possible areas of concern for consideration;
  - using a natural language processing algorithm to allow real-time review of declarations of independence, relevant relationships and indemnities;
  - monitoring conditions imposed on liquidator registrations; and
  - exercising ASIC's registered liquidator regulatory powers under Schedule 2 of the Act (further information on this is set out in Appendix 1).
- enforcement action, including:

- referring registered liquidator misconduct to disciplinary committees convened under Schedule 2;
- entering court enforceable undertakings, where necessary; and,
- engaging in court proceedings either as an intervener or amicus curiae where necessary.

• guidance, including:

- publishing detailed regulatory guides on relevant topics and issues (including registration and discipline of registered liquidators); and
- developing and updating forms to enable compliance with duties and obligations, such as forms following the 2017 and 2020 law reforms.

• education, including:

- publishing information sheets to assist registered liquidators to comply with their duties and obligations (such as INFO 29);
- publication of quarterly newsletters on relevant topics; and
- authoring articles for publication in journals published by professional organisations.

• stakeholder engagement, including:

- issuing emails to registered liquidators and other interested parties on specific topics and issues;
- conducting surveys on topical issues; and
- facilitating and engaging in liaison meetings with registered liquidators, government and statutory and professional bodies.

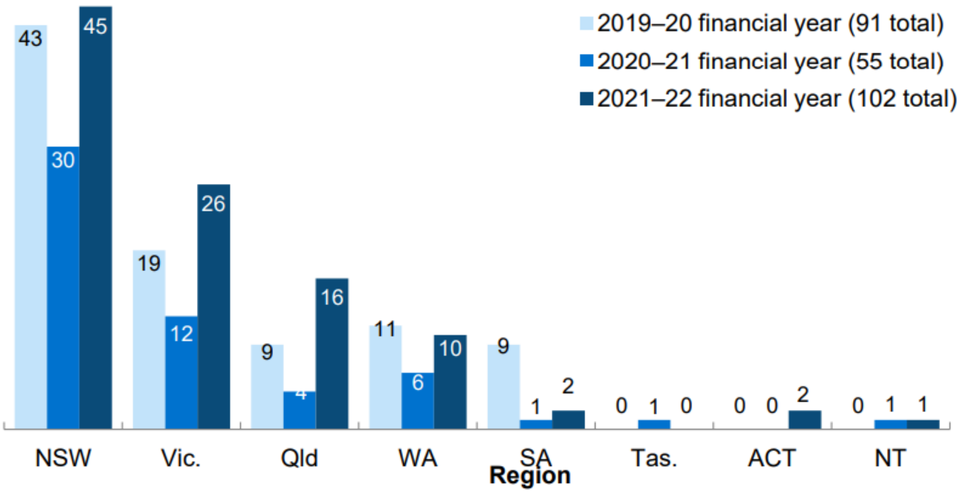
• policy work, including:

- providing data and feedback to government on proposed reforms;
- implementing systems and processes to enable registered liquidators to comply with their duties and obligations following law reform; and
- implementation of new laws[.][25]

8.32 Figure 8.3 below identifies the number of supervision cases finalised by ASIC in the 2019–20, 2020–21 and 2021–22 financial years.

25 ASIC, *Submission 29*, pp. 14–15.

Figure 8.3 Number of finalised insolvency practitioner cases, by state and financial year



Source: ASIC records.

Note: The decrease in matters finalised 2020-21 likely reflects the lower number of external administration appointments post COVID pandemic and consequential lower number of misconduct reports

Source: ASIC, Submission 29, p. 16.

8.33 ASIC noted that '[a] significant portion of [its] supervision activities result in a change in behaviour of the registered liquidator and their staff without formal enforcement action'.[26]

8.34 In 2021-22, ASIC considered 351 reports of misconduct in relation to registered liquidators (being 4 per cent of the total reports of the 8,688 misconduct received in that period).[27] Of these:

- 12 per cent were referred for further action;
- 3 per cent resulted in a warning letter being issued to the registered liquidator;
- approximately 25 per cent related to 'a lack of understanding of the insolvency process on the part of the reporter or communication issues'; and
- a further 60 per cent were analysed and assessed for no further action.[28]

8.35 As well as being regulated by ASIC, insolvency practitioners are subject to further standards and oversight arrangements under their relevant professional body. Registered liquidators are also subject to the ARITA *Code of Professional Practice*.[29]

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26 ASIC, *Submission 29*, p. 15.

27 ASIC, *Submission 29*, p. 27.

28 ASIC, *Submission 29*, p. 27.

29 Mr Brereton, ARITA, *Committee Hansard*, 14 December 2023, p. 2.

8.36 Disciplinary action may be taken against a registered liquidator following consideration of a committee, constituted by representatives of the same organisations that may sit on a committee considering registration applications (ASIC, ARITA and a nomination by the Minister).

8.37 Mr Ben Sewell raised questions about the presence of ARITA on these committees, stating that this presence ‘muddies the waters in terms of the model of who is the arbiter’. He explained:

> Where you have a professional association that both has some hand in whether its members get appointments and how they get punished and also basically collects fees from them and advocates on their behalf, I think that's a short-sighted process. If the real issue is the integrity of the system as a whole—that's one problem that you're being called to deal with—then avoiding conflicts of interest is something very important.[30]

8.38 Mr Sewell recommended that ARITA be removed from this position on the basis that it ‘lacks the impartiality to perform this kind of public service role’.[31]

8.39 Mr Michael Brennan, Liquidator and Bankruptcy Trustee at Offermans, described the uneasy relationship between ASIC and the population of insolvency practitioners that it regulates. He described a ‘high level of distrust between the two groups’, which in his view ‘at best could be classified as a wary détente’.[32] Mr Brennan compared this to the dynamic between AFSA and its regulated population, describing that relationship as ‘very collaborative and collegiate’.[33]

Remuneration of insolvency practitioners

8.40 In a report tabled in June 2004, this committee commented that it had received feedback that ‘clearly indicated a widespread perception that fees for insolvency services are high and may be unnecessarily so’.[34] Evidence to this inquiry also focused on the expense involved in engaging insolvency practitioners, but most of this commentary noted the degree to which the complexity of the task, and the amount of public interest work involved contributes to this expense. Indeed, the committee was told that much of insolvency practitioners’ work is not fully remunerated.

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30 Mr Ben Sewell, *Committee Hansard*, 28 February 2023, p. 60.

31 Mr Ben Sewell, *Submission 12*, p. 22.

32 Mr Michael Brennan, *Submission 73*, [p. 25].

33 Mr Michael Brennan, *Submission 73*, [p. 25].

34 Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: A Stocktake*, June 2004, xxii.

8.41 Remuneration for external administrators appointed to a company must be approved by either a resolution of that company's creditors, a committee of inspection or a court.[35]

8.42 Evidence from the Hon Bruce Billson from the Australian Small Business and Family Enterprise Ombudsman (ASBFEO), indicated that concerns remain about the extent of company assets that are consumed by meeting external administrators' costs and remuneration.[36] He described the sentiment as follows:

> Where the beneficiary of a business [is] in trouble, once engaged in the insolvency process, people sort of wonder, 'What's the outcome for people?' We like to use the word 'stakeholders'. It's not only about secured creditors but also about business owners who have put their life into it, employees who would love to see the business going, and investors who kind of wonder, 'Where's my spot in this conversation?' at times when significant proportions of residual assets end up going to the practitioner.[37]

8.43 Mr Murray explained that a thorough review of issues surrounding insolvency practitioner remuneration goes beyond simply regulating excessive charging:[38]

> Remuneration highlights a range of idiosyncratic features of insolvency law and practice that should be acknowledged when remuneration is being assessed, and which should provide some springboard for efficiency-based law reform.[39]

8.44 In addition to Mr Murray's general response, a number of specific factors which are discussed in more detail below, were raised as contributors to the cost of insolvency practitioner remuneration, including the:

- the degree to which insolvency practitioners undertake work for which they do not receive remuneration;
- complexity of the task;
- personal risk taken on by insolvency practitioners upon appointment;
- burden imposed by reporting obligations to creditors and regulators.

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35 ASIC, *Submission 29*, p. 19.

36 The Hon Bruce Billson, Ombudsman, Australian Small Business and Family Enterprise Ombudsman (ASBFEO), *Committee Hansard*, 13 December 2022, p. 38.

37 The Hon Bruce Billson, Ombudsman, ASBFEO, *Committee Hansard*, 13 December 2022, p. 34.

38 Mr Michael Murray, 'Rethinking Insolvency Practitioner remuneration', *Insolvency Law Bulletin,* November 2022, p. 38, available at Professor Jason Harris and Mr Michael Murray, *Submission 18, Attachment 1*.

39 Mr Michael Murray, 'Rethinking Insolvency Practitioner remuneration', *Insolvency Law Bulletin,* November 2022, p. 38, available at Professor Jason Harris and Mr Michael Murray, *Submission 18, Attachment 1*.

Unpaid work

8.45 The point was made to the committee that in many cases, liquidators forego full payment of their fees due to the inadequacy of available assets to cover them and the statutory obligations imposed on insolvency practitioners to undertake work even where assets are not available to remunerate them for it.[40]

8.46 While the committee was told that there is a degree of poverty of data and a lack of transparency about how the insolvency profession charges its work,[41] some statistics were cited as providing an idea of the scale of this issue. ASIC told the committee that 29.7 per cent of forms lodged at the end of external administrations and controllerships between 1 September 2017 and 30 September 2022 stated that no remuneration had been received during that appointment.[42] Referring to statistics from 2018/19, ARITA said that 'around 37% of the businesses being liquidated had no assets and a further 31% had less than $20,000 in assets', which is not enough to cover the full amount of practitioner's fees.[43] Mr Murray and Professor Harris cited a 2013 study which quantified the amount of unfunded work undertaken by liquidators at $47 million.[44] Professor Harris described this situation, being one where professionals are expected to take on jobs in which they may not be paid for 40 per cent of their work, as 'market failure'.[45]

8.47 A significant contributing factor in the creation of these circumstances is that insolvency practitioners are required by statute to take on a significant amount of 'public' work in the course of an administration or a liquidation, such as investigating the history of the company it has been appointed to, the activities of that company's directors and the preparation of reports on misconduct to ASIC.[46] However, the nature of this work increases pressure on the costs charged by insolvency practitioners, particularly because a great deal of this work is unlikely to generate financial returns for insolvency practitioners.[47] BlueRock

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40 ARITA, *Submission 36*, p. 20; Mr Michael Murray, 'Rethinking Insolvency Practitioner remuneration', *Insolvency Law Bulletin,* November 2022, pp. 33-34, available at Professor Jason Harris and Mr Michael Murray, *Submission 18, Attachment 1*; Mr Billson, ASBFEO, *Committee Hansard*, 13 December 2022, p. 33; CPA Australia, *Submission 11*, [p. 4].

41 Professor Jason Harris, *Committee Hansard*, 13 December 2022, p. 41.

42 ASIC, *Submission 29*, pp. 4, 23.

43 ARITA, *Submission 36*, p. 20.

44 Mr Michael Murray and Professor Jason Harris, *Submission 18*, p. 4.

45 Professor Jason Harris, *Committee Hansard*, 13 December 2022, p. 40.

46 BlueRock, *Submission 8*, p. 5; Professor Jason Harris and Mr Michael Murray, *Submission 18*, p. 4.

47 BlueRock, *Submission 8*, p. 5.

described this as 'free' work.[48] ARITA estimated that the value of this work to be around $100 million per year.[49]

Cross subsidisation

8.48 Some inquiry participants, such as Professor Harris and Mr Murray, suggested that in response to the quantum of unfunded work, there is a practice of cross-subsidisation occurring, wherein higher rates are charged in some administrations in order to cover lost funds on other accounts.[50] Professor Harris noted that judges had referred to 'the well-known principle of swings and roundabouts—that you might charge less on low-value jobs, and you charge more on high-value jobs'.[51]

8.49 The BLS LCA took a different view. They agreed with the economic proposition that where practitioners are not remunerated for aspects of their work, they must be able to receive enough funds from other work to ensure the viability of their business model. However, it did not take the view that cross-subsidisation was occurring as a result. It stated:

> It is not a necessary consequence that the system involves material "cross-subsidisation" as has been put to the Inquiry in some submissions. Ultimately that is only the case if creditors should be charged (or perhaps would be charged if liquidators were fairly remunerated for other work or not required to perform unfunded work).
>
> It is expected that creditors being paid a low cents-in-the-dollar return would scrutinise or feel aggrieved by a material portion of available funds being used to fund the work necessary to restructure or wind up the affairs of the company that owes them money. The public conversation about insolvency remuneration and consideration of stakeholder comments on those matters must be seen in that light.[52]

8.50 Chartered Accountants Australia New Zealand (CA ANZ), the Institute of Public Accountants (IPA) and CPA Australia described the notion that registered liquidators charge higher fees to businesses with sufficient assets as a gross misrepresentation, emphasising that liquidator remuneration is subject to approval by creditors. They stated:

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48 BlueRock, *Submission 8*, p. 5.

49 ARITA, *Submission 36*, p. 64.

50 Professor Jason Harris and Mr Michael Murray, *Submission 18*, p. 4; see also, Mr Michael Murray, 'Rethinking Insolvency Practitioner remuneration', *Insolvency Law Bulletin,* November 2022, p. 34, available at Professor Jason Harris and Mr Michael Murray, *Submission 18*, Attachment 1; Mr Scott Connolly, ACTU, *Committee Hansard*, 1 March 2023, p. 4.

51 Professor Jason Harris, *Committee Hansard*, 13 December 2022, p. 41.

52 BLS LCA, answers to written questions on notice [general questions], 23 December 2022 (received 14 February 2023) p. 22.

> In setting that rate, a registered liquidator must consider contingency for unfunded work, just as other service provides price in bad debts when providing services. This is simply pricing services at a rate that sustains a viable business, not cross-subsidisation.[53]

Public funding

8.51 It was put to the committee by some inquiry participants that government should fund these public functions performed by liquidators. ARITA told the committee that this would reduce the need for practitioners to cross-subsidise in other accounts.[54] On this view, the existing Assetless Administration Fund required further funding, and the threshold for accessing it to be too high, for it to be adequately working as intended.[55]

8.52 Mr Richard Fisher, a consultant to Ashurst Australia, noted that the Harmer Report, on which he was a Commissioner, recommended the creation of an assetless administration fund funded through an annual levy on companies. Mr Fisher explained:

> If you want a proper regime in terms of the costs of administration, then you put into place a regime funded by the corporate world to ensure that when companies fail there is at least a base level of investigation into the reasons for the failure for the purpose of identifying whether claims ought to be pursued as a result of misfeasance or on other bases.
>
> …
>
> The policy question, if I might put it in those terms, seems to us to be should there be a regime which facilitates the effective investigation of companies that fail. If I might put it in this way: so long as liquidators are expected to act as corporate policemen, at least in the first instance, that won't happen under the current regime simply because, in most cases, there are insufficient funds to support the investigation.[56]

8.53 Others supported the creation of an official receiver for corporate insolvency, reflecting the Official Trustee in Bankruptcy,[57] however, this view was not universally supported.

8.54 Discussion regarding the Assetless Administration Fund and other questions relating to public funding for insolvency are discussed in chapter 9.

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53 Ms Jill Lawrence, Chartered Accountants Australia New Zealand (CA ANZ), *Committee Hansard*, 28 February 2023, pp. 38-39.

54 ARITA, *Submission 36*, p. 22.

55 See, for example, views proffered by Mr Richard Fisher, Consultant, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 22; CPA Australia, *Submission 11*, [p. 5]; Deloitte, *Submission 32*, p. 9.

56 Mr Richard Fisher, Consultant, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 23.

57 Professor Jason Harris and Mr Michael Murray, *Submission 18*, pp. 2-4, 15; Mr David Levi, Committee Member, Association of Independent Insolvency Practitioners, *Committee Hansard*, 14 December 2022, p. 50.

Complexity

8.55 Mr Murray added that the fact that insolvency practitioner remuneration absorbs so much of the funds in a liquidation 'is perhaps indicative of the reality that winding up and investigations takes time and skill, and that any funds or assets that remain are difficult to locate and retrieve'.[58] ARITA, expressing a similar view, cited the views of former High Court Justice, the Hon Michael Kirby AC CMG who stated that:

> …the task of insolvency administration is inherently expensive. Principally this is so because of the intensive nature of the investigation of accounts (sometimes in a shambles and sometimes deliberately deceptive) that the insolvency practitioners must analyse and understand. … It is unreasonable to demand that skilled professionals should perform their functions at low cost.[59]

8.56 ARITA acknowledged that large firms that deal with high profile insolvencies receive 'significant' fees, although it asserted that these fees are 'proportionate to the…cost of expert staff and technical resources they bring to the task, as well as the scale of the personal liability their principals accept'.[60] However, ARITA told the committee that in the vast majority of cases, practitioner fees are modest.[61] ARITA further noted that 'in all liquidations and administrations the fees insolvency practitioners receive must be agreed by creditors or the courts'.[62]

Personal risk

8.57 ARITA, Mr Murray and other inquiry participants highlighted that insolvency practitioners take on personal financial risk upon appointment to an administration.[63] ARITA stated that insolvency accountants are paid around 20 per cent less than audit or tax accountants despite the fact that they carry significantly greater personal financial risk'. ARITA stated that this suggests 'that the market for insolvency services is at least workably competitive'.[64]

8.58 Mr Michael Brennan (Offermans) identified that the risk assumed by external administrators upon appointment is unique:

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58 Mr Michael Murray, 'Rethinking Insolvency Practitioner remuneration', *Insolvency Law Bulletin*, November 2022, p. 34, available at Professor Jason Harris and Mr Michael Murray, *Submission 18, Attachment 1*.

59 The Hon Michael Kirby AC CMG quoted in ARITA, *Submission 36*, p. 20.

60 ARITA, *Submission 36*, p. 20.

61 ARITA, *Submission 36*, p. 20.

62 ARITA, *Submission 36*, p. 20.

63 Mr Michael Murray, 'Rethinking Insolvency Practitioner remuneration', *Insolvency Law Bulletin*, November 2022, p. 34, available at Professor Jason Harris and Mr Michael Murray, *Submission 18, Attachment 1*. See also, KordaMentha, *Submission 14*, p. 7.

64 ARITA, *Submission 36*, p. 20.

> There is no other professional role in Australia where part of your job is to walk into a business, largely sight unseen, and take on the risk associated with being an Officer of that company immediately.[65]

8.59 Mr Brennan stated that to address this exposure, appointees require resources in order to 'assimilate knowledge and identify risk'.[66]

8.60 Further, Mr Brennan highlighted that while appointees usually seek an indemnity out of company assets, where the assets are not sufficient to cover the exposure, or the indemnity is disputed, the appointee is left financially exposed.[67]

Reporting obligations

8.61 Another factor proffered as impacting increasing insolvency practitioners' costs is the extent of the burden imposed by the reporting obligations.[68] The Business Law Section of the Law Council expressed this view as follows:

> …it is at least arguable that there is too heavy a burden placed on insolvency practitioners to provide comprehensive information to stakeholders (primarily creditors but also others, including government) at the expense of any consideration of the cost-benefit analysis of the investigative work necessary to realise that information.[69]

8.62 The Law Council recommended consideration on whether wholesale reform could truncate these requirements so as to improve returns to creditors.[70] ARITA shared a similar view and noted the perception amongst creditors that 'the extent of information provided [is] "padding" to justify the remuneration sought by the practitioner'.[71]

8.63 ARITA stated that reports provided to ASIC as required by liquidators' statutory obligations, may cost at least $5,000. They added that the preceding investigation could cost significantly more.[72] ARITA provided examples of such reports receiving an instantaneous response from ASIC indicating that no

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65 Mr Michael Brennan, *Submission 73,* [p. 18].

66 Mr Michael Brennan, *Submission 73,* [p. 17].

67 Mr Michael Brennan, *Submission 73,* [p. 18].

68 ARITA, *Submission 36,* p. 39.

69 BLS LCA, *Submission 30*, p. 48.

70 BLS LCA, *Submission 30*, pp. 48–49.

71 ARITA, *Submission 36*, p. 39.

72 Mr Brereton and Mr Winter, ARITA, *Committee Hansard*, 14 December 2022, p. 8.

further action is required.[73] This issue is discussed in further detail in relation to ASIC's regulatory activities (chapter 10).

Committee view

8.64 The issue of insolvency practitioner remuneration is a perfect example of the many competing interests that arise in a liquidation. The committee understands how, in the emotionally charged setting of a liquidation, the diminishment of an already limited pool of assets by the liquidators' fees can become contentious for creditors and directors.

8.65 However, the task of an insolvency practitioner is deeply complex, involves a great degree of personal risk and, in many cases, often goes without full remuneration. Only adding to these circumstances is the degree of public interest work required to be taken which, while of critical importance, inevitably contributes to the costs and expenses of liquidators and administrators.

8.66 It seems to the committee that this issue is indicative of broader systemic factors within the insolvency system itself which deserve thorough consideration by a broad scale review.

Recommendation 13

8.67 The committee recommends that the comprehensive review include consideration of the remuneration of insolvency practitioners, including:

- **the extent to which public interest work carried out by liquidators for no or limited pay is sustainable; and**
- **the impact of this on all stakeholders in external administrations.**

Independence requirements

8.68 A number of stakeholders raised concerns around the independence of insolvency practitioners once appointed to an external administration. In particular, there were concerns around the independence of practitioners appointed to external administrations who had advised the relevant company prior to the commencement of an administration.

8.69 Mr Murray and Professor Harris explained to the committee that independence requirements for insolvency practitioners differ from other professions. This is because once appointed, a practitioner occupies 'a statutory role independent of the person appointing them and independent of the creditors'. Administrators' responsibilities require them to investigate the performance of directors prior to appointment, which, as Mr Murray and Professor Harris explained, requires the

73 Mr Brereton and Mr Winter, ARITA, *Committee Hansard*, 14 December 2022, p. 8; see also, ARITA, Supplementary *Submission 36.1*, p. 52-53, [88-112].

administrator to both be, and be seen to be, independent of all parties.[74] Mr Murray and Professor Harris asserted that:

> If the practitioner has given prior advice to the company or the director on a certain course of action in respect of the company's assets or financial affairs in order to try to resolve the company's financial difficulties, it is not possible for the practitioner to then take an independent appointment as the liquidator or administrator.[75]

8.70 Mr Murray and Professor Harris identified that at present, a 'special purpose liquidator' (or administrator) may be appointed where concerns are raised about an appointed liquidator or administrator.[76]

8.71 There are some practical considerations around the independence requirements. As Professor Harris and Mr Murray explained in *Keay's Insolvency*, 'not every prior association…will lead to a lack of independence'. They added:

> Indeed, some prior contact is inevitable and necessary, for example, in relation to a creditors' voluntary liquidation, where the directors must seek out a registered liquidator to consent to being appointed.[77]

8.72 Mr Murray and Professor Harris explained this differentiation further in evidence to the committee, stating:

> There are circumstances which often apply where the insolvency practitioner explains the options to the individual director and suggests for example that their company should be liquidated. The relevant code and the law do not see that as impinging upon their independence. It is when that advice goes further and involves dealings in company assets that problems would arise.[78]

8.73 Importantly, the committee was told that the independence requirements increase the expense of voluntary administration trading activity. The BLS LCA stated that:

> it is at least arguable that those rules overemphasise the risks associated with poor corporate behaviour by insolvency practitioners, to the detriment of

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74 Mr Michael Murray and Professor Jason Harris, answers to questions on notice, Professional groups, 1 March 2023 (received 22 March 2023), p. 2.

75 Mr Michael Murray and Professor Jason Harris, answers to questions on notice, Professional groups, 1 March 2023 (received 22 March 2023), p. 2.

76 Mr Murray and Professor Harris, answers to questions to notice, Professional groups, 1 March 2023 (received 22 March 2023).

77 Mr Michael Murray and Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Insolvency Law and Practice*, 11th ed, Thomson Reuters, 2022, pp. 423-424.

78 Mr Michael Murray and Professor Jason Harris, answers to questions on notice, Professional groups, 1 March 2023 (received 22 March 2023), p. 2.

creditors, whose returns are diminished by the increased costs associated with having an additional practitioner involved.[79]

8.74 BLS LCA recommended that consideration should be given to relaxing these requirements on voluntary administrations or providing more efficient mechanisms for managing them, for example, simplifying the appointment of special purpose investigators to report on pre-appointment matters.[80]

8.75 McGrathNicol also supported the relaxation of independence requirements for the following reasons:

- the cost saving benefit of having an existing adviser familiar with the position of the company and the corresponding advantage of being able to more effectively plan and prepare to commence the appointment;
- the impediments to giving effective advice to the company in distress when the practitioner is focused on avoiding any apprehension of a lack of independence;
- lack of clarity of approach between recent caselaw and the approach of professional bodies and ASIC as to the interpretation of independence requirements, resulting in an unhelpful level of uncertainty; and
- the availability of the special purpose liquidator to address any matters of controversy that present a potential conflict of interest.[81]

8.76 However, evidence from other inquiry participants indicates that some have concerns about the independence of advisors who provide advice prior to appointment. Mr David Noonan, appearing in his capacity as the then-National Secretary of the Construction Forestry Maritime Mining Energy Union (CFMMEU) (Construction and General Division), said that there is a crisis of confidence in insolvency practitioners amongst some in the construction industry due to perceptions of a lack of independence,[82] regardless of whether or not nefarious activity had taken place.[83] Mr Noonan called for oversight and review where such circumstances arise.[84]

8.77 The Australian Council of Trade Unions (ACTU) highlighted broader concerns with the ability of directors to appoint preferred liquidators and administrators, describing this as a 'long standing' issue. In expressing support for a public liquidator, the ACTU noted concerns that under voluntary administration,

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79 BLS LCA, *Submission 30*, p. 23.

80 BLS LCA, *Submission 30*, p. 24.

81 McGrathNicol, *Submission 67*, p. 10.

82 Mr Noonan, Construction Forestry Maritime Mining Energy Union (CFMMEU), *Committee Hansard,* 21 February 2023, pp. 26, 30, 32.

83 Mr Noonan, CFMMEU, *Committee Hansard,* 21 February 2023, p. 30.

84 Mr Noonan, CFMMEU, *Committee Hansard,* 21 February 2023, p. 30.

directors can 'appoint their preferred administrators who are not inclined to report or disclosure director breaches'.[85]

8.78 Mr Ben Sewell noted that the business model which requires independence from, but at the same time allows directors to appoint external administrators has evident weaknesses whereby 'insolvency practitioners find themselves under pressure to compromise their integrity in order to attract business'.[86]

8.79 KPMG Australia highlighted that:

> there are some very strict rules about independence…this independence of the insolvency practitioner, the liquidator or the administrator, is really, really important. It is difficult because you do need to do a little bit of work beforehand, before you get thrown in. But there are cases and some practitioners who will do too much pre-planning and compromise their independence going forward. I think one of the ways to try and deal with that is stricter enforcement of independence.[87]

8.80 KPMG Australia pointed out that ASIC is 'quite vigilant' in regulating independence and has been for some time. It identified that creditors play an important role in reporting breaches of independence requirements, but acknowledged that on occasion, economic considerations may discourage creditors from pursuing these claims.[88]

8.81 There was some discussion by stakeholders of potential options to address the concerns relating to the independence of insolvency practitioners. There were mixed views as to whether there should be a formal separation between professional groups. For example, between those who provide advice to companies in relation to financial distress and might be involved in attempts to restructure, and those who may be appointed to administer an insolvency, whether it be in the form of administration or liquidation.

8.82 The case for such a proposal was explained to the committee by Mr Ben Sewell:

> …what I referred to in my submission was that in the…administration process you have the same appointee who's working on the restructure. They're being appointed by the directors with the promise of getting a restructure of the balance sheet to basically cut down debt, but then, on the other hand, there's an incentive for them to then work on the winding-up process afterwards and essentially be paid twice. I think that creates a conflict of interest. I believe it would be in everybody's best interests to have a split of the profession, a bit like barristers and solicitors, where you have the restructuring side and then the investigative side. This is something that was created last year with the restructuring practitioner process. What that

85 Australian Council of Trade Unions (ACTU), *Submission 75*, p. 16.

86 Mr Ben Sewell, *Submission 12*, p. 26.

87 Mr Gothard, KPMG Australia, *Committee Hansard*, 21 February 2023, p. 51

88 Mr Gothard, KPMG Australia, *Committee Hansard*, 21 February 2023, p. 51

> would mean is you would have one set of consultants who would come in to try and restructure and work as hard as they could to get that over the line, and if that failed then the team B would come in to go through the wind-up process. So you wouldn't have the conflict of interest, and you wouldn't have the potential battles between the director and the people they appointed because of expectations that they're loyal to them in some way.[89]

8.83 Professor Harris and Mr Murray were dubious about the proposal stating that 'the issues and the options are not clear'.[90]. These witnesses acknowledged that the current environment, wherein a director seeking advice from a liquidator is unlikely to receive limited advice in order to not comprise their independence in a potential appointment 'seems unsatisfactory'. They raised the point of whether a specialist body of professionals should be developed to provide fulsome advice without the fear of compromising independence requirements on appointment. They were of the view that a body already exists to provide turnaround and restructuring advice that does not necessarily lead to formal solvency appointments. They stated, however, that there could be better regulation in this area (see discussion in relation to pre-insolvency advisors in paragraph 8.88 below).[91]

8.84 As well as better regulation of pre-insolvency advice, Mr Murray and Professor Harris suggested that a review of the laws of independence of insolvency practitioners should be considered with the aim of legislative reform is necessary. They stated:

> That would require careful consideration and would best be achieved through legislative change. At the same time, the need for the practitioner to be seen as independent, given the strong powers and authority they have, is important, and any watering down of that perception might have unwanted consequences in terms of the integrity of the insolvency process.[92]

Committee view

8.85 There is a balance to be struck in establishing the appropriate level of restrictions around how involved an insolvency practitioner may be in dealing with a company prior to it entering insolvency. On the one hand, having access to information about the company could lead to greater efficiencies and lower costs which may, in turn, bring higher returns to creditors. This committee has also repeatedly heard of the importance of receiving good advice and receiving it early. Therefore, placing further barriers on access to such information may

89 Mr Ben Sewell, C*ommittee Hansard*, 28 February 2023, p. 61.

90 Mr Murray and Professor Harris, answers to questions to notice [Professional groups], 1 March 2023 (received 22 March 2023).

91 Mr Murray and Professor Harris, answers to questions to notice [Professional groups], 1 March 2023 (received 22 March 2023).

92 Mr Murray and Professor Harris, answers to questions to notice [Professional groups], 1 March 2023 (received 22 March 2023).

seem counterintuitive. However, having confidence in liquidators and administrators is key not only to the profession by to the system as whole, and it appears that even under the current settings, there is some sense that conflicts of interest, whether perceived or actual, are detracting from that.

8.86 On the current evidence, the committee is not in a position to conclude whether the current settings are appropriate. However, the committee is of the view that this issue warrants further consideration as part of any comprehensive review. Such consideration should consider whether the current arrangements are achieving the policy settings that inform them, and whether or not those policy settings themselves are best serving the Australian economy and the participants in it. The committee is of the view the comprehensive review should also consider whether there is a need to formally separate the roles of advice and restructuring on the one hand, and administration and liquidation on the other. The implications this may have for the profession, as well as for those that engage with it should also be carefully considered.

Recommendation 14

8.87 The committee recommends that the comprehensive review include consideration of the operation, efficacy, and efficiency of the current independence requirements for insolvency practitioners, including:

- **whether the current requirements are achieving the policy settings that inform them and whether these policy settings are optimal; and**
- **the advantages and disadvantages of formally separating the roles of advice and restructuring from formal appointments to liquidations and administrations.**

Pre-insolvency advisors

8.88 The lack of definition and legislative parameters around the term ‘insolvency practitioner’ becomes problematic in the context of a collection of consultants commonly referred to as ‘pre-insolvency advisors’ or ‘untrustworthy pre-insolvency advisors’. Inquiry participants highlighted that there are many trustworthy sources of pre-insolvency advice within the insolvency industry,[93] and that companies are encouraged to seek advice from these sources prior to entering insolvency or even significant financial difficulty.[94] However, the committee was told that the lack of regulation around who may term themselves as a ‘pre-insolvency’ or ‘turnaround’ advisor was of some concern, with the lack

[93] Mr Murray, *Committee Hansard*, 13 December 2022, p. 46; Mr Gavin McCosker, Deputy Chief Executive, Australian Financial Security Authority (AFSA), *Committee Hansard*, 13 December 2022, p. 61; Mr Christopher Pearce, Chair, Chair, Insolvency & Restructuring Committee, BLS LCA *Committee Hansard,* 14 December 2022, p. 29.

[94] Mr Murray, *Committee Hansard*, 13 December 2022, p. 46.

of regulation in this area permitting some to market themselves as such while promoting illegal activities, or methods to avoid paying outstanding obligations.[95]

8.89 Professor Harris and Mr Murray told the committee that some of the advice provided by these practitioners is 'inappropriate and illegal advice on how to avoid paying debts, particularly tax debts'.[96] ARITA shared a similar sentiment, stating:

> Not to be confused with qualified professionals giving lawful advice, these 'pre-insolvency advisors' counsel their clients on how to avoid paying their debts and meeting their legal obligations. They are 'ambulance chasers' who prey on people and businesses in financial distress. They claim to be able to remove the worry of a dire financial situation, but they often encourage unlawful conduct such as hiding or stripping assets and illegal phoenixing.[97]

8.90 Professor Harris and Mr Murray explained to the committee that at present there is a 'regulatory blind spot of "pre-insolvency" advisors'.[98] Professor Harris said that these advisors may be accountants, lawyers, or 'struck-off insolvency practitioners…who refashion themselves…and say: "I understand the system. I can show you how to beat the system"'.[99] ARITA described that these advisors are 'almost invariably…not registered liquidators or trustees, not lawyers or tax practitioners, typically not part of any professional body and don't hold Australian Financial Services Licences'.[100] They added that such advisors operate in the absence of any licensing, scrutiny and indemnity insurance, and operate knowing 'that the regulators are unlikely to chase them'.[101]

8.91 The BLS LCA highlighted that 'despite near universal support conceptually for cracking down on pre-insolvency advisors, there is no consensus on (indeed no real suggestion of) a set of defined characteristics of "untrustworthy advisors"'.[102] It also suggested that these advisors, should they be lawyers, accountants, insolvency practitioners or tax agents, may already be subject to

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95 Mr Michael Murray and Professor Jason Harris, answers to questions on notice, Professional groups, 1 March 2023 (received 22 March 2023), p. 3.

96 Mr Michael Murray and Professor Jason Harris, answers to questions on notice, Professional groups, 1 March 2023 (received 22 March 2023), p. 3.

97 ARITA, *Submission 36*, p. 49.

98 Mr Michael Murray and Professor Jason Harris, *Submission 18*, p. 6.

99 Professor Harris, *Committee Hansard*, 13 December 2022, p. 45.

100 ARITA, *Submission 36*, p. 51.

101 ARITA, *Submission 36*, p. 51.

102 BLS LCA, answers to written questions on notice [General questions], 23 December 2023 (received 14 February 2023), p. 43.

some form of regulation or professional standards requirements.[103] It supported the creation of a clear definition of this category of advisors if attempts are made to regulate them.[104]

8.92 Pre-pandemic data presented in ARITA's submission indicated rising concern amongst some insolvency practitioners about the influence of these advisors. This data, which was collected through a 2019 survey conducted by ARITA indicated that almost 50 per cent of respondent registered liquidators had observed an increase in the extent of influence of illegitimate pre-insolvency advisors compared to 2017, with 20 per cent of the respondents noting that this influence had greatly increased.[105] Other data collected during this survey indicated that:

- 39 per cent of respondents believed that more effective enforcement action was needed to 'shut down these dodgy advisors'; and
- 30 per cent said that pre-insolvency advisors should be regulated.[106]

8.93 Professor Harris stated that part of the issue with insolvency advisors is that they are readily accessible, often advertised on Google, which is a common avenue for small business owners facing financial difficulty to look for advice. He explained:

> One problem, particularly for small business, is that they often don't have access to high-quality advice and information. If they don't know who to turn to or when, perhaps, the ATO or another creditor takes an enforcement action, what do they do? They go to Google. The sorts of firms that advertise on Google are the sorts that say, 'We can help you to avoid paying tax, so engage our services.' That's what AFSA, for example, calls untrustworthy advisors.[107]

8.94 AFSA identified that it also shared concerns about the activity of untrustworthy advisors, which it described as follows:

> …we're particularly focused on the unregulated, unregistered operators who are seeking to exploit and take advantage. Often, it can be a financial advantage in terms of getting money from someone who's in difficulty or it can run right to the extreme in terms of creating fictitious creditors and trying to influence the outcome of an insolvency process.[108]

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103 BLS LCA, answers to written questions on notice [General questions], 23 December 2023 (received 14 February 2023), p. 42.

104 BLS LCA, answers to written questions on notice [General questions], 23 December 2023 (received 14 February 2023), p. 43.

105 ARITA, *Submission 36*, p. 50.

106 ARITA, *Submission 36*, p. 50.

107 Professor Harris, *Committee Hansard*, 13 December 2022, p. 34.

108 Mr Paul Shaw, National Manager, Enforcement and Practitioner Supervision, AFSA *Committee Hansard,* 13 December 2022, p. 61. See also, AFSA, *Untrustworthy Advisors: A hidden scourge in Australia's personal insolvency system,* 1 July 2022

8.95 AFSA views these advisors 'as a real potential harm to the insolvency system',[109] adding that 'there's a strong correlation between their adverse impact in the personal insolvency system and in the corporate insolvency system'.[110] In AFSA's view, a key mechanism for addressing these activities is ensuring that information reaches those who may be the subject of such advisors' activities to help them make informed decisions.[111] Another is building partnerships relationships, including with creditors, to try and 'bring decision-making forward' in order to address some of these risks.[112]

8.96 The ATO stated that it targets pre-insolvency advisors facilitating illegal phoenixing through its work on the Phoenix Taskforce and the Serious Financial Crime Taskforce.[113] It added that where it identifies suspect behaviour amongst registered liquidators, it refers those matters to ASIC as the regulator.[114] The ATO informed the committee that joint activity between the ATO and ASIC has resulted in the criminal prosecution of some pre-insolvency advisors, including:

> A recent joint ATO and ASIC operation resulted in a pre-insolvency advisor being sentenced to five years in prison after pleading guilty to one charge of dealing in the proceeds of crime. Another joint ATO and ASIC operation has resulted in a pre-insolvency advisor currently facing 13 criminal charges; four charges of obstruction of Commonwealth officials and nine charges for dishonestly causing a loss to the Commonwealth.[115]

8.97 The ATO informed the committee that an intelligence program undertaken by the Serious Financial Crime Taskforce which ended in October 2021 identified approximately 200 suspected high risk insolvency advisors, most of which were

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https://www.afsa.gov.au/sites/default/files/afsa_untrustworthy_advisors_report.pdf (accessed 22 May 2023).

109 Mr Paul Shaw, National Manager, Enforcement and Practitioner Supervision, AFSA *Committee Hansard*, 13 December 2022, p. 61.

110 Mr Paul Shaw, National Manager, Enforcement and Practitioner Supervision, AFSA, *Committee Hansard*, 13 December 2022, p. 61.

111 Mr Paul Shaw, National Manager, Enforcement and Practitioner Supervision, AFSA *Committee Hansard*, 13 December 2022, p. 61.

112 Mr Paul Shaw, National Manager, Enforcement and Practitioner Supervision, AFSA *Committee Hansard*, 13 December 2022, p. 61.

113 ATO, answers to questions on notice, [Registered liquidator and pre-insolvency advisor practices], 1 March 2023 (received 23 March 2023).

114 ATO, answers to questions on notice, [Registered liquidator and pre-insolvency advisor practices], 1 March 2023 (received 23 March 2023).

115 ATO, answers to questions on notice, [Registered liquidator and pre-insolvency advisor practices], 1 March 2023 (received 23 March 2023).

operating outside the regulatory regime. Additional intelligence obtained in the intervening period has not led to the identification of a change in this number.[116]

Proposals to address untrustworthy pre-insolvency advice

8.98 Stakeholders presented various strategies to address the problem of untrustworthy pre-insolvency advice. A threshold issue appeared to be the ability to define and identify who might fall into the category of 'untrustworthy advisor' or 'pre-insolvency advisor'. CA ANZ, CPA Australia and (IPA) advised that the first step in addressing this problem is to identify them.[117] These organisations referred to the requirement in personal insolvency, wherein persons are asked to identify whether they have received any advice, are asked to name the provider of that advice and state how much was paid. Similarly, registered trustees in bankruptcy are required to ask whether the bankrupt individual had received any advice, and who provided it. Such processes may produce information that assists in the identification of pre-insolvency advisors.[118]

8.99 A number of other submissions expressed support for introducing a regulation or licensing scheme.

8.100 Mr Murray and Professor Harris acknowledged that a further scheme of regulation may increase the cost of advice, and in turn hinder access to advice, particularly for small businesses. They also stated that the introduction of such a system would require the creation of a designated regulator, for both personal and corporate insolvency.[119] However, they stated that 'greater regulation would promote greater transparency and confidence in pre-insolvency advice'. They added:

> 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.[120]

8.101 CPA Australia and the IPA supported regulation of insolvency practitioners, and the commencement of a public discussion of what that may look like. As for

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116 ATO, answers to questions on notice, [Registered liquidator and pre-insolvency advisor practices], 1 March 2023 (received 23 March 2023).

117 (CA ANZ), CPA Australia and the Institute of Public Accountants (IPA), answers to questions on notice [Regulation of pre-insolvency advice] 28 February 2023 (received 21 March 2023), p. 2.

118 CA ANZ, CPA Australia, and IPA, answers to questions on notice [Regulation of pre-insolvency advice] 28 February 2023 (received 21 March 2023), p. 2.

119 Mr Murray and Professor Harris, answers to written questions on notice [Various], 22 December 2022 (received 10 February 2023), p. 23.

120 Mr Murray and Professor Harris, answers to written questions on notice [Various], 22 December 2022 (received 10 February 2023), p. 23.

the creation of a new regulator, these witnesses suggested that the Tax Practitioners Board might be looked at as a potential model for such a body.[121]

8.102 Professor Harris and Mr Murray suggested that 'increased regulatory guidance on who can serve as a safe harbour adviser and on practitioner registration requirements may assist',[122] as well as some form of licensing regime.[123] They further suggested the implementation of the small business viability voucher initiative, as recommended by the ASBFEO in is 2020 *Insolvency Inquiry Report*, could guide directors seeking advice away from these advisors. Under this proposal, directors could be required to use the voucher with a list of accredited advisors, a register of which could be maintained by ASIC.[124]

8.103 ARITA also supported the introduction of a licensing scheme. It identified this measure as 'one piece of the puzzle in fighting illegal phoenixing'.[125] It noted that the advice provided by pre-insolvency advisors stated that existing licensing systems, such as those that regulate providers of financial, accounting or legal advice, have failed to address this problem.[126]

8.104 As opposed to introducing a new system of regulation, Mr Michael Brennan (Offermans) argued in favour of strengthening the existing legislative sanctions and the use severe penalties against persons engaged in this conduct.[127]

Committee view

8.105 The behaviour of untrustworthy pre-insolvency advisors has an impact that extends far beyond the immediacy of their actions. It undermines some of the key purposes of the corporate insolvency regime, including the efficient re-distribution of resources around the economy and the regulation of poor director behaviour. It exploits the position of creditors. It challenges the credibility of the broader insolvency practitioner profession, the majority of whom maintain high ethical standards in their work.

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121 CA ANZ, CPA Australia, and IPA answers to questions on notice [Regulation of pre-insolvency advice] 28 February 2023 (received 21 March 2023), p. 3.

122 Mr Michael Murray and Professor Jason Harris, answers to questions on notice, Professional groups, 1 March 2023 (received 22 March 2023), p. 3.

123 Mr Michael Murray and Professor Jason Harris, answers to questions on notice, Professional groups, 1 March 2023 (received 22 March 2023), p. 3.

124 Professor Harris, *Committee Hansard*, 13 December 2022, p. 45; Mr Michael Murray and Professor Jason Harris, answers to questions on notice, Professional groups, 1 March 2023 (received 22 March 2023), p. 3.

125 ARITA, Supplementary Submission 36.1, p. 42.

126 ARITA, Supplementary Submission 36.1, pp. 42-43.

127 Mr Michael Brennan, Liquidator and Bankruptcy Trustee, Offermans, *Committee Hansard*, 21 February 2023, p. 42

8.106 Evidence to this inquiry indicated that these operators are more identifiable by the harm they perpetrate rather their job title or profession. In order to address this harm, we need to be able to understand the extent of the impact of this behaviour, the nature and number of those who engage in it, as well as the root causes for it. Only then can we properly consider solutions for addressing it.

8.107 For these reasons, the committee is of the view that broader engagement with, and analysis of, these issues is necessary and should be included in a broader review of the insolvency framework. This analysis should consider:

- the harm caused by the activities of pre-insolvency advisors;
- those who engage in such activities; and
- options to address these issues.

Recommendation 15

8.108 The committee recommends that the comprehensive review include consideration of the nature and extent of the harm posed by 'untrustworthy pre-insolvency advisors', and whether further regulation or enforcement measures are needed to address this issue. The committee further recommends that in the interim, the government take prompt action to improve the regulation and active enforcement of pre-insolvency advisers.

Chapter 9
Assetless administrations and the role of the state

9.1 This chapter considers the issues that arise when a company with few or no assets becomes insolvent, and how the public interest purposes of insolvency processes might be better met in such cases.

9.2 The operation and adequacy of the Assetless Administration Fund is examined, including potential changes to the fund. In turn, this chapter considers proposals to establish a government liquidator in corporate insolvency.

The public functions of insolvency processes: who pays?

9.3 In administering an insolvent company, insolvency practitioners attend not only to the interests of private creditors and employees, but also to broader public interests. In particular, insolvency practitioner investigations of director misconduct are largely a public interest function, even allowing that such investigations also serve private interests inasmuch as they can assist efforts to recover creditor funds.

9.4 The importance of insolvency law's public interest function and the state's role in funding a portion of the system is generally taken as a given. As Mr Michael Murray and Professor Jason Harris have pointed out, the need for public funding 'is relatively uncontentious in relation to the system of courts, a public register, and relevant laws' that support corporate insolvency.[1]

9.5 Questions remain, however, as to whether the state's role should be expanded in places where there are currently funding gaps in the work of insolvency. These funding gaps are especially pronounced in relation to administrations of companies that have few or no assets available to cover an insolvency practitioner's fees and expenses. Such work is currently either 1) undertaken by insolvency practitioners, and often unremunerated (as covered in chapter 8); or 2) not undertaken at all because an insolvent company does not go through a formal insolvency process.

9.6 Professor Harris and Mr Murray proposed that the role the state might play in addressing funding gaps in the corporate insolvency system should be a foundational issue in a comprehensive review process:

> We're saying that, ultimately, within that regime within which the system operates, there's really not enough money floating around coming out of insolvent estates for the work that needs to be done to be done properly.

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1 Mr Michael Murray and Professor Jason Harris, 'Rebuilding the structure of the Australian insolvency system,' *Insolvency Law Bulletin* (July 2022), p. 14.

> That's where we're saying there needs to be a greater role of the state. In my view, a root-and-branch review would start at that initial point.[2]

9.7 Proposals for the state to better fund or itself undertake the public interest work of insolvency, especially in relation to assetless administrations, is considered below.

Insolvency practitioners and the identification of misconduct

9.8 As noted above, insolvency practitioners are required to carry out a range of public interest work in administrations. This includes investigations of misconduct under section 533 of the *Corporations Act 2001* (Corporations Act) and related sections, and the referral of other offences to the Australian Securities and Investments Commission (ASIC). As the Business Law Section of the Law Council of Australia (BLS LCA) explains, the 'putative purpose of that sort of obligation goes beyond the returns to stakeholders and extends to the discouragement of poor corporate behaviour generally and the provision of assistance to the regulator'.[3] However, even where insolvency practitioners are providing statutory reports identifying potential misconduct, evidence received by this committee would suggest these statutory reports of misconduct are not met with a commensurate enforcement response from ASIC. Referring to evidence received by the committee, Mr Christopher Pearce explained that:

> …there is a public good associated with the sorting out of the affairs of insolvent entities. Someone needs to ask the question: what is the extent of that public good, and what is required and what is not required? You've heard a lot of evidence about the extent of the work that goes nowhere and whether it needs to be done or whether perhaps more needs to be done with it.[4]

9.9 The current statutory reporting requirements on insolvency practitioners and the adequacy of ASIC's responses to those reports, are matters discussed in further detail in chapter 10.

The problem of low- and no-asset insolvent companies

9.10 Insolvency processes are ordinarily funded through the assets of the company in administration. However, where a company has few or no assets, this is not possible. As discussed in chapter 8, where an insolvency practitioner does engage in work on an assetless company, it is likely they cross-subsidise a large extent of unremunerated work through higher charge out rates where assets can be realised.

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2 Mr Michael Murray, Private capacity, *Committee Hansard*, 13 December 2022, pp. 38–39.

3 Law Council of Australia, Business Law Section (BLS LCA), answers to written questions on notice, 23 December 2022 (received 14 February 2023), p. 21.

4 Mr Christopher Pearce, Chair, Insolvency & Restructuring Committee, BLS LCA, *Committee Hansard*, 14 December 2022, p. 30.

9.11 However, it is also likely that in many cases involving insolvent assetless companies, no administration takes place. As the Harmer Report explained, faced with the prospect of no recovery, creditors are understandably reluctant to incur the costs of pursuing the administration of an assetless company. Directors of such companies, who may be 'anxious to avoid any examination of their conduct', will rarely take steps to wind up the company, and the company is simply left unadministered.[5] Evidence to the committee suggests that a similar problem may persist today, with assetless companies left dormant before eventually being deregistered. However, as discussed in chapter 7, there is a lack of data as to the solvency status of these companies which needs to addressed.[6]

9.12 The fact that the Harmer Report findings remain relevant today speaks to the possible persistence of the problem; indeed, when this committee conducted a 'stocktake' of corporate insolvency laws in 2004, it referred to the question of assetless administrations as 'one of the more difficult, longstanding and important issues' in the corporate insolvency space.[7]

9.13 While creditors do not stand to gain anything from the proper liquidation of an assetless company, allowing an assetless company to simply be deregistered is problematic for a range of reasons. The Harmer Report, as summarised elsewhere, concluded:

> …that there were strong reasons for encouraging administrations of assetless companies. Allowing an assetless company simply to lie dormant, eventually to be deregistered, means that there would never be a review of the company's activities by someone other than the company officers. Unscrupulous directors could improperly move assets out of companies into related companies or appropriate the corporate property themselves. As long as they do not leave enough assets behind to pay for an administration, their activities would probably not be subject to scrutiny and they would not be subject to clawback provisions and other remedies available to a liquidator. Furthermore, the regulator would not find out about the conduct so the directors would not be subject to action by the regulator. This would leave little in the way of deterrence for illegal conduct and entering voidable transactions—rather it would be likely to encourage abuse.[8]

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5 Australian Law Reform Commission (ALRC), Report No. 45, *General Insolvency Inquiry*, Vol. 1 (1988), p. 148.

6 Chapter 7 addresses the prevalence and import of company deregistrations.

7 Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: a Stocktake* (June 2004), p. 126.

8 *Review of the Regulation of Corporate Insolvency Practitioners Report of the Working Party* (June 1997), p. 20, as cited in BLS LCA, *Submission 30*, p. 36.

9.14 When asked what value there was in an insolvency process in instances of low- or no-asset insolvency, Mr Murray noted that UNCITRAL explained the value in two ways. First, simply allowing assetless companies to disappear would ignore the possibility that some of those companies may be assetless by design:

> In other words, the directors have just depleted the assets and moved onto another company, they've been phoenixed, or there might be some other untoward conduct. There should at least be some scrutiny of those, and that is one purpose.[9]

9.15 A more positive or 'elevated' purpose (and one that does not fit strictly within the public purposes that this chapter is primarily concerned with), is that good corporate governance should allow the compliant, law-abiding director of an insolvent company access to an insolvency process, however it is funded. This would then allow the company to 'have its insolvent circumstances resolved through some formal purpose, at least to give some closure to those that have been dealing with it'.[10] This would provide those who have been dealing with the company, including employees and creditors, some finalisation and would enhance transparency.[11]

9.16 Mr Murray noted the contrast between individual debtors with access to a free government trustee in bankruptcy and companies that are undergoing insolvency. He observed that it was broadly supported that:

> …we wouldn't privatise or leave hanging those debtors who might have had to pay a trustee to go bankrupt. We wouldn't leave those debtors unable to go bankrupt in that sphere, in the personal insolvency sphere. I suppose there's not that much difference between all of these companies in the corporate sphere, where we say there should be at least an opportunity for a director of an insolvent company to have their company wound up, even if they don't have the funds in order to enable them to do that.[12]

9.17 Mr Pearce, BLS LCA, also drew the committee's attention to the problem of low- or no-asset administrations, and who should pay for the work undertaken by insolvency practitioners. He noted the apparent current approach of cross-subsidisation of insolvency practitioner costs, with costs effectively passed to the creditor body able to pay, along with proposed alternative approaches whereby work would be funded by a company levy or through consolidated revenue. But ultimately, he told the committee, 'if we decide that that public

9 Mr Murray, *Committee Hansard*, 13 December 2022, p. 43.

10 Mr Murray, *Committee Hansard*, 13 December 2022, p. 43.

11 Mr Murray, *Committee Hansard*, 13 December 2022, p. 43.

12 Mr Murray, *Committee Hansard*, 13 December 2022, p. 45.

good is sufficient, that we require the work to be done, we have to work out who's going to pay for it'.[13]

9.18 UNICTRAL's Legislative Guide on Insolvency Law points to four mechanisms for pursuing the administration of assetless estates:

- levying a surcharge on creditors to fund administration;
- establishing a public office or utilizing 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.[14]

Assetless Administration Fund (AA Fund)

Background to the establishment of the AA Fund

9.19 The Harmer Report canvassed a range of options for funding the administration of assetless companies. Options included establishing a publicly funded office to administer such companies (similar to the Official Trustee in Bankruptcy), or, alternatively, retaining the existing system of 'private sector' administration but with a new funding mechanism, albeit one that did not 'impose a further burden on consolidated revenue'.[15]

9.20 The Harmer Report recommended the second option to establish an Assetless Administration Fund (AA Fund) to 'enable the winding up of and investigation into assetless companies', funded by a levy on all companies payable annually at the time of the filing of a company's annual return.[16] The fund, to be administered by the corporate regulator (then the National Companies and Securities Commission) would pay prescribed amounts to both creditors who brought applications to wind up an assetless company 'in respect of the taxed costs of the winding up'; and the liquidator, 'for the costs of inquiry into the business, property and affairs of the company and reporting to creditors'.[17]

9.21 The recommendation was unimplemented at the time of the Parliamentary Joint Committee on Corporations and Financial Services's (PJC's) 2004 'stocktake' of corporate insolvency. The PJC report recommended the establishment of an ASIC-supervised AA Fund along the lines suggested by the Harmer Report:

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13 Mr Christopher Pearce, Chair, Insolvency & Restructuring Committee, BLS LCA, *Committee Hansard*, 14 December 2022, p. 30.

14 As noted in Australian Securities and Investments Commission (ASIC), answer to question on notice (ASIC10), 23 December 2022 (received 8 February 2023), p. 1.

15 ALRC, Report No. 45, *General Insolvency Inquiry*, Vol. 1 (1988), pp. 150–51.

16 ALRC, Report No. 45, *General Insolvency Inquiry*, Vol. 1 (1988), p. 152.

17 ALRC, Report No. 45, *General Insolvency Inquiry*, Vol. 1 (1988), p. 154.

> The Committee is of the firm belief that the problem of assetless companies must be addressed. It recommends that the Government establish an assetless company administration fund to finance preliminary investigations of breaches of directors' duties and fraudulent conduct using the skills of registered insolvency practitioners.[18]

Overview of the AA Fund

9.22 In response to the PJC's 2004 report, in October 2005 the government established the AA Fund,[19] which ASIC explains, supports:

> …preliminary investigations and reports by liquidators into the failure of companies with few or no assets, where it appears to us that enforcement action may result from the investigation and report. A particular focus of the AA Fund is to curb fraudulent phoenix activity.
>
> The AA Fund enables a liquidator to carry out a proper investigation and report, which then helps us decide whether to commence enforcement action. It also funds a liquidator to take action to recover assets when fraudulent or illegal activity is suspected.[20]

9.23 In 2021-22, ASIC approved grant funding totalling just over $9 million to liquidators through the AA Fund, with 210 of 475 grant applications to ASIC successful.[21] Grant amounts vary depending on type—for example, director banning grants (144 of the 210 successful grants) are fixed at $10,500, and abandoned companies grants at $12,000.[22] The AA Fund is funded for approximately $4.7 million in 2022-23 and $5 million in 2023-24.[23]

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18 Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: a Stocktake* (June 2004), p. 128.

19 Government response to the Report of the Parliamentary Joint Committee on Corporations and Financial Services, 'Corporate Insolvency Laws: A Stocktake', p. [10]; the Hon Chris Pearce MP, Parliamentary Secretary to the Treasurer, *Media release*, 12 October 2005, 'Pearce announces insolvency reform package'.

20 Additionally, the AA Fund also funds liquidators appointed by ASIC to an abandoned company, and a reviewing liquidators appointed by ASIC to review a matter that relates to the external administration of a company. ASIC, https://asic.gov.au/for-finance-professionals/registered-liquidators/your-ongoing-obligations-as-a-registered-liquidator/assetless-administration-fund/, (accessed 26 April 2023). The types of grants provided under the AA Fund are set out in ASIC, *Submission 29*, pp. 28e–29.

21 ASIC, *Annual Report 2021-22*, p. 245. Since the AA Fund's inception, approximately $55 million funding has been approved in response to 3,800 approved funding applications. ASIC, answer to question on notice [Response to ASIC mentions and claims made by hearing participants], 14 December 2022 (received 8 February 2023), p. 4.

22 ASIC, *Submission 29*, p. 36–37.

23 ASIC, *Submission 29*, p. 30.

Productivity Commission 2015 recommendation on the AA Fund

9.24 In its 2015 report, the Productivity Commission recommended changes to the way low-asset liquidations were funded, including through changing and renaming the AA Fund the 'Public Interest Administration Fund', to better reflect a public rather than creditor interest in most small liquidations:

> In instances of small liquidations where a liquidator is unable to recover funds to cover their own fee, and where the Australian Securities and Investments Commission (ASIC) is satisfied that the activities are not excessive, the liquidator should be able to apply for the balance of their fees to be paid through ASIC.
>
> The existing Assetless Administration Fund should be renamed the Public Interest Administration Fund and its objectives and funding modified to reflect this new function.
>
> To the extent that this requires additional funding, it should be raised by increasing the annual review fee for company renewals.
>
> Funding should also be available from the Public Interest Administration Fund in instances where ASIC initiates further investigations beyond those required by the small liquidation process.[24]

9.25 Explaining its 2015 recommendations, including that additional funding be raised through an increase to the annual review fee for company renewals, Ms Rosalyn Bell, Productivity Commission, advised:

> In general, you would be looking to avoid situations where there is a substantial amount of cross-subsidisation [of insolvency practitioner work], particularly where you have public and private interests, but it's a matter of, if there are public interests, who actually funds those public interests, and it's not always a situation where it's appropriate to push that back onto taxpayers at large, either.[25]

9.26 In its response to the Productivity Commission's recommendation, in May 2017 the then government noted the recommendation, while observing that the Public Interest Administration Fund (PIAF) proposal would extend:

> …the existing purpose of the Assetless Administrative Fund, which is to finance preliminary investigations or recovery actions, with a particular focus on curbing illegal phoenixing activity. The fund was not designed to support small scale liquidation more generally.[26]

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24 Productivity Commission, Inquiry Report No. 75, *Business Set-up, Transfer and Closure* (September 2015), p. 39.

25 Ms Rosalyn Bell, Acting Head of Office, Productivity Commission, *Committee Hansard*, 13 December 2022, p. 25.

26 Australian Government, *Response to the Productivity Commission Inquiry into Business Set-up, Transfer and Closure* (May 2017), p. 28.

9.27 The Australian Restructuring Insolvency and Turnaround Association (ARITA) wrote in support of the Productivity Commission's recommendation, suggesting:

Other views on the AA Fund

9.28 A number of inquiry participants suggested the AA Fund needed to be broadened to properly support the administration of assetless companies.

9.29 The BLS LCA submitted that the AA Fund 'is not the all-encompassing programme of the type anticipated by the Harmer Report recommendation', and thus the establishment of a formal assetless companies fund remained one of the unimplemented reforms recommended by the Harmer Report.[27]

9.30 The Society of Corporate Law Academics (SCoLA) suggested that the AA Fund was underfunded and difficult to access, making it currently inadequate in addressing most instances of unfunded insolvency work. It noted:

> …anecdotal evidence from conversations with multiple insolvency practitioners suggests that it can cost up to $6-10,000 work of WIP to complete an application that may itself only provide $10-15,000 in funding.[28]

9.31 Deloitte submitted that the AA Fund should:

> …be better funded to fund the reasonable costs and expenses of [external administration] in all assetless administrations. Alternatively, the Government could consider empowering ASIC to perform this unfunded work.[29]

9.32 Deloitte added that funding can be difficult to obtain through the AA Fund, and:

> …the time required to prepare an application is not funded and we believe corporate abuse often goes un-investigated. This is not in the community's interest. The funding of the AAF should be expanded considerably.[30]

9.33 KPMG also submitted that an increase in the AA Fund would 'help assist with winding up insolvent assetless businesses where there is no opportunity for a corporate rescue or that a rescue has failed'.[31] It noted that additional funding would benefit:

> …the broader community as external administrators are required by law to undertake certain tasks which may not benefit creditors directly, including

27 Law Council of Australia, Business Law Section, *Submission 30*, p. 58.

28 SCoLA, answers to questions on notice, 23 December 2022 (received 17 February 2023), p. 6.

29 Deloitte, *Submission 32*, p. 9 (emphasis in original).

30 Deloitte, *Submission 32*, p. [12].

31 KPMG Australia, *Submission 55*, p. 3.

investigating whether any offences have been committed and reporting to ASIC.[32]

9.34 CPA Australia emphasised the importance of a properly funded AA Fund:

> The task of investigating offences and collecting evidence of offences serves an important function in the economy and in protecting creditors. Registered Liquidators should be viewed as the gate keepers of the economy. Without adequate funding of the Assetless Administration Fund, these offences may not be prosecuted by ASIC. This funding should be seen as an investment in compliance by directors, who would then be seen as upholding their obligations and duties.[33]

9.35 Addressing the problem of directors who are unwilling to comply with their statutory obligations to assist a liquidator, including to deliver up company books and records, the Australian Credit Form questioned whether the AA Fund was current adequate to its policy purpose:

> The liquidator, in order to properly comply with its statutory duties, often incurs costs to compel compliance where prospects for recoverability on behalf of creditors is low.
>
> While the Assetless Administration Fund (AA Fund) does provide some assistance and resources in the liquidation process, it is often insufficient for liquidators to properly finalise the investigative work required of them, particularly if court proceedings are involved and require the liquidator to retain solicitors and barristers to properly prosecute those claims.[34]

9.36 Ashurst also questioned whether the AA Fund was effective in achieving its purposes. Ashurst noted that the AA Fund had been established to:

> …encourage effective administration of assetless companies and the enforcement of director-misconduct by providing liquidators funding for investigations where the company is without sufficient assets to do so. However, the effectiveness of the AAF in achieving its initial aims is questionable in light of reportedly low levels of applications being approved and funding granted. A fundamental limitation of the AAF is that the application criteria requires a liquidator to lodge a section 533 report. As such, liquidators may be disincentivised to apply for funding as the preparation of the report and preliminary investigations may deplete funds in the administration available to pay their remuneration and expenses, particularly where it is unlikely they will receive approval for their application and subsequent funding.[35]

9.37 Ashurst also wrote in support of the Harmer Report's recommendation that an assetless administration fund should be funded by an annual levy on all

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32 KPMG Australia, *Submission 55*, p. 29.

33 CPA Australia, *Submission 11*, p. [5].

34 Australian Credit Forum, answers to questions on notice, 21 February 2023 (received 21 March 2023), p. 10.

35 Ashurst, *Submission 26*, p. 7.

companies, although it indicated this funding should be supplementary to—not in place of—Commonwealth funding. Ashurst also submitted that the current definition of 'assetless' was problematic, insomuch as it takes into account assets (or lack thereof) available to a company within 12 months of application for AA Fund funding. Ashurst noted that 'this prospective assessment is disadvantageous for liquidators who must prove the company is "assetless" in circumstances where it is uncertain whether those assets can in fact be realised'.[36]

9.38 Representing Ashurst, Mr Richard Fisher also noted a 'chicken and egg' challenge for insolvency practitioners in accessing the AA Fund, in that they are required to determine that a company is assetless, when it may not be possible to do so until the work was already undertaken:

> The threshold issue seems to be that, in order to access the fund, firstly, it requires a deal of work to put the application together; and secondly, it's necessary not only to put a value on the assets which have come under the control of the liquidator but to estimate the value of assets which will come under the liquidator's control within the following 12 months. So it's the threshold challenge of establishing that the company is assetless for the purposes of accessing the fund, which is a primary barrier as we understand it.[37]

ASIC's response to criticisms of the AA Fund

9.39 ASIC provided some acknowledgement of the limitations of the AA Fund, in terms of the amounts provided to insolvency practitioners and the overall quantum of funding available. When asked about the $10,500 fixed amount limit on director banning grants made under the AA Fund, Ms Thea Eszenyi, ASIC, explained that in administering the fund, ASIC was mindful of the budgetary constraints it faced, and noted that the appropriation for the fund had decreased in the current funding year:

> We're very mindful that we need to make careful decisions, given that last year we had $7.1 million and this year we've got $4.7 million. That's a consideration we need to have, as far as the balancing of individual grants versus the fund in total.[38]

9.40 When asked how often cases where the AA Fund was accessed resulted in successful enforcement action, Mr Warren Day from ASIC acknowledged that enforcement outcomes were low, relative to the number of grants made (see Figure 9.1 below):

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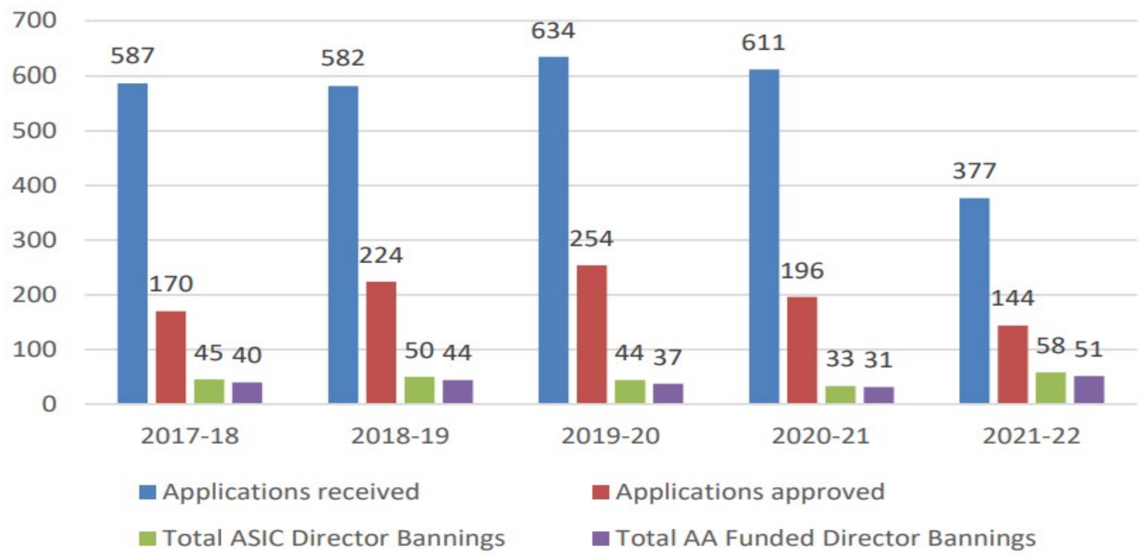
36 Ashurst, *Submission 26*, pp. 7–8.

37 Mr Richard Fisher, Consultant, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 22.

38 Ms Thea Eszenyi, Senior Executive Leader, Registered Liquidators & Financial Reporting, Australian Securities and Investments Commission (ASIC), *Committee Hansard*, 14 December 2022, p. 69.

> Often we will approve funding per the request for assetless administration funding, and, after the work has been done, either there is insufficient evidence that we think we can take to make the relevant standards, depending on if it's a director banning or a criminal action et cetera, or it may be that what they thought was initially the case actually, on further investigation, wasn't the case.
>
> The other thing is that there are a large number that we will approve that may not actually get an outcome for that matter, but effectively we're propping one up so that we can take a director-banning for another matter because we will need two reports—good, solid 533 reports often—to take a successful director disqualification action.[39]

Figure 9.1: Director Banning Grant Applications Received and Approved, Total ASIC Director Bannings, and Total AA Funded Director Bannings, by financial year



Source: ASIC, Submission 29, *p. 36.*

9.41 Mr Yanco, ASIC, also explained that ASIC was working to improve the quality of applications to the fund:

> On the assetless administration fund, generally, and outcomes, the team has done a lot of work in the last four years to get better applications. […] There are about six different initiatives to improve the quality, including a guide on how to do the application, and having our enforcement team engaged in assisting with making sure that the applications we get are ones that they're likely to accept when it comes to consideration of the final report. This is a really important fund, and we want to make sure we get really good value out of it, so we have put this extra effort in.[40]

39 Mr Warren Day, Chief Operating Officer, ASIC, *Committee Hansard*, 14 December 2022, pp. 67–68.

40 Mr Greg Yanco, Executive Director Markets Group, ASIC, *Committee Hansard*, 14 December 2022, p. 68.

Reforms announced in March 2022

9.42 In March 2022, the then government announced an additional $20 million in funding over two years to the AA Fund, with liquidators able to apply for up to $5,000 per assetless liquidation without needing to provide evidence of potential misconduct.[41] No legislation was introduced into the Parliament to implement the measure, and in its submission the Department of the Treasury (Treasury) advised that 'it was decided as part of the October 2022-23 Budget that the measures would not proceed, allowing the Committee to conduct its inquiry without prejudicing the outcomes'.[42]

9.43 KPMG recommended that the additional funding for the AA Fund outlined in March 2022-23 Budget proceed.[43]

Committee view

9.44 The AA Fund, as currently designed, seeks to address an important public interest purpose—namely, supporting the investigative functions of insolvency practitioners in companies with few or no assets, as a precursor to possible enforcement action.

9.45 However, evidence put to the committee would suggest that the AA Fund is not adequate to meeting this purpose. The committee agrees with this assessment and considers the enforcement outcomes achieved through the fund underwhelming. The committee is recommending that the government consider changes to the AA Fund to ensure that it is achieving its intended policy objectives and that this should be done independently of the comprehensive review.

Recommendation 16

9.46 The committee recommends that the government consider changes to the Assetless Administration Fund to ensure that it is achieving its intended policy objectives.

9.47 In addition to an immediate increase to the overall AA Fund, the committee considers further consideration should be given to expanding its design and purpose to support the administration of assetless companies more generally.

9.48 The committee considers the Productivity Commission's 2015 proposal to expand the purpose of the AA Fund and rename it as the Public Interest Administration Fund (PIAF) worthy of further consideration. The response

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41 The Hon Michael Sukkar MP, Assistant Treasurer, 'Simpler and fairer insolvency processes,' *Media release*, 30 March 2022, https://ministers.treasury.gov.au/ministers/michael-sukkar-2019/media-releases/simpler-and-fairer-insolvency-processes.

42 Department of the Treasury (Treasury), *Submission 34*, p. 13.

43 KPMG Australia, *Submission 55*, p. 16.

from then government to this recommendation simply noted the recommendation and observed that it would expand the existing purpose of the AA Fund to fund small scale assetless administrations more generally. However, the committee notes that this expanded purpose was in fact the intent of the Productivity Commission's recommendation. The committee also observes that the proposed PIAF would likely better realise the broader purposes of the assetless administration fund originally recommended in the Harmer Report. More broadly, the proposed PIAF would better meet the public purposes of insolvency processes and help address the problem of apparent cross-subsidisation of insolvency practitioner costs.

9.49 It would be worthwhile to, at a minimum, better understand the costs and benefits of the Productivity Commission's proposal. It would, for instance, be useful to understand if, in fact, ARITA is correct in its suggestion that the PIAF would have 'no impact on the fiscal position of the Commonwealth' and ultimately be of net benefit to companies.

9.50 Rather than repeat the Productivity Commission's recommendation, the committee instead recommends that the government prepare further analysis on the likely costs and benefits of the proposal, including an estimate as to the resulting increase of the annual review fee for company renewals. Subsequent to preparing this analysis, the government might consider implementing the proposal, or alternatively provide its analysis to a comprehensive review for its information.

Recommendation 17

9.51 The committee recommends that the Department of the Treasury consider assessing the potential benefit of the Public Interest Administration Fund proposed by the Productivity Commission in 2015, including the impacts of the required increase on the annual review fee for company renewals; and either consider implementing the proposal, or provide that analysis to a comprehensive review.

Public liquidator

9.52 This section of the chapter considers calls to create a public liquidator to address the issues arising from assetless administrations.

9.53 SCoLA noted that in other common law jurisdictions, such as the United Kingdom, Singapore and New Zealand, a government liquidator performed both personal and corporate appointments.[44] Contrasting this with the unremunerated public interest work undertaken by insolvency practitioners in Australia, SCoLA submitted that a:

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44 SCoLA, answers to questions on notice, 23 December 2022 (received 17 February 2023), p. 1; SCoLA, *Submission 37*, p. 7.

> … system that depends on professionals working for free is a broken system in our view and needs more government support, either through increased funding to the Assetless Administration Fund to provide a basic level of funding for low and no asset insolvencies, or through a government liquidator's office (such as an Official Receiver) to take on public interest work (which is what occurs in the UK).[45]

9.54 When this committee considered the 'market failure' presented by assetless administrations in its 2004 inquiry, it noted (although did not recommend) that one option for addressing this market failure would be the creation of a public office in Australia similar to the Insolvency Service in the United Kingdom:

> This Service undertakes, in every winding up order, the initial investigation into a company's failure, the causes of failure and generally the promotion, formation, business dealings and affairs of the company and makes its report to the court. If assets are available to fund the administration a private practitioner is appointed. This suggestion was rejected by the Harmer Report which preferred to use the skills of private practitioners to investigate assetless companies.[46]

9.55 The Australian Council of Trade Unions (ACTU) argued a public liquidator could better realise the public interest objectives of the insolvency system, while emphasising the ACTU's broader concerns regarding the overreliance on private insolvency practitioners. The ACTU argued in favour of the creation of a Commonwealth Company Insolvency Service, noting:

> …while the cost of administrating assetless failures are partly covered by the taxpayer via the Assetless Administration Fund (AAF) the cost of sustaining the insolvency industry has largely been shifted onto employees and creditors of less distressed but still insolvent companies. This results in longer and more expensive administrations and liquidations. Others have noted this cost shifting dynamic reduces the, albeit, small chance of turnarounds. As such the ACTU supports the creation of a Commonwealth company insolvency service that employs insolvency practitioners and oversees both administrations and liquidations.[47]

9.56 The ACTU added that a Commonwealth Company Insolvency Service:

> …would complement work of the Bankruptcy Trustee. For this reason, it is likely that administrations, liquidations and business-related bankruptcies would become more coordinated and efficient. Although abolishing floating charge receiverships is preferable, the creation of such a service would allow the appointment of disinterested receivers and allow the public examination

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45 SCoLA, *Submission 37*, p. 7.

46 Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: a Stocktake* (June 2004), p. 127.

47 Australian Council of Trade Unions (ACTU), *Submission 75*, p. 16.

> of companies where individual creditors holding floating charges are concerned about default.[48]

9.57 Mr Bruce Billson from the Australian Small Business and Family Enterprise Ombudsman(ASBFEO) supported calls for a public liquidator. He explained that such an entity could provide a streamlined approach for winding up small businesses with limited debts and assets, leaving those with assets to private insolvency practitioners.[49] Mr Bilson also suggested this would help prevent such businesses from being deregistered in the absence of any processes required to appropriately close the business down.[50]

9.58 Representatives from the Small Business Debt Helpline noted that the organisation typically talks to clients who are financially unable to access formal insolvency processes. While sole traders are afforded free access to the bankruptcy services provided by the Official Trustee in Bankruptcy, no such option is available to small businesses operated through a company. It suggested this should be a priority issue for policy reform, with consideration given to, among other things, the relative merits of various delivery models, including ‘private liquidators, an official liquidator or a hybrid model’.[51]

9.59 Mr Murray described the lack of an official receiver in corporate insolvency in Australia as a ‘historical quirk’, noting that both England and New Zealand had adopted official receivers in both bankruptcy and corporate insolvency in the early 20th century.[52]

9.60 Professor Harris contended that a greater role for the state in corporate insolvency, comparable to the role it already played in personal insolvency, would help to address the current gap in the system. The current system, he argued:

> …sets unrealistic and unachievable goals in a system that cannot afford to pay for the work that is currently required. We say that a greater role for the state is needed to address this gap. This is recognised in many other countries, including the UK, Singapore and New Zealand, with a government liquidator's office. It's been recognised here, in Australia, for

48 ACTU, *Submission 75*, pp. 16–17. Also see Mr Scott Connolly, Assistant Secretary, ACTU, *Committee Hansard*, 1 March 2023, p. 4.

49 The Hon Bruce Billson, Ombudsman, Australian Small Business and Family Enterprise Ombudsman (ASBFEO), *Committee Hansard*, 13 December 2022, p. 34.

50 Mr Billson, ASBFEO, *Committee Hansard*, 13 December 2022, p. 34.

51 Small Business Debt Helpline, answers to question on notice, 28 February 2023 (received 22 March 2023), p. [2]. Also see Ms Helen Davis, General Manager, Small Business Debt Helpline, *Committee Hansard*, 28 February 2023, p. 28.

52 Mr Murray, *Committee Hansard*, 1 March 2023, p. 28.

> more than 100 years in personal insolvency with the government bankruptcy trustee's office.[53]

9.61 The concept of a public liquidator encountered some resistance from various inquiry participants. Mr Pearce indicated that the BLS LCA had reservations about a proposed public liquidator, suggesting that private practice in Australia does good work. He added that in countries with a public liquidator in place, such the United Kingdom, work is often funded out to the private sector anyway.[54]

9.62 The BLS LCA also submitted that:

> …there appears to be little appetite amongst the profession for the introduction of a Government-run (and Government-funded) official liquidator akin to the Official Trustee in Bankruptcy. Avoiding such a body may be wise given the tendency for insolvency stakeholders to be aggrieved at what they consider to be uncommercial outcomes, coupled with material recent criticism of State-run public trustees.[55]

9.63 Treasury noted some of the considerations that would be relevant to any proposal for a government run liquidator. Mr Tom Dickson observed that in addition to the question of cost, it would also be necessary to weigh 'the onboarding of risk and responsibility to the Commonwealth'.[56] Questions would also need to be considered as to the benefits of a public liquidator:

> Would there be benefits in how liquidations are conducted? Would they be more efficient or less efficient? Would there be sufficient independence to make sure that those things are conducted in a certain way?[57]

9.64 Mr Dickson also noted that the concept of a public liquidator did not necessarily reduce system costs, but instead shifted them elsewhere:

> In terms of the question around where the cost should be borne for insolvency practitioners, the costs are borne somewhere in the system. There are suggestions that we've heard that those costs should be borne by taxpayers—that the government should provide some sort of service that helps with the liquidation of corporations. Of course, what that doesn't do is reduce the expense; it just shifts the expense from one place to another place.[58]

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53 Professor Jason Harris, private capacity, *Committee Hansard*, 13 December 2022, p. 38.

54 Mr Christopher Pearce, Chair, Insolvency & Restructuring Committee BLS LCA, *Committee Hansard*, 14 December 2022, p. 30. See also, BLS LCA, answers to written questions on notice, 23 December 2022 (received 14 February 2023), p. 24.

55 BLS LCA, *Submission 30*, p. 58.

56 Mr Tom Dickson, Acting First Assistant Secretary, Market Conduct Division, Treasury, *Committee Hansard*, 1 March 2023, p. 57.

57 Mr Dickson, Treasury, *Committee Hansard*, 1 March 2023, p. 57.

58 Mr Dickson, Treasury, *Committee Hansard*, 13 December 2022, p. 5.

9.65 On the fact that there is an Official Trustee for Bankruptcy but no equivalent office for corporate insolvency, the Attorney General's Department (AGD) drew the committee's attention to the differences between the profiles of corporate and personal insolvencies, with 50 per cent of personal insolvencies involving debts of less than $50,000.[59] At the same time, Treasury acknowledged that many small businesses in the corporate insolvency space were carrying similarly small debts, and there was considerable overlap between people in the personal and corporate insolvency spaces.[60]

9.66 Mr Michael Brennan, Liquidator and Bankruptcy Trustee, Offermans, contended that a public liquidator for corporate insolvency was unlikely to be realistic in an Australian context, given the resources that would be required:

> As both a Trustee in Bankruptcy and Registered Trustee I can speak from experience on this issue. I do not believe that a government liquidator is realistic or workable in Australia. Given the number of companies likely to be administered, the workforce and funding required to do this job properly would be prohibitive.[61]

9.67 Mr Brennan explained that the cost to the taxpayer of the government liquidator in corporate insolvency was likely to be multiples of the costs of the Official Trustee in Bankruptcy. He noted that the cohort of companies that a government liquidator might investigate—that is, the approximately 50,000 ASIC-initiated deregistrations per year (see chapter 7)—was more than five times higher than the number of personal estates administered by AFSA.[62] Mr Brennan also noted that at the moment AFSA was outsourcing some of their files to the private sector so that more personal estates that would traditionally have been administered by the organisation are instead being sent to Registered Trustees.[63] Appearing before the committee, Mr Brennan reiterated that while a government liquidator analogous to the official trustee might be useful, the question of cost was likely critical:

> I think it would be great, but it would be very expensive. I don't know what the costs would be, but just the sheer size of the issue—it would be quite significant. I think whilst theoretically it's a wonderful idea, finding the funding for it would be problematic. If you look at AFSA, where they're trying to outsource their files again, I think it's probably impractical, particularly in the corporate space given the sheer volume of businesses. At

59 Ms Alice Linacre, First Assistant Secretary, Courts, Tribunals and Commercial Division, Attorney-General's Department, 1 March 2023, p. 57.

60 Mr Dickson, Treasury, *Committee Hansard*, 1 March 2023, p. 57.

61 Mr Michael Brennan, *Submission 73*, p. [25].

62 Mr Michael Brennan, *Submission 73*, pp. [25–26].

63 Mr Michael Brennan, *Submission 73*, p. [26].

> the end of the day, you can fix anything if you're willing to throw enough money at it. It's just who pays.[64]

9.68 While expressing reservations about the idea of a government liquidator (as noted above), the BLS LCA nonetheless suggested that the cost to the taxpayer may be justified by the costs of misconduct that occurs in the absence of a proper administration process:

> …the Phoenix Taskforce estimates that the economic impact of illegal phoenix activity on business, employees, and government to be between $2.85 billion and $5.13 billion annually. If improved funding of liquidators has a material effect on misconduct, the net positive on the taxpayer is likely to be substantial.[65]

9.69 Professor Lombard also expressed a need for careful consideration of the value and practicality of a government liquidator of last resort in corporate insolvency, particularly in the Australian context where there is a division between personal and corporate insolvency. While suggesting the idea 'merits serious consideration', she also wrote that Mr Brennans' arguments regarding cost appeared sound:

> …especially given the evidence that he provides regarding AFSA's recent policy to outsource files to the private sector. It is also important to note that some of the jurisdictions that are held up as examples to demonstrate the utility of a government liquidator (particularly the United Kingdom and Singapore), possess uniform insolvency legislation, unlike Australia.[66]

9.70 Professor Sulette Lombard added that the successful operation of a government liquidator should not be assumed based purely on the operations of the Official Trustee, noting that the operating contexts were quite different and AFSA and ASIC were themselves very different regulatory bodies. However, in commenting on the government liquidator concept, Professor Lombard noted the broader importance of public support for insolvency work:

> Should the costs of creation of an AFSA type body in a corporate context prove to be prohibitive, consideration should at least be given to improved funding for work undertaken by private liquidators to ensure that insolvent companies are not able to avoid existing regulatory measures.[67]

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64 Mr Michael Brennan, Liquidator and Bankruptcy Trustee, Offermans, *Committee Hansard*, 21 February 2023, p. 44.

65 BLS LCA, answers to written questions on notice [General questions], 23 December 2022 (received 14 February 2023), pp. 23–24.

66 Dr Sulette Lombard, answer to question on notice [Proposed public funder model], 21 February 2023 (received 14 March 2023), p. [2].

67 Dr Sulette Lombard, answer to question on notice [Proposed public funder model], 21 February 2023 (received 14 March 2023), p. [2].

9.71 Professor Lombard observed calls for a comprehensive review of Australian insolvency law directed toward the adoption of a single insolvency law and for purpose regulator. Such reforms, she concluded:

> …could likely prove to be more cost-efficient and could perhaps create a better environment and scope for the creation and operation of a body similar to the Official Trustee in respect of companies in liquidation.[68]

Committee view

9.72 On the basis of the evidence before it, the committee is not able to determine with any certainty whether a public liquidator would be the best means to address the problems arising from low- and no-asset administrations. There may be meaningful public interest benefits from the creation of a 'liquidator of last resort'. However, further consideration is required to assess the cost of such a service and how it would be met, risks to the Commonwealth of taking on this role, and if there might be better ways of realising the same public interest objectives. The possibility of a public liquidator is properly one for a comprehensive review to examine, in the context of a broader consideration of how the insolvency system should attend to insolvent companies with few or no assets.

Recommendation 18

9.73 The committee recommends that the comprehensive review consider and make recommendations on options for funding the administrations of assetless companies, including reforms to the Assetless Administration Fund (noting the committee's recommendation 16) and the merits of creating a public liquidator for corporate insolvency.

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[68] Dr Sulette Lombard, answer to question on notice [Proposed public funder model], 21 February 2023 (received 14 March 2023), p. [3].

Chapter 10
The role of government agencies in insolvency and responses to misconduct

10.1 As canvassed elsewhere in this report, the Australian Securities and Investments Commission (ASIC) is responsible for the regulation of the corporate insolvency system, while the Australian Financial Security Authority (AFSA) oversees the personal insolvency regime.

10.2 Other government agencies often play key roles in corporate insolvency, most notably the Australian Taxation Office (ATO) and the Department of Employment and Workplace Relations (DEWR) through the Fair Entitlements Guarantee Scheme (FEG). While the involvement of these two agencies is of the nature of a creditor, rather than a regulator, both have access to tools other creditors do not to protect their interests.

10.3 This chapter will focus primarily on the regulatory activities of ASIC and the ATO (other than in respect of insolvency practitioners, which is discussed in chapter 8). Arguments concerning a possible expanded role for government in the Australian insolvency framework are discussed in chapter 9.

Regulation of corporate insolvency

10.4 In this inquiry, much consideration was given to the role and effectiveness of ASIC as the regulator of Australia's corporate insolvency framework, most notably in response to its enforcement activities and its utilisation of reports provided to it by insolvency practitioners in particular.

10.5 The following paragraphs consider:

- ASIC's regulator activities and approaches to enforcement;
- reporting obligations of liquidators; and
- specific enforcement issues, including:
  - insolvent trading; and
  - illegal phoenixing.

ASIC's activities and approaches to enforcement

10.6 ASIC told the committee that its activities in the field of corporate insolvency extend to:

> - assessing applications for funding under the Assetless Administration Fund (AA Fund);
> - appointing reviewing liquidators to conduct a review in relation to the external administration of a company, including of the registered liquidator's conduct, and report to the registered liquidator and ASIC;

- assisting registered liquidators to obtain a Report on Company Affairs and Property (ROCAP), information and/or books and records of a company under external administration via the External Administration Compliance Assistance program and prosecuting directors who fail to assist an external administrator;
- liaising with registered liquidators regarding director and third-party misconduct investigations;
- winding up abandoned companies under Pt 5.4C of the Corporations Act to enable former employees to recover unpaid entitlements via the fair entitlements guarantee scheme and appointing liquidators to these companies funded through the AA Fund;
- granting eligible applicants requests for authorisation to conduct public examinations;
- assessing numerous insolvency related court applications;
- assessing applications for extensions of time or other relief;
- assessing and, where applicable, granting requests for the voluntary suspension or cancellation of a registered liquidator's registration;
- reviewing and, where relevant, granting the renewal application for the registered liquidator's registration;
- providing information to Schedule 2 Committees convened for registration and disciplinary matters as required…and representing ASIC in AAT proceedings relating to applications to be registered as a liquidator or registered liquidator disciplinary appeals.[1]

10.7 A range of witnesses commented on the frequency and nature of matters on which ASIC pursues enforcement action. Acknowledging that ASIC is required to respond to a broad remit on scarce resources, a number of inquiry participants expressed dissatisfaction with ASIC's responsiveness to serious matters reported to it.

10.8 The Australian Restructuring Insolvency and Turnaround Association (ARITA) said that very few of the 10,000 suspected cases of illegal director activity that are reported to ASIC by liquidators are ever prosecuted. It raised questions about ASIC's enforcement priorities, stating 'ASIC has notably taken more action recently against directors who make false statements on forms lodged with it to voluntarily deregister their companies than directors reported by liquidators'.[2]

10.9 Some inquiry participants stated that they knew personally of cases where suspected serious misconduct had been reported by liquidators to ASIC, but no enforcement action had followed.[3]

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1 Australian Securities and Investments Commission (ASIC), *Submission 29*, pp. 16–17.

2 Australian Restructuring Insolvency and Turnaround Association (ARITA), *Submission 36*, p. 48.

3 See, for example, Mr Richard Fisher, Consultant, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 24; Mr Bruce Collins, Chair, Small and Medium Enterprise Business Law Committee, Business Law Section, Law Council of Australia (BLS LCA), *Committee Hansard*,

10.10 Mr Richard Fisher, consultant to Ashurst Australia and a former Commissioner on the Harmer Report, stated that this issue is long standing,[4] and resolution of it would require consideration of a different model for corporate regulation.[5]

10.11 The Business Law Section of the Law Council of Australia (BLS LCA) recorded that it had received anecdotal reports that 'SME directors appear to consider ASIC to be somewhat ineffective in respect of pursuit of poor corporate behaviour by SME directors'.[6]

10.12 The BLS LCA also questioned whether ASIC's funding was adequate and enabled the agency to meet the standard expected of it by the Australian public:

> It's often said in response that you can't expect the corporate regulator to investigate every instance of corporate misconduct. If you asked the Australian public whether it was acceptable to investigate five per cent of home break-ins, or two per cent of armed robberies, I'm not sure whether they'd be happy with that. So the question of the extent to which ASIC is funded to take proper action and properly investigate corporate misconduct has to be asked.[7]

10.13 The Australian Council of Trade Unions (ACTU) submitted that ASIC has:

> …a longstanding reputation of not prosecuting breaches of directors' duties with sufficient vigour. Extra resources also need to be committed to building out inter-agency cooperation with the ATO, AFSA, Austrac, FWO, Federal Police, Border Force (amongst others) in order to more closely monitor high risk industries and combat related sharp practices such as phoenixing, modern slavery abuses, tax avoidance and wage theft.[8]

10.14 Mr Michael Brennan, Liquidator and Bankruptcy Trustee at Offermans, encouraged the government to give ASIC more direction on prosecuting breaches of insolvent trading laws:

> Overall, our insolvency laws are very good and with some cleaning up would be more than capable of continuing without wholesale change. What is required is a policy directive from Government to focus prosecutions where most breaches are occurring. By weight of numbers, the offending cohort are [Micro, Small and Medium Enterprise] MSME directors and advisors. Nothing will better destroy that narrative that ASIC is ineffective

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14 December 2022, p. 34; Mr David Walter, Member, Insolvency & Restructuring Committee, BLS LCA, *Committee Hansard*, 14 December 2022, p. 34; Mr Christopher Pearce, Chair, Insolvency & Restructuring Committee, BLS LCA, *Committee Hansard,* 14 December 2022, p. 34; Mr Anthony Ryan, Deputy Chair, Insolvency & Restructuring Committee, BLS LCA , *Committee Hansard,* 14 December 2022, p. 34

4 Mr Fisher, Ashurst Australia, *Committee Hansard,* 14 December 2022, p. 24.

5 Mr Fisher, Ashurst Australia, *Committee Hansard,* 14 December 2022, p. 23.

6 BLS LCA, *Submission 30*, pp. 28–29.

7 Mr Pearce, BLS LCA, *Committee Hansard*, 14 December 2022, p. 33.

8 Australian Council of Trade Unions (ACTU), *Submission 75*, p. 17.

> in this space (and that there are no ramifications for flaunting director rules) that seeing more average Australian directors feel the full weight of the law.[9]

10.15 ASIC acknowledged that it does not undertake a formal investigation of every matter that is brought to it. It explained that it considers a wide range of factors when deciding whether to investigate and possibly take action in a specific case 'to ensure that we direct our finite resources appropriately'.[10]

10.16 ASIC stated that the specific factors that influence whether ASIC will choose to respond to a breach change depending on circumstances and the focus of enforcement activities at the time. However, four issues form part of that consideration:

> - preventing or addressing significant harm to consumers, markets or the financial system;
> - the benefits to the public from enforcement, including where there is significant public interest or concern;
> - whether there are issues specific to the case which warrant us pursuing action; and
> - whether there are any alternatives to formal enforcement action or investigation which would, on balance, be more efficient— such as engagement with stakeholders, surveillance, guidance and education.[11]

10.17 ASIC also highlighted that it is one of the widest remit regulators in the world and works with whatever budget is provided to it. However, it acknowledged that choices have to be made in relation to resource allocation.[12] Mr Warren Day, Chief Operating Officer at ASIC explained:

> Could we do more if there were more resources allocated for our own decisions? Absolutely. But we think that, with the resources we've got, focusing on liquidator conduct, assisting small business, engagement with small business, supporting small business by taking enforcement and compliance action—small-business industry groups say to us all the time they actually want to see action, because the No. 1 group that often causes harm to other small business is small business. So we think that we give a good telling with what we've got. Obviously, through a review like this, it may be said that there probably needs to be more focus by ASIC in certain spaces, and that might cause a conversation we can have with government in relation to our funding mix.[13]

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9 Mr Michael Brennan, *Submission 73*, p. [26].

10 ASIC, *Submission 29*, p. 11.

11 ASIC, *Submission 29*, p. 11.

12 Mr Warren Day, Chief Operating Officer, ASIC, *Committee Hansard*, 14 December 2022, p. 63.

13 Mr Day, ASIC, *Committee Hansard*, 14 December 2022, p. 63.

Reporting obligations to ASIC and the regulator's response

10.18 Related to concerns about ASIC's enforcement approach were discussions about the relative benefit achieved by the existing reporting obligations on insolvency practitioners compared to the burden imposed by them.

10.19 A significant point of contention in the inquiry was ASIC's utilisation of and responses to reports provided to it in accordance with its statutory duties. Reporting obligations to ASIC arise for insolvency practitioners under various provisions of the Corporations Act. Three such provisions, namely sections 422, 438D and 533 require liquidators to report misconduct on the basis of an appearance of misconduct, or if there will be returns to shareholders of less than 50 cents in the dollar.[14] ASIC told the committee that these reports:

> …provide [it] with valuable information to support our regulatory actions. They provide the basis for successful enforcement actions and enable ASIC to ban company directors with a history of failed companies from managing corporations.[15]

10.20 ASIC explained that it assesses initial statutory reports provided to it against 'confidential criteria' in order to determine whether further information is required or whether a finding of no further action will be made. If further information is required, that would take the form of a supplementary report. If ASIC does not request a supplementary report, ASIC told the committee that a liquidator still has discretion to lodge one.[16] In 2021–22, of the 3,767 initial statutory reports submitted,[17] ASIC requested supplementary reports in relation to 593 (or 16 per cent) of them. This compared to the previous financial year, in which 704 (or 19 per cent) of the 3,810 initial statutory reports resulted in a requirement for a supplementary report.[18]

10.21 ARITA raised concerns about the process adopted by ASIC to select which of these initial statutory reports are to be further considered in the form of a recent example:

> We've recently lodged a report with ASIC. Within 45 seconds we got a 'no further action' response from ASIC—so, clearly, they've got an AI system in the background that's automated that reviews the reports, and you get an

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[14] ASIC, *Submission 29*, p. 58.

[15] ASIC, *Submission 29*, p. 25.

[16] ASIC, *Submission 29*, p. 26.

[17] In subsequent evidence to the committee, ASIC advised that prior to the COVID-19 pandemics it would receive between 8,000 and 9,000 of these reports each year: Ms Thea Eszenyi, Senior Executive Leader, Registered Liquidators & Financial Reporting and Audit, ASIC, *Committee Hansard*, 14 December 2022, p. 64.

[18] ASIC, *Submission 29*, p. 26.

> instantaneous response that no further action is being undertaken in relation to that particular report.[19]

10.22 ARITA stated that such an experience is 'a common theme across all liquidators',[20] and occurred both in instances of minor breaches of the Corporations Act due to a lack of expertise, as well as more significant occurrences of fraudulent behaviour and malfeasance.[21]

10.23 ARITA added that efforts to liaise with ASIC to improve the likelihood of instances of what liquidators perceive to be serious matters being highlighted have been unsuccessful and continue to be very difficult to achieve. It explained:

> The system is designed so that you submit your report through the electronic portal and you get a response back via email. The system is not designed for you to then contact someone at ASIC to discuss particular reports. Yes, that happens in the background at times but that's not the way ASIC is designed.

10.24 This experience with ASIC was contrasted to the experience with AFSA:

> With AFSA, if you have misconduct that you believe you've uncovered and wish to report, AFSA actively encourages practitioners to ring them and discuss putting in offence reports. So you know, before you go to the effort of putting in that report, if the regulator has, shall we say, an interest in looking at that matter.
>
> With ASIC and corporate matters, liquidators are required to put in a report for any misconduct. As Senator Scarr mentioned, it could be a lack of maintaining books and records, which is a common instance across pretty much every appointment. You have to put in that report to ASIC. Unless you're paying more than 50c in the dollar, you are required to lodge that report. So the magnitude of reports going through ASIC is significantly more than in the corporate space.[22]

10.25 The committee heard that high profile matters, including where there is a big company failure, tend to come to ASIC's attention, however ARITA said that a majority of reports, which concern phoenixing in the small to medium end of the economy, tend to receive the AI generated 'no further action' response.[23]

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19 Mr Michael Brereton, President, ARITA, *Committee Hansard*, 14 December 2022, p. 8.

20 Mr Brereton, ARITA, *Committee Hansard*, 14 December 2022, p. 9.

21 Mr Brereton, ARITA, *Committee Hansard*, 14 December 2022, p. 9.

22 Ms Narelle Ferrier, Technical and Standards Director, ARITA, *Committee Hansard*, 14 December 2022, p. 9.

23 Mr John Winter, Chief Executive Officer, ARITA, *Committee Hansard*, 14 December, p. 9.

10.26 The estimated cost of preparing these reports was put to the committee as around $5,000, and increases depending on the circumstances of the liquidation.[24]

10.27 The reporting obligations were supported by some key stakeholders. The Association of Independent Insolvency Practitioners (AIIP) argued that these reports 'are disciplined on liquidators to actually do their job–to go in, look at the file and report back'. Mr Stephen Hathaway, President of the AIIP, explained that the reporting requirement was introduced because not all liquidators were completing statutory reports. He emphasised that they 'are absolutely essential' and explained:

> But, to move away from not doing them, I think it would be—for the society to understand what happened to that company and for the government to understand what happened to that company. Someone later on will be able to understand whether that box was just closed and nobody ever looked.
>
> I think it would only encourage phoenixing activity, asset moving and asset stripping. We're the last resort to say, 'Hang on, he just keeps moving the assets along and leaving behind a pool of misery.' Some liquidator jumps in front of us and says, 'No, that's enough. We're taking you to court. We're going to freeze your assets until you go back.' I've got one with $35 million worth of tax owed. It's a property developer in the western suburbs of Sydney. Unless someone jumps in and stops them, they just keep going. They'd still be building these wretched buildings that are falling down.[25]

10.28 The ATO drew attention to how it and other agencies used liquidator reports to address illegal phoenixing:

> Due to the pervasiveness of the risk, it is not possible for any regulator to eliminate Illegal phoenix behaviour. However, intelligence sharing and data driven approaches provide greater opportunities to detect and deal with this behaviour. As part of the Mid-Year Economic and Fiscal Outlook (MYEFO) 2019-20, the government provided additional funding to ATO and ASIC to establish better data sharing, data fusion and improved analytics capabilities. Data fusion integrates ASIC data sets including liquidator Initial Statutory Reports with ATO data, which then undergo analytics and modelling to identify illegal phoenix activity.
>
> The importance of the information reported by Registered Liquidators to ASIC in relation to illegal phoenix cannot be underestimated. This information is integral to the effectiveness of our data fusion program and therefore in detecting illegal phoenix activity.[26]

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[24] Mr Stephen Hathaway, President, Association of Independent Insolvency Practitioners (AIIP), *Committee Hansard*, 14 December 2022, p. 52.

[25] Mr Hathaway, AIIP, *Committee Hansard*, 14 December 2022, pp. 51–52.

[26] Australian Taxation Office (ATO), *Submission 35*, p. 8.

10.29 The BLS LCA said that it is not convinced that the extent of ASIC's enforcement activities is an indication that the misconduct reports should not be required. It explained:

> The disadvantage of removing the obligation to do the work is relatively obvious. Less investigation will lead to even less concern by bad actors about misconduct, and likely cause an increase in misconduct levels…It may be that more enforcement activity is necessary.[27]

10.30 ASIC suggested that consideration could be given to raising the threshold for misconduct reporting. It noted that the current requirements compel registered liquidators to undertake the work and incur costs to report matters 'where there is not, and never will be, sufficient and adequate evidence to enable any enforcement action to be taken'.[28]

10.31 ASIC stated, however, that there is a public policy question that any movement to raise the threshold should be weighed against.[29] It identified that raising the thresholds could result in some offences going unreported and a loss of intelligence for ASIC, the ATO and other agencies who draw on that data.[30] It also highlighted that even if intelligence about a director is not be used in the first instance, interest in it may increase should subsequent reports be made about the same director.[31]

10.32 ASIC did, however, acknowledge that there is a cost involved for insolvency practitioners:

> I know it's frustrating for liquidators, because they'll say, 'I did a lot of work and I gave you this report,' and then they'll say nothing happened. But some of it is about effectively pulling together a database of antecedence so that when we see other things go wrong, we can say, 'This person should sit out the game of being a director for a period of time until they can show they can improve.'[32]

Committee view

10.33 The committee is concerned about the time-consuming ASIC reporting requirements for liquidators and that, in some cases, automatic software is responding rapidly to reports with no subsequent follow-up. The committee is concerned that unnecessary costs may impact liquidator business models. The committee, like many stakeholders, is left wondering whether better outcomes

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27 BLS LCA, answers to written questions on notice, 23 December 2023 (received 14 February 2023), p. 23.

28 ASIC, *Submission 29*, p. 58; see also, Mr Day, ASIC, *Committee Hansard*, 14 December 2022, p. 66.

29 Mr Day, ASIC, *Committee Hansard*, 1 March 2023, p. 37.

30 ASIC, *Submission 29*, p. 58.

31 Mr Day, ASIC, *Committee Hansard*, 1 March 2023, p. 36.

32 Mr Day, ASIC, *Committee Hansard*, 1 March 2023, p. 37.

would be achieved if there were far fewer forms being lodged, but those that were required were dealing with far more material issues.

10.34 The committee acknowledges that, inevitably, a trade-off needs to be made in determining the balance between the cost of reporting and the benefits arising. The committee notes that there are direct benefits, where ASIC undertakes follow-up action and indirect benefits, where the information contributes to the cache of data on the insolvency system that ASIC and other agencies can use. The committee considers that now would be an appropriate time for the costs and benefits to be examined in some detail to provide an appropriate basis for future policy and legislative settings.

Recommendation 19

10.35 The committee recommends that the comprehensive review consider whether the current statutory reporting obligations for insolvency practitioners are best serving the integrity, efficiency, and efficacy of the Australian corporate insolvency framework, including (but not limited to):

- **the ability of the Australian Securities and Investments Commission (ASIC) to appropriately process, utilise and respond to initial statutory reports on current resources; and**
- **the appropriateness of existing reporting thresholds, having regard to their regulatory value as well as the burden imposed on insolvency practitioners.**

The committee further recommends that in the interim, the government and ASIC consider whether any timely changes can be made to the regulations on reporting thresholds, and ASIC's response to insolvency practitioner reports.

Reporting obligations to creditors

10.36 Concerns about ASIC's current reporting obligations imposed on insolvency practitioners extended to reports to creditors. ARITA told the committee that while it recognised the need for transparency in the insolvency process, particularly with respect to small business creditors, it observed that 'the vast majority of creditors do not read the reports provided and find the quantum and complexity of material overwhelming'.[33] It stated:

> Instead of the reporting providing insights to inform creditors, the extensive reporting often leads to active creditor disengagement in the insolvency process, most of whom are just interested in how much money they will receive.[34]

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33 ARITA, *Submission 36*, p. 39.

34 ARITA, *Submission 36*, p. 39.

10.37 ARITA called for a review of the current reporting requirements in order to 'identify and recommend the reduction and/or elimination of unnecessary regulatory burdens'.[35] An example of a reporting obligation that ARITA proposed be improved is the requirement to report about dividends to be given in certain external administrations under the Insolvency Practice Rules (Corporations) 2016.[36] ARITA compared these requirements under the Corporations Act against provisions of the *Bankruptcy Act 1966* (Bankruptcy Act) (see Figure 10.1 below).

Figure 10.1 Comparison of reporting obligations – Corporations Act versus Bankruptcy Act

Corporations	Bankruptcy
IPRC 70-40 - Report about dividends to be given in certain external administrations *Simplified liquidation process* The liquidator must provide to the creditors of the company a report containing information on the following: • anything relating to the winding up of the company that has been done by the liquidator to date; • the date on which, in the liquidator's opinion, the winding up of the company is likely to end; • the likelihood of creditors receiving a dividend before the affairs of the company are fully wound up. *Not following the simplified liquidation process, or has ceased to follow the simplified liquidation process* The liquidator must provide to the creditors of the company a report containing information on the following: • the estimated amounts of assets and liabilities of the company; • inquiries relating to the winding up of the company that have been undertaken to date; • further inquiries relating to the winding up of the company that may need to be undertaken; • what happened to the business of the company; • the likelihood of creditors receiving a dividend before the affairs of the company are fully wound up; • possible recovery actions.	**Bankruptcy Act - 19 Duties etc. of trustee** The duties of the trustee of the estate of a bankrupt include … reporting to creditors within 3 months of the date of the bankruptcy on the likelihood of creditors receiving a dividend before the end of the bankruptcy.

Source: ARITA, Submission 36, p. 40.

ARITA suggested that the prescriptive reporting requirements under the Corporations Act could be replaced with a simpler format such as those under

35 ARITA, *Submission 36*, p. 39.

36 ARITA, *Submission 36*, p. 40.

section 19 of the Bankruptcy Act. In its view, any reduction in the amount of information provided to all creditors would be offset by the right of existing creditors to requestion information from appointees.[37]

Insolvent trading

10.38 Concerns were raised during this inquiry about the operation and enforcement of insolvent trading laws. Inquiry participants noted that despite these laws, ASIC statistics demonstrate that a significant majority of companies entering external administration have continued to trade and incur debts for months despite being insolvent. Both Associate Professor Mark Wellard and Mr Nick Pilavidis from the Australian Institute of Credit Management (AICM) pointed to ASIC's 2018-19 statistics (consistent with the 2021-22 statistics), which records that in both periods, 71 per cent of initial statutory reports of external administrators reported insolvent trading.[38]

10.39 Associate Professor Wellard added that during the latter period, external administrators assessed that insolvency had occurred more than two years before their appointment in 45 per cent of these cases. He added:

> In 29 per cent of cases, up to $250,000 worth of debt had been incurred compared to the reported estimated asset position of less than $10,000. In 13 per cent of cases, between a quarter of a million dollars and $1 million worth of debt had been incurred compared to, again, an estimated asset position of less than $10,000.[39]

10.40 Associate Professor Wellard said that in his view, much of the disenchantment vocalised about the insolvency system, be it in respect of liquidator remuneration or proceeds of preference claims not being returned to creditors, 'is caused more by the reality that many company balance sheets are leveraged into oblivion well before a liquidator arrives on the scene'.[40]

10.41 Associate Professor Wellard stated that this issue, in his view, has exceeded beyond simply being an enforcement issue.[41] He explained:

> For financially distressed SMEs that end up in liquidation, antecedent—that is, pre-appointment insolvent trading—appears to be mainstream rather than exceptional. Whether it's because directors don't know how or where to get the relevant advice they need, whether it's because they're unaware of the duties that are owed by a company director, whether it's simply human nature in some cases to ignore the inevitable or whether it's genuine hardship cases the

37 ARITA, *Submission 36*, p. 41.

38 Mr Nick Pilavidis, Chief Executive Officer, Australian Institute of Credit Management (AICM), *Committee Hansard*, 28 February 2023, p. 10; Associate Professor Mark Wellard, *Committee Hansard*, 1 March 2023, p. 11.

39 Associate Professor Mark Wellard, private capacity, *Committee Hansard*, 1 March 2023, pp. 11–12.

40 Associate Professor Wellard, *Committee Hansard*, 1 March 2023, p. 12.

41 Associate Professor Wellard, *Committee Hansard*, 1 March 2023, p. 12

> committee heard about yesterday, the reality is that many directors are trading on their companies and incurring debt at a point long past when the business has ceased to be viable. This is bad for creditors, it's bad for our economy and…sometimes it's bad for the wellbeing of the directors themselves.[42]

10.42 Associate Professor Wellard identified addressing insolvent trading as a good place to start if the objective is to improve returns to unsecured creditors. He suggested measures to address insolvent trading, including legislating consequences for directors whose companies generate minimal returns to general unsecured creditors, and automatic disqualification for directors in two liquidations with minimal returns. He stated that at the very least, review of insolvent trading should be front and centre in a comprehensive review.[43]

10.43 Taking firmer action on insolvent trading was also supported by Narrow Road Capital, who described that, at present, ASIC rarely prosecutes insolvent trading.[44] The AICM expressed a similar view, stating that the non-existent enforcement of insolvent trading means that directors are not deterred from continuing to trade whilst insolvent. This comes at a direct cost for creditors and lessens the chance for business turnaround at the end of an insolvency process.[45]

10.44 ASIC conceded that more could be done to address insolvent trading, but it identified that 'most of the time insolvent trading might stop a director, but it might not get any money back'.[46]

Wrongful trading

10.45 During the inquiry, consideration was given to possible changes to the 'insolvent trading' threshold, perhaps to mirror the 'wrongful trading' standard as is presently applied in the United Kingdom.

10.46 ASIC expressed its awareness of questions about whether the current insolvent trading provisions are achieving their objectives. It suggested that these provisions could be an area for further consideration, particularly in relation to how they impact the ability of businesses experiencing financial difficulty where the safe harbour provisions may not be available.[47] ASIC proposed a number of matters that could be the subject of such consideration, namely whether:

- the threshold for criminal insolvent trading is appropriate

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42 Associate Professor Wellard, *Committee Hansard*, 1 March 2023, p. 12

43 Associate Professor Wellard, *Committee Hansard*, 1 March 2023, p. 12.

44 Mr Jonathan Rochford, Managing Director, Narrow Road Capital Pty Ltd, *Committee Hansard*, 28 February 2023, p. 24.

45 AICM, *Submission 9*, [p. 2].

46 Mr Day, ASIC, *Committee Hansard*, 1 March 2023, p. 39.

47 ASIC, *Submission 29*, pp. 58-58.

- it is appropriate to differentiate between the size of companies based on liabilities (similar to the small business reforms)
- some monetary thresholds to individual debts incurred should be applied
- certain classes of liabilities should not be included.[48]

10.47 The 'wrongful trading' standard is higher than the civil 'insolvent trading' standard which currently exists in Australia. According to ASIC, it applies to situations where 'a company's directors have continued to trade when they knew, or should have concluded, that there was no reasonable prospect that the company would avoid insolvent liquidation or insolvent administration'.[49]

10.48 This matter was also considered by the 2021 *Review of the Insolvent Trading Safe Harbour*. In its final report published on 23 November 2021, the Review Panel concluded that it was beyond the scope of its task to consider whether Australia's prohibition on insolvent trading should be replaced by the 'wrongful trading' or another model. However, noting that such a change would have 'significant ramifications', any such proposal 'should be the subject of in-depth consideration and consultation'.[50] The Review Panel stated, however, that despite the operation of the safe harbour provisions, there remain 'significant queries about the underlying effectiveness of the prohibition, and its interaction with corporate governance, risk allocation and other legislative obligations of directions'.[51] Those difficulties, it stated, 'arise because of the starting position of the duty: directors are liable for all insolvent trading, unless carve-outs or defences apply'.[52]

10.49 In the Review Panel's view, 'the appropriateness of that base position (from a policy perspective) is worthy of being questioned'.[53] It added:

> To the extent a 'wrongful trading' model can achieve similar policy objectives while also clarifying and simplifying the concept of insolvent

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48 ASIC, *Submission 29*, p. 59.

49 ASIC, *Submission 29*, p. 58.

50 Treasury, *Review of the Insolvent Trading Safe Harbour*, 23 November 2021, https://treasury.gov.au/sites/default/files/2022-03/p2022-p258663-final-report.pdf, (accessed 6 June 2023), p. 84

51 Treasury, *Review of the Insolvent Trading Safe* Harbour, 23 November 2021, https://treasury.gov.au/sites/default/files/2022-03/p2022-p258663-final-report.pdf, (accessed 6 June 2023), p. 84.

52 Treasury, *Review of the Insolvent Trading Safe* Harbour, 23 November 2021, https://treasury.gov.au/sites/default/files/2022-03/p2022-p258663-final-report.pdf, (accessed 6 June 2023), p. 84.

53 Treasury, *Review of the Insolvent Trading Safe* Harbour, 23 November 2021, https://treasury.gov.au/sites/default/files/2022-03/p2022-p258663-final-report.pdf, (accessed 6 June 2023), p. 84.

> trading from the perspective of directors, is, at least on its face, appealing. However, its appropriateness within the Australian jurisdiction must be considered.[54]

10.50 Associate Professor Wellard encouraged lawmakers to reconsider and reformulate the legislative settings that will:

> encourage directors to satisfy themselves that their companies are adequately capitalised when regard is had to the scale of the operations and the level of the commitments into which they are proposing to enter.'[55]

10.51 The Australian Institute of Company Directors (ACID) suggested that a comprehensive review consider:

> …amending the threshold of the insolvent trading director duty to 'wrongful trading'—that is, that the threshold for director liability would require (as it does in the United Kingdom) *actual knowledge or negligence* that there was no reasonable prospect of the company avoiding liquidation and they did not take steps to minimise losses, as opposed to the current lower threshold in Australia of a *reasonable suspicion* in the mind of the director that the company was insolvent…[56]

Committee view

10.52 From the evidence it has received, the committee is concerned that the current insolvent trading regime is not working effectively to prevent companies from becoming deeply insolvent before they enter formal insolvency or restructuring pathways. At this point it is hard to determine what the root causes behind the problems are. However, the evidence suggests that likely causes include weaknesses in the legislative provisions and lack of enforcement by ASIC. Both those potential causes may contribute to ineffective deterrence in the face of strong cultural incentives for directors to avoid acting until too late.

10.53 As discussed in other chapters (for example, in chapter 11 on voidable transactions and unfair preference claims), deeply insolvent trading distorts other parts of the insolvency system. The committee, therefore, suggests that one of the top priorities for the proposed comprehensive review should be to address the ineffectiveness of the insolvent trading regime, its enforcement, and the distorting impacts on other parts of the insolvency system.

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54 Treasury, *Review of the Insolvent Trading Safe* Harbour, 23 November 2021, https://treasury.gov.au/sites/default/files/2022-03/p2022-p258663-final-report.pdf, (accessed 6 June 2023), p. 84.

55 Associate Professor Mark Wellard, *Submission 51*, p. 5. See also, Report of the Review Committee on Insolvency Law and Practice (1982) Cmnd 8558 ('the UK Cork Report'), Ch 44 'Wrongful Trading', [1784] – [1785].

56 Australian Institute of Company Directors (AICD), *Submission 44*, p. 4.

Recommendation 20

10.54 The committee recommends that the comprehensive review examine the operation of the insolvent trading regime and its impact on the broader corporate insolvency framework.

Illegal phoenixing

10.55 The majority of Australian business do the right thing and comply with Australia's taxation and corporate insolvency laws. However, there is a proportion of the population that choose not to comply, with some using illegal phoenix activity as part of their business operating model. It occurs when a new company, for little or no value, continues the business of an existing company that has been liquidated or otherwise abandoned to avoid paying outstanding debts, which can include taxes, creditors and employee entitlements.[57] Illegal phoenix activity is a serious financial crime. It is perpetrated by some in an opportunistic manner to retain business and personal assets. In other cases, it involves organised criminal networks, assisted by professional enablers and facilitators.[58]

10.56 Illegal phoenixing causes significant harm to the community. Employees miss out on wages, superannuation and entitlements, suppliers and subcontractors are left unpaid, and governments miss out on tax revenue. It is estimated by the ATO that the impact on businesses and employees is between $2.85 billion and $5.13 billion annually.[59] In addition to the direct impact, illegal phoenix activity creates an uneven playing field, where honest businesses who pay their tax, superannuation, suppliers and subcontractors, are not able to compete.[60]

10.57 The risks arising from illegal phoenixing are not static nor confined to certain industries or locations, although it is prevalent in the property and construction, labour hire and security industries. The controls implemented to respond to illegal phoenix activity must continually adjust and respond to evolving behaviour and methodologies used by phoenix operators.[61]

10.58 Noting the difficulty in defining illegal phoenixing, the ATO provided the following information on how it distinguishes between illegal phoenixing and the legitimate winding up of businesses:

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57 ASIC, *Illegal Phoenix Activity*, https://asic.gov.au/for-business/small-business/closing-a-small-business/illegal-phoenix-activity/, (accessed 6 June 2023).

58 ATO, *Submission 35*, pp. 7–8.

59 ATO, *Submission 35*, p. 8.

60 ATO, *Submission 35*, pp. 7–8.

61 ATO, *Submission 35*, p. 8.

- Illegal phoenixing is usually deliberate and serial liquidation of companies and inappropriately transferring assets to a third parties.
- Illegal phoenixing can also be opportunistic, companies get themselves into trouble and they move the assets into a new business so they can start up again, as a way of taking an advantage.
- There are also some instances where someone is in business, they liquidate in a lawful manner and then they start a new business up in the industry that they were in. They actually haven't done anything wrong, they haven't shifted assets, they've gone through the process, but generally speaking the person might be in a particular industry—that's their skill and expertise—and then they move on, and they've had a business failure, but they never repeat that.[62]

10.59 The extent to which illegal phoenixing remains prevalent in the Australian economy, despite the implementation of recent reforms aimed at addressing this issue, was discussed during the inquiry. The summary view provided by participants is that phoenixing activity continues to occur, and, while more time is likely required to properly assess the impact of the recent reforms, stronger regulatory action is likely to be required.

10.60 The recent reforms, implemented with the passage of the *Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020*, were twofold:

- the legislation introduced a new category of voidable transaction, namely the creditor-defeating disposition. This allowed liquidators to pursue transactions wherein a company had disposed of assets effectively below their true value; and
- liquidators could seek a determination from ASIC that the relevant disposition was creditor-defeating. Any recipient subject to such a determination would need to prove in court that it was not.[63]

10.61 Mr Ben Sewell commented on the lack of data around the frequency and costs of phoenix activity in Australia and suggested that any quantifications of these figures are likely speculative.[64]

10.62 Evidence to this inquiry raised questions about the effectiveness of the scheme, and ASIC's enforcement activities in respect of it.[65] ARITA told the committee that 'the market needs stronger signals that poor director behaviour won't be

62 Mr George Montanez, Assistant Commissioner, Integrated Compliance, Phoenix and Evasion Program, Australian Taxation Office, *Committee Hansard*, 13 December 2022, p. 57.

63 Explanatory Memorandum, *Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020*, p. 15

64 Mr Ben Sewell, *Submission 12*, p. 14.

65 BLS LCA, *Submission 30*, p. 28; ARITA, *Submission 36*, p. 49.

tolerated'.[66] It said that '[s]trengthening the legislation is part of this, a dedicated engagement-focused regulator is the other'.[67] The need to strengthen the anti-phoenixing regime with more regulation was supported by other stakeholders such as the Construction Forestry Maritime Mining Energy Union (CFMMEU)[68] and Southern Steel Group.[69]

10.63 The BLS LCA recommended that 'consideration should be given to the effectiveness of, and any potential improvements to, the creditor-defeating disposition regime, including the administrative process by which ASIC may made orders about creditor-defeating dispositions'.[70] Expanding upon its position before the committee, the BLS LCA emphasised that there is a need for the enforcement of consequences under the scheme for it to be effective, noting that while the legislation itself is a disincentive, 'it doesn't necessarily make much difference unless people also see that the consequence will be real'.[71]

10.64 The BLS LCA noted that while the limited reported legal cases and ASIC determinations on creditor-defeating dispositions does not necessarily tell the whole story about the effectiveness of the reforms, reflection was warranted to determine whether the regulatory scheme was really working.[72]

10.65 The Australian Institute of Credit Management (AICM) and the Housing Industry Association (HIA) supported the introduction of a statutory definition of illegal phoenixing behaviour in order to clarify what is and what is not illegal behaviour.[73]

10.66 ARITA suggested that the following reforms should be pursued:

- substantially more enforcement actions need to be taken against directors and facilitators of illegal phoenixing;
- more needs to be done to strengthen existing anti-phoenixing tools within the law rather than creating quasi-duplicate mechanisms. This is consistent with the Australian Law Reform Commission's (ALRC) recent recommendation that 'offence and penalty provisions in corporations and

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66 ARITA, *Submission 36*, p. 49.

67 ARITA, *Submission 36*, p. 49.

68 Mr David Noonan, National Secretary, Construction Forestry Maritime Mining Energy Union (CFMMEU), *Committee Hansard, 21 February 2023, p. 32.*

69 Mr Grant Morris, National Credit Manager, Southern Steel Group, *Committee Hansard*, 21 February 2023, p. 68.

70 BLS LCA, *Submission 30*, p. 29.

71 Mr Collins, BLS LCA, *Committee Hansard*, 14 December 2022, p. 33.

72 Mr Pearce, BLS LCA, *Committee Hansard*, 14 December 2022, p. 33.

73 Mrs Jocelyn Martin, Deputy Managing Director, Housing Industry Association (HIA), *Committee Hansard*, 21 February 2023, p. 57; Mr Pilavidis, AICM, *Committee Hansard*, 28 February 2023, p. 12.

financial services legislation should be consolidated into a smaller number of provisions covering the same conduct.'[74]

- an actual 'phoenixing' offence needs to be created. Its absence hinders any effective communication strategy to drive cultural change to call out and mitigate this behaviour.
- a lack of adequate funding and documentary evidence available to liquidators will continue to hamper the effectiveness of the reforms, including the ability of ASIC to make any recoveries via the administrative recovery regime.[75]

10.67 ARITA, like a number of other inquiry participants, recognised that part of the response to address illegal phoenixing involves addressing the harms posed by pre-insolvency advisors.[76] Further discussion about this issue, including proposals to address it, is available from paragraph 8.88 in chapter 8.

Director identification numbers

10.68 The recent anti-phoenixing reforms also included requirement for directors to obtain a Director Identification Number (Director ID). The Director ID program is part of the Australian Business Registry Services (ABRS) which is managed by the ATO. Mr Ben Sewell described the Director ID reforms as follows:

> It is a process where you get a unique identifier and it goes to your tax agent. Basically there is no way that you can commit fraud with writing your name down on a company or corporation or fudging the date of birth or the name.[77]

10.69 While the initiative remains in its early stages, the general sense from inquiry participants is that the Director ID program will be a useful mechanism for combatting illegal phoenixing.[78] However, further sentiment amongst submitters indicated that this will not be a cure-all mechanism.[79] For example,

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74 Australian Law Reform Commission (ALRC), *Financial Services Legislation: Interim Report B*, ALRC Report 139, September 2022, p. 147.

75 ARITA, *Submission 36*, pp. 7, 51.

76 ARITA, Submission 36, pp. 49–51.

77 Mr Ben Sewell, Private capacity, *Committee Hansard*, 28 February 2023, p. 59.

78 See, for example, Mr David Walter, Member, Insolvency & Restructuring Committee, BLS LCA , *Committee Hansard*, 14 December 2022, p. 33; Mr David Noonan, National Secretary, CFMMEU (Construction and General Division), *Committee Hansard*, 21 February 2023, p. 31; Mr Shaun Schmitke, Chief Executive Officer, Master Builders Association, *Committee Hansard*, 21 February 2023, p. 59; Ms Melissa Adler, Executive Director, Industrial Relations and Legal Services, (HIA), *Committee Hansard*, 21 February 2023, p. 59; Mr Sewell, *Committee Hansard*, 28 February 2023, p. 60; CPA Australia, *Submission 11*, [p. 3];

79 Mr Russell Morgan, *Submission 2*, p. 2; see also, Mr Trevor Gauld, National Policy Officer, Electrical Trades Union (ETU), *Committee Hansard*, 21 February 2023.

ARITA said that '[i]t is not a silver bullet, but it's an incredibly important tool in the shed'.[80]

10.70 Mr Russell Morgan noted that while the recently implemented Director ID initiative 'is a step to combat phoenix companies', such a measure, while capable of identifying regular phoenixers, does not appear to be directed at directors who engage in one-off phoenixing behaviour.[81]

10.71 The Electrical Trades Union (ETU) suggested that there is a gap that exists in identifying and defining straw directors and imposing penalties where directors have been appointed either without that person's knowledge or who don't exist. The ETU stated that while the Director ID reforms will go some way to addressing those issues, they haven't gone far enough.[82]

10.72 The BLS LCA observed that it is a generally accepted view that the introduction of Director ID requirements is a welcome and potentially useful reform.[83] However, it questioned why this registry sits within the ATO, rather than ASIC. It stated that '[a]t least at first impression, the addition of an additional regulator into the company officer registration space is likely to create inefficiency'.[84]

Committee view

10.73 The committee notes that additional time may be necessary to properly ascertain the effectiveness of the anti-phoenixing reforms. However, the committee is of the view that a further review, after an appropriate amount of time, may be necessary to determine whether additional administrative or enforcement mechanisms are needed to ensure the reforms are meeting their objectives.

Australian Taxation Office (ATO)

10.74 This section discusses:

- the ATO's roles in corporate insolvency;
- ATO assistance to businesses during the pandemic;
- how vigorously the ATO pursues insolvency-related debts;
- the ATO as a model creditor; and
- ATO suggestions for reform.

The ATO's roles in corporate insolvency

10.75 An insolvency process of a company will often involve the ATO, as most companies will have some tax liability. The ATO indicated that the

80 Mr Winter, ARITA, *Committee Hansard*, 14 December 2022, p. 10.

81 Mr Russell Morgan, *Submission 2*, p. 2.

82 Mr Trevor Gauld, National Policy Officer, ETU, *Committee Hansard*, 21 February 2023, p. 34.

83 BLS LCA, *Submission 30*, p. 29.

84 BLS LCA, *Submission 30*, pp. 29–30.

Commissioner of Taxation plays two roles in the insolvency system. The first role is acting as administrator of the tax and superannuation systems to recover debts until insolvency. The second is post-insolvency involvement as a major creditor. The ATO indicated that its approach to debt recovery and insolvency is measured and cautious, and it seeks to work with businesses on tailored solutions.[85]

10.76 Once a company enters insolvency, the ATO's role largely goes from the administrator of the tax and super systems to that of an unsecured creditor. Historically, the ATO has been a creditor in three-quarters of company insolvencies and is often the largest and sometimes the only creditor.[86]

10.77 The ATO noted that its tax collection mechanisms could bring issues to a head for struggling companies. The ATO will usually issue a Director Penalty Notice (DPN) before taking liquidation proceedings if the company's debts are under the pay-as-you-go tax provisions, superannuation guarantee charge, or Goods and Services Tax (GST). It is not uncommon for directors to initiate insolvency following the ATO issuing a DPN.[87]

10.78 A standard DPN can be remitted by the company paying the debt or appointing a liquidator, a voluntary administrator, or a small business restructuring practitioner. Each of these appointees is required to be a registered liquidator. The directors often choose to appoint a registered liquidator when the company cannot pay the debt (or agree to a payment arrangement). It has not been possible to accurately estimate how many appointments of liquidators are indirectly triggered following the issue of DPNs.[88]

10.79 Where a tax debtor does not propose or adhere to an acceptable proposal to pay a tax debt, the ATO may issue a creditor's statutory demand. If the tax debtor fails to comply with the demand (pay, secure or compound the debt), the company will be presumed to be insolvent, and the Commissioner may, in appropriate circumstances, commence winding up proceedings.[89]

ATO assistance to businesses during the pandemic

10.80 During the pandemic, the ATO helped businesses, including:

- deferring of payment and lodgment dates;
- allowing businesses to vary their payment instalments;

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85 Ms Jillian Kitto, Assistant Commissioner, Lodge and Pay Enforcement, ATO, *Committee Hansard*, 13 December 2022, p. 50.

86 Ms Kitto, ATO, *Committee Hansard*, 13 December 2022, p. 50.

87 ATO, *Submission 35*, pp. 3, 6.

88 ATO, *Submission 35*, pp. 3, 6.

89 ATO, *Submission 35*, p. 3.

- remitting interest and penalties;
- withholding enforcement actions, including DPN and wind-ups; and
- pausing enforcement activities that lead to insolvency appointments.[90]

10.81 As the pandemic pressures on business eased, the ATO resumed its activities. In March 2022, the ATO commenced an awareness campaign by contacting company directors via letter to inform them about their potential personal liability for company tax debts under the DPN program. An awareness letter differs from a DPN as it notes that the ATO is considering acting if the company does not actively manage their debt. Following the DPN awareness campaign, between July and September 2022, the ATO issued 7,523 DPNs, compared to 125 DPNs issued over the same reporting period in the previous year. The ATO indicated that in late 2022 it was on average issuing 150 DPNs each business day and increasing. Pre-COVID, the ATO issued fewer DPNs, averaging around 52 each business day in the 2019 financial year.[91]

10.82 Historically, the ATO has been a creditor in 74 per cent or around three in four company insolvencies. The ATO the largest creditor and sometimes the only creditor.[92] However, the ATO suggested it is a relatively minor initiator of corporate insolvency appointments. The ATO suggested that most corporate insolvency appointments are initiated by the directors of the corporate entity or another creditor.[93] ARITA disputed the ATO view as follows:

> I'm a little surprised at the ATO's position that they're a minor player in the insolvency market. That's simply not true. Even if you look at their graph for the wind-ups that occur, it shows that they're doing about 50 per cent of them. That is the long-term historical perspective. The ATO were the primary organisation to initiate wind-ups pre-COVID. Their absence from the market is what shut down the level of insolvency over the course of the last couple of years, alongside stimulus. They act as the principal signaller to the market about whether or not a company is in distress. Indeed, it has changed creditor behaviour, because most other creditors were reliant on the ATO taking that wind-up action. [94]

How vigorously the ATO pursues insolvency related debts

10.83 Some witnesses raised concerns that when the ATO does not take strong action to enforce tax debts, companies that would otherwise be triggered to enter insolvency do not, causing larger losses to other creditors. For example,

[90] ATO, *Submission 35*, p. 6.

[91] ATO, *Submission 35*, pp. 6–7.

[92] Ms Kitto, ATO, *Committee Hansard*, 13 December 2022, p. 50.

[93] ATO, *Submission 35*, p. 3.

[94] Mr Winter, ARITA, *Committee Hansard*, 14 December 2022, p. 13.

Mr Jonathan Rochford from Narrow Road Capital, made the following observations:

> …I want to encourage the committee to reassure the ATO that they should collect their debts in full and on time. The ATO typically collects GST and pay-as-you-go taxes after the business has received them or withheld them. As the business should already have the money, there is no reason it should not be able to pass it on to the ATO promptly. Without the ATO taking swift action to recover debts, insolvent businesses can continue to trade, fleecing their customers, employees, trade creditors and taxpayers.[95]

10.84 Mr Michael Brennan (Offermans) also argued that the ATO taking a stronger role in enforcing debt associated with insolvency has broader impact on the market:

> I think the ATO needs to lead the discussion on the fact that paying tax is an obligation. It seems to be an opt-in opt-out sort of situation these days. I just think we need to get back to a scenario where, regardless of what's happening in the broader community, tax needs to be paid because that money is used for vital public good. You do have a market distortion where some businesses aren't paying tax and some are. I know that seems overly harsh. It's certainly been the case that the ATO drive insolvency. They can deny it for whatever reasons. I think that the data shows that, when the ATO is seeking tax recovery, businesses that aren't performing either go and get firmer advice on how to perform or end up looking at how they exit the ecosystem. Those assets then get redeployed to other businesses. I think that's the massive part of the ATO's tradition that it needs to reclaim—accept the fact that it's not going to be popular and that it's a vital part of driving the way businesses operate.[96]

10.85 Mr Grant Morris, National Credit Manager at Southern Steel Group held a slightly different view, noting that the ATO is still readjusting its practices following the pandemic:

> I thought some of the comments were interesting, such as some of the comments about whether the ATO should be stepping in and taking action. I think it's fairly common knowledge at the moment that the ATO hasn't been taking action in terms of insolvencies and winding up companies. I think the reports I've seen as recently as in the last two or three days show that that action is just starting, although we're still a long way behind what the historical levels were in terms of pursuing debts and so on. I personally don't see it as the ATO's responsibility to decide whether they have the opportunity to collect somebody's debt. I think that's more a Treasury issue and a government big-picture type of issue. I don't think it's the ATO's

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95 Mr Jonathan Rochford, Managing Director, Narrow Road Capital Pty Ltd, *Committee Hansard*, 28 February 2023, p. 21.

96 Mr Michael Brennan, Liquidator and Bankruptcy Trustee, Offermans, *Committee Hansard*, 21 February 2023, p. 42–43.

> responsibility. Isn't there something like $55 billion in collectable debt outstanding at the moment?[97]

10.86 The BLS LCA noted a diversity of views within its membership on the effectiveness of the ATO in its role and how vigorously it should pursue debts in potentially insolvent companies. The BCS LCA indicated that its members are in general agreement that a hard-line enforcement approach to collectable debt may increase corporate insolvencies and have impacts on the economy, businesses, employees, and individuals that are not in the national interest and that the ATO must take a nuanced approach that differentiates between different risks in this area and seeks to get the balance right between enforcement and support.[98]

10.87 The ATO annual report indicates that significant collectable debt has accrued during the pandemic, increasing from $26.5 billion at 30 June 2019 to $44.8 billion at 30 June 2022, up $18.3 billion or 69 per cent. The small business sector has $29.3 billion of collectable debt (more than 65 per cent). The largest type of tax debt is activity statement debt (e.g. Business Activity Statement (BAS) instalments), amounting to $29.7 billion, over 66 per cent of collectable debt.[99]

10.88 The BCS LCA drew attention to the significance of the debts owed to the ATO in the context of the federal budget. Australia's projected deficit in the government's October 2022 Budget was $36.9 billion. That means that the total collectable debt at the same time exceeds the deficit, and the small business collectable debt represents almost 80 per cent of the deficit.[100]

10.89 KPMG also commented on the balance to strike for the ATO between collection activities and business support. It's often tax office action which is the thing that puts pressure on the company to do something. In the absence of pressure to do something, it's human nature to do nothing, and if they do nothing, then the problem goes down the road further. The ATO could play a part in encouraging companies to face their problems sooner, which would allow insolvency practitioners more latitude to rescue the company, save the jobs and hopefully produce a better return for the creditors.[101]

10.90 AICM told the committee that other credit providers, who do not have the same access to information, rely mainly on the expectation that if the ATO hasn’t taken enforcement action, the entity is viable and will continue to provide credit.

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97 Mr Grant Morris, National Credit Manager, Southern Steel Group, *Committee Hansard*, 21 February 2023, p. 69.

98 BLS LCA, *Submission 30,* p. 54.

99 BLS LCA, *Submission 30,* pp. 52–53; Commissioner of Taxation's Annual Report 2021–2022, p. 18.

100 BLS LCA, *Submission 30,* pp. 52–53.

101 Mr Peter Gothard, Leader, Asia Pacific Restructuring Services, KPMG Australia, *Committee Hansard*, 21 February 2023, p. 48.

AICM stated that the post-COVID debt levels are a 'significant concern to credit professionals' because it is a hidden risk to them, and the suspension of enforcement activity during the emergency period caused increased uncertainty. While it supported calls for the ATO to be consistent with enforcement proceedings, AICM also supported the ATO, aiding viable businesses. However, it argued that this approach must be accompanied by greater transparency to assist credit providers in making informed decisions.[102]

10.91 AICM suggested expanding the disclosure of tax debt measures as follows:

- Amend the threshold amount from $100,000 to $10,000, or provide a mechanism for regular review of this threshold amount.
- Information be included on credit reports for five years from the date of disclosure, and during this period, it is updated in the same manner as any other commercial default.[103]

10.92 The BCS LCA recommended that consideration should be given to whether the ATO's armoury of various enforcement mechanisms remains appropriate. The BCS LCA also suggested steps that could be taken outside insolvency to improve the collection of tax:

- increasing public education to articulate risk factors to match ATO action with those which are high risk or lower risk;
- increasing ATO collection and enforcement activity for high risk debt;
- making payment plans more attractive for lower risk debt;
- increasing small business tax debt advisory support and education;
- establishing more support for struggling industry sectors; and
- considering the feasibility of tax system changes to bring forward the date of payment of tax withholding instalments to when payment occurs.[104]

ATO as a model creditor

10.93 There was also some discussion during the inquiry about whether the ATO should be a model creditor. This discussion was promoted by ARITA, who recommended that:

> in addition to being a model litigant as required under the *Legal Services Directions 2017*, the ATO must be required to act as a model creditor at all times, and that its compliance with both requirements be reviewed annually by the Inspector General of Taxation.[105]

10.94 The model litigant requirement, which applies to the Commonwealth and Commonwealth agencies, obliges these parties to 'act honestly and fairly in

[102] AICM, *Submission 9*, [pp. 8–9].

[103] AICM, *Submission 9*, [p. 9]. See also, Australian Credit Forum, *Submission 22*, p. 9.

[104] BLS LCA, *Submission 30*, pp. 54–55, 57.

[105] ARITA, Submission 36, pp. 10, 77,

handling claims and litigation brought by or against the Commonwealth or an agency of it'.[106] This obligation includes (among other things):

- dealing with claims promptly and not causing delay in the handling of claims and litigation;[107]
- acting consistently in the handling of claims and litigation;[108]
- not taking advantage of a claimant who lacks the resources to litigate a legitimate claim;[109] and
- not relying on technical defences unless the Commonwealth's or the agency's interests would be prejudiced by the failure to comply with a particular requirement.[110]

10.95 ARITA explained the characteristics of a model creditor as follows:

- not abstaining from voting at meetings;
- attending all meetings, whether by sending a staff member or by providing a proxy to the Chairperson;
- supporting resolutions about appointee remuneration wherever it is for necessary work, properly performed;
- not taking advantage of external administrators who have insufficient resources to pursue a claim against it;
- not seeking to prioritise the ATO's position above other ordinary unsecured creditors;
- ensuring requests for information made in accordance with creditor rights are reasonable in the circumstances;
- reporting potential breaches of the law to relevant regulators. For example, where the ATO identifies a derelict company that should be deregistered but does not seek to liquidate the company for commercial reasons, it should nevertheless advise ASIC that the company should no longer be registered.[111]

10.96 The ATO's statutory priority as a creditor in insolvency was abolished in 1993. However, ARITA argued that the ATO has used other powers to get ahead of other unsecured creditors and is therefore not following the *pari passu* principle.[112]

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106 *Legal Services Directions 2017*, Appendix B, paragraph 2.

107 *Legal Services Directions 2017*, Appendix B, subparagraph 2(a).

108 *Legal Services Directions 2017*, Appendix B, subparagraph 2(c).

109 *Legal Services Directions 2017*, Appendix B, subparagraph 2(f).

110 *Legal Services Directions 2017*, Appendix B, subparagraph 2(g).

111 ARITA, *Submission 36*, pp. 78–79.

112 ARITA, Submission 36, pp. 79–80.

10.97 Professor Harris agreed that the ATO should be a model creditor. He explained that during his research, he received feedback from practitioners that indicated confusion about the role of the ATO in liquidations: 'Is it a commercial creditor or is it a policeman?'.[113]

10.98 The BLS LCA recommended that consideration should be given to binding legislative guidance governing the way the Commissioner should exercise enforcement rights and the Commissioner's attitude to votes at creditors' meetings and to legislating the application of judicial review rules to the Commissioner's decisions at creditors' meetings.[114]

10.99 The ATO responded that it is bound to comply with model litigant obligations, which include principles such as promptness, avoiding unnecessary litigation, consistency and being cost-effective. The ATO indicated that it abides by those principles in its role as the administrator of the tax and superannuation systems and when acting as a creditor. The ATO uses the Practice Statement Law Administration 2011/16 (PS LA 2011/16) regarding insolvency, which guides ATO officers and the public on how the ATO votes in creditors' meetings and what the ATO considers. The ATO is also bound by the broader Taxpayers' Charter, which is about treating taxpayers fairly, reasonably, and honestly, as well as the requirement for ATO officers to apply the APS Code of Conduct. While the practice statement doesn't currently cover small business restructuring, the ATO follows the principles of the PS LA 2011/16 when it assesses restructuring plans as well.[115]

ATO suggestions for reform

10.100 The ATO declined to provide suggestions for insolvency reform to the committee, indicating that:

> 'The ATO is separately engaging with the Department of Treasury, which is responsible for providing policy and law advice to Government concerning potential reform opportunities to improve the operation of the corporate insolvency system.[116]

Committee view

10.101 The committee notes that the ATO felt it could not include suggestions for reform in its submission to such a critical policy inquiry. While the committee acknowledges that departments and agencies must take the appropriate care in their work for the government of the day, the committee considers that

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113 Professor Harris, *Committee Hansard*, 13 December 2023, p. 48.

114 BLS LCA, *Submission 30,* p. 57.

115 Ms Kitto and Mr Gary Busby, Senior Insolvency Advisor, Lodge and Pay Enforcement, ATO, *Committee Hansard*, 13 December 2022, p. 55.

116 ATO, *Submission 35*, p. 6.

government departments and agencies should be able to contribute to inquiries by identifying areas of policy where issues have arisen that need reform. The committee notes that departments and agencies have access to rich information on such matters. The committee, therefore, encourages the ATO and Treasury to add such information to their submissions in future.

10.102 The committee observes that inquiry participants had varying views on whether the ATO should take a hard line on insolvency-related debt. Some inquiry participants have identified the significant impacts on the rate of insolvencies in the economy of the ATO adjusting how vigorously it pursues insolvency-related debts. In particular, the committee notes that the ATO provided significant relief to businesses during the pandemic. The committee also acknowledges the broader economic and social importance of the ATO's capacity to vary its approach, and that capacity can assist the country in responding to economic shocks, such as the shock created by the pandemic. The committee considers it would be appropriate for the comprehensive review to analyse and make recommendations on the overall economic and social benefits and costs of ATO relief to potentially insolvent companies in hard economic times, in the context of the impacts on the purposes of the insolvency system.

10.103 The committee notes suggestions that the ATO acts as a model creditor when participating in insolvencies as a creditor. The committee notes that the statutory priority for the ATO as an insolvency creditor was removed in 1993. However, it was suggested to the committee that the ATO may use other powers to get ahead of other creditors in some circumstances. The committee notes that the ATO responded, indicating how it applies model litigant obligations and the Practice Statement Law Administration 2011/16 (PS LA 2011/16), which requires that the Commissioner will neither prejudice other creditors' entitlements nor accept that other creditors can prejudice the Commissioner's entitlements.

10.104 The committee considers that there should be no harm in the ATO following a model creditor guideline if such guidelines were available. Hence, the committee is recommending that the ATO consult, act on and publish model creditor guidelines, consistent with its model litigant obligations.

Recommendation 21

10.105 The committee recommends that the comprehensive review analyse and make recommendations on the overall economic and social benefits and costs of Australian Taxation Office relief to potentially insolvent companies in hard economic times, in the context of the impacts on the purposes of the insolvency system.

Recommendation 22

10.106 The committee recommends that the Australian Taxation Office consult, act on and publish model creditor guidelines, consistent with its model litigant obligations.

Chapter 11
Assets of the company and creditors' priority

11.1 This chapter is the first of four chapters covering the assets of the company and creditors' priority. The introductory section provides some background on the liquidator's tasks relating to the company's assets and creditors' priority. The last part of the introductory section provides an outline of the remainder of this chapter and the remaining three chapters of the report.

Introduction

11.2 When conducting a liquidation[1] of a company, liquidators are required to identify all the company's property—in order for it for to be realised and for the proceeds to be distributed to creditors. The liquidator's tasks include:

- protecting, collecting and selling the company's assets;
- investigating and reporting to creditors about the companies affairs, including;
  - voidable transactions and unfair preferences (payments made to certain creditors over others) that may be recoverable;
  - possible claims against the company’s officers (including insolvent trading);
  - creditor-defeating dispositions that may be recovered, including in relation to illegal phoenix activity;
- inquiring into the failure of the company; and
- distributing money from the collection and sale of assets in the following order:
  - payment of the costs of the liquidation, including the liquidator's fees (subject to the rights of any secured creditor);
  - secured creditors where they hold a security interest typically over non-circulating assets (such as plant, equipment, and real estate);
  - employees as priority unsecured creditors[2] (with funds coming principally from circulating assets e.g. inventory) in the following order;

    (i) outstanding employee wages and superannuation;

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1 Includes creditors' voluntary liquidation and court liquidation.

2 Employees are a special category or class of unsecured creditors. In a liquidation, outstanding employee entitlements are paid before the claims of other unsecured creditors. Australian Securities and Investment Commission (ASIC), *Liquidation: A guide for creditors*, https://asic.gov.au/regulatory-resources/insolvency/insolvency-for-creditors/liquidation-a-guide-for-creditors/ (accessed 21 May 2023).

(ii) outstanding employee leave of absence (including annual leave and long service leave);

(iii) employee retrenchment pay; and

– then to other unsecured creditors.[3]

11.3 Each category of creditor must be paid in full before the next category is paid. If there are insufficient funds to pay a category in full, the available funds are paid on a pro-rata basis—with the implication or flow on effect being that the next category of creditors in line will not receive any funds.[4]

11.4 The priority principle is a departure from the *pari passu* rule that unsecured debts should be treated equally.[5] The *Companies Act 1883* (UK) introduced the priority to company law. It recognises that, unlike other creditors, employees are typically unable to shield themselves from the risk of their employer's insolvency (for example, employees generally devote all their human capital to one employer, cannot diversify risk, cannot take security for their debts, and do not have the same access to financial information).[6]

11.5 Creditors might be owed money because they supplied goods or services to the company, made loans, paid for goods or services that they have not received, or are an employee owed money for unpaid wages and other entitlements. Creditors might be secured or unsecured:

- A secured creditor holds a security interest, such as a mortgage, in some or all of the company's assets to secure a debt owed by the company. Lenders might require a security interest in company assets when they provide a loan. If the creditor wants to ensure their security interest over personal property other than land is enforceable and given priority in insolvency, they generally register the security on the Personal Property Securities Register (PPSR).

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3 ASIC, *Liquidation: A guide for creditors*, https://asic.gov.au/regulatory-resources/insolvency/insolvency-for-creditors/liquidation-a-guide-for-creditors/ (accessed 21 May 2023); James Hodgson, Company Liquidation: Who Gets Paid First? *Lawpath*, 21 February 2020, p. 1, https://lawpath.com.au/blog/liquidation-paid-first (accessed 21 May 2023); Nicholas Poole and Jonathon McRostie, *Priority creditors and circulating security interests: what's a liquidator to do?*, Clayton Utz, https://www.claytonutz.com/from-red-to-black-2020/priority-creditors-and-circulating-security-interests (accessed 21 May 2023).

4 ASIC , *Liquidation: A guide for creditors*, https://asic.gov.au/regulatory-resources/insolvency/insolvency-for-creditors/liquidation-a-guide-for-creditors/ (accessed 21 May 2023).

5 *Pari passu* is a Latin term that means 'ranking equally and without preference'. If a company's debts are *pari passu*, they are all ranked equally, so the company pays each creditor the same amount in insolvency.

6 Department of Employment and Workplace Relations (DEWR), *Submission 52*, p. 7.

- An unsecured creditor does not hold a security interest in the company's assets.[7]

11.6 The assets available to the liquidator fall into four broad types:

(1) circulating assets of the company that are available to unsecured creditors through the priority process;
(2) non-circulating secured assets of the company that are available to secured creditors;
(3) assets that may be recovered from voidable transactions and unfair preferences; and
(4) assets involved with trust structures.

11.7 For an insolvent company, a large portion of the liquidator's work involves the collection and sale of circulating and non-circulating assets and the subsequent distribution of funds to creditors to recycle those assets into more productive uses in the economy. However, for deeply insolvent companies, there may be few, if any, circulating assets and any non-circulating assets may have a high level of secured interests. Consequently, in such deeply insolvent cases, a higher portion of the liquidator's work involves recovering voidable transactions and unfair preferences. In situations where trusts have been used as a significant structure in a business, an increased share of the liquidator's work will be associated with assets that are held in trusts.

11.8 The remainder of this chapter and the following three chapters of this report consider the issues that arise when liquidators seek to realise each asset type, and related questions regarding the overall operation of the corporate insolvency regime, as follows:

(a) this chapter covers circulating assets that belonged to the company at the commencement of the liquidation and existing and proposed mechanisms for establishing the priority of creditors over unsecured assets;
(b) chapter 12 considers the personal property securities regime intended to facilitate the handling of secured assets;
(c) chapter 13 addresses voidable transactions and unfair preferences; and
(d) chapter 14 examines issues for assets held in trusts.[8]

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7 ASIC, *Liquidation: A guide for creditors*, https://asic.gov.au/regulatory-resources/insolvency/insolvency-for-creditors/liquidation-a-guide-for-creditors/ (accessed 21 May 2023).

8 Mr Michael Murray & Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, 11th edition, Pub. Thomas Reuters, July 2022, pp. 550–558.

Assets of the company

11.9 Circulating assets were the main type of unsecured company asset that submitters and witnesses raised with the committee. This section provides:

- background on circulating assets;
- views of inquiry participants on the Whittaker Review recommendations on circulating assets; and
- other issues raised by submitters and witnesses.

Background on circulating assets

11.10 In its submission, the Attorney General's Department (AGD) explained how the *Personal Property Securities Act 2009* (PPS Act) introduced the concepts of circulating assets and non-circulating assets:

> The circulating asset provisions in the PPS Act are also particularly relevant in a corporate insolvency context because they affect the size of the asset pool available for sale and distribution. Prior to the introduction of the PPS Act, it was common for a lender to a corporation to take a fixed and a floating charge over the corporation's assets. The fixed charge would typically be taken over the company's major assets such as plant and equipment, whereas the floating charge would be taken over inventory or other assets that may typically turn over in the ordinary course of the company's business.[9]

11.11 The PPS Act removed the distinction between fixed and floating charges and instead created the concept of a non-circulating asset (to mirror collateral over which a fixed charge would traditionally have been taken) and a circulating asset (to mirror the type of collateral over which a floating charge would traditionally have been taken). The corresponding provisions in the *Corporations Act 2001* (Corporations Act) were updated to reflect this change.[10]

11.12 The PPS Act also provides that an asset that might otherwise be a circulating asset might be deemed to not be a circulating asset if the secured party has control of the asset and, has registered a financing statement concerning the collateral on the Personal Property Securities Register (PPS Register), disclosing that it has control over the asset.[11]

11.13 The relevant sections of the PPS Act are Sections 340 to 341A, which set out the meaning of a circulating asset. The Whittaker Review (discussed in Chapter 13) noted that those sections are very detailed and technical and, at times, difficult to apply. Several submissions to the Whittaker Review described these provisions as being unnecessarily complicated and suggested that they be restructured. The Whittaker Review also noted that:

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9 Attorney-General's Department (AGD), *Submission 33*, p. 3.

10 AGD, *Submission 33*, p. 3.

11 AGD, *Submission 33*, p. 4.

> The same submissions pointed out that the concepts of 'circulating asset' and 'circulating security interest' draw distinctions that are based on whether the grantor or the secured party has title to the affected assets, or has 'control' of them. The submissions noted that this is inconsistent with the general approach of the Act, which is to de-emphasise the location of title and to look more to the underlying commercial substance of an arrangement to determine its legal effect.[12]

11.14 Whether or not an asset is a circulating asset is significant if a corporate grantor becomes insolvent. Suppose the personal property falls within the definition of a circulating asset, the statutory priority afforded to employee creditors under the Corporations Act will apply where unsecured asset realisations are insufficient to meet employee claims. For non-circulating assets, the secured party may have recourse against the property in accordance with its priority.[13]

11.15 Section 556 of the Corporations Act establishes the priority for debts and claims that 'must be paid in priority to all other unsecured debts and claims', which includes employee claims. Employee claims are also prioritised under Section 561 of the Corporations Act over circulating assets (which is contingent on insufficient unencumbered assets to meet employee claims). Therefore, Section 556 applies to unsecured assets, while Section 561 applies (for employee claims) to circulating assets.[14]

11.16 Mr Michael Murray and Professor Jason Harris noted that employees and, therefore, the Fair Entitlements Guarantee (FEG) has priority over the company's circulating assets – such as work-in-progress payments and receivables. The liquidator must take care to use such assets with that priority in mind, coupled with uncertainty as to the extent of the priority of the liquidator's remuneration.

11.17 Mr Murray and Professor Harris clarified that, historically employees were given priority for their wages over floating charge assets of an insolvent enterprise dating back to the 19th century.[15] Mr Whittaker expanded on the history of the priority in his evidence to the committee, stating:

> My understanding is that the original policy objective behind the statutory priority that is afforded to employees over floating charge assets was developed in England during the Industrial Revolution, in the context of a manufacturing business that granted a fixed and floating charge over its assets to its bank. The view was taken that factory workers, whose labours produced the inventory that the company would subsequently sell, should

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12 Mr Bruce Whittaker, Review of the Personal Property Securities Act 2009, *Final Report*, 27 February 2015, pp. 432–433.

13 AGD, *Submission 33*, p. 5.

14 Australian Institute of Insolvency Practitioners, *Submission 20,* pp. 16–17; see also DyeCo Solvency and Turnaround, *Submission 13*, p. 5.

15 Mr Michael Murray and Professor Jason Harris, *Submission 18*, p. 17.

> be entitled to priority in relation to the inventory to recover their unpaid wages, rather than leave them exposed to the risk that their efforts could produce the inventory but that they might not be paid for their work because the proceeds of sale of the inventory had been claimed by the bank that held the security. It is also said that employees deserve particular protection because of their vulnerability, and their inability to protect themselves from the consequences of the insolvency of their employer.
>
> The desirability or otherwise of protecting employee entitlements from an employer's insolvency, and the most appropriate way of doing this, continues to be a topic of discussion as a matter of corporations law policy.[16]

Whittaker Review recommendations

11.18 Mr Whittaker indicated that it was not the role of his review to express a view on the policy behind Section 561 of the Corporations Act. However, the Whittaker Review concluded that Sections 340 to 341 of the PPS Act should be restructured based on support from respondents and made the following six recommendations:

- Recommendation 356: Sections 340 to 341A be amended so that collateral is only a circulating asset of a grantor if it is in the inventory of the grantor or its proceeds.
- Recommendation 357: Section 340 to 341A, be removed from the PPS Act and relocated to the Corporations Act.
- Recommendations 358–361: to clarify the circumstances in which an account in an Authorised Deposit Taking Institution (ADI) is a non-circulating asset, registration requirements and when an ADI or secured party has control and priority.[17]

Issues raised by submitters and witnesses

11.19 The committee heard various concerns about the complexity and need for legislative clarity for provisions on the relative priority of liquidator remuneration and employee entitlements over circulating assets.

11.20 The Business Law Section of the Law Council of Australia (BLS LCA) drew attention to the issue on who has priority over circulating assets. Some interpretations of section 561 of the Corporations Act have the effect of putting liquidators behind both employees and security holders. In the United Kingdom (UK), this issue came to a head following a decision of the House of Lords in the case of *Leyland DAF v Talbot* [2004] UKHL 9 that liquidator fees did not have

16 Mr Bruce Whittaker, Review of the Personal Property Securities Act 2009, *Final Report*, 27 February 2015, pp. 433–434.

17 Mr Bruce Whittaker, Review of the Personal Property Securities Act 2009, *Final Report*, 27 February 2015, pp. 434–438; see also Department of Employment and Workplace Relations (DEWR), answers to questions on notice, 1 March 2023 (received 23 March 2023); Turnaround Management Association Australia (TMA), *Submission 38*, p. 18.

priority. This decision then led to amendments to the UK equivalent of section 561, reversing the position and prioritising liquidator remuneration (including general costs and remuneration). Considering the decision and the legislative amendments in the UK, the BLS LCA recommended amendments are made to the Corporations Act— in particular sections 433 and 561— to provide clear priority to insolvency practitioners for payment of external administration costs and expenses.[18]

11.21 Also identifying applicable case law in this area, the Association of Independent Insolvency Practitioners (AIIP) discussed in its submission to the inquiry, the continuing disagreements between liquidators and the FEG in relation to sections 561 and 556 of the Corporations Act: FEG:

> Universal Distributing Co. Ltd (In Liq) (1933) 48 CLR 171 allows the liquidator to be paid for time incurred in securing, preserving and realising assets, but this does not extend to general expenses (such as statutory tasks like investigations, reports filed with ASIC and reports prepared for creditors etc).
>
> So at present, employees (and in their stead the Government body under the Fair Entitlements Guarantee) stand ahead of the costs incurred by a liquidator for completing statutory tasks like investigations, reports filed with ASIC and reports prepared for creditors etc).
>
> There is often disagreement between FEG and registered liquidators on the correct interpretation of the Corporations Act in relation to both Sections 561 and 556. In brief, where there are insufficient assets to pay creditors in full from circulating assets, FEG requires that the whole of the proceeds are paid to FEG with some modest allowance for the direct costs of realisation, but not general expenses.[19]

11.22 Mr Michael Murray and Professor Jason Harris suggested that amendments to the legislation or regulatory guidance on the expectations of external administrator's use of circulating assets and proceeds to fund trade-on activity would provide much needed clarity to the law. Mr Murray and Professor Harris also suggested that providing clear priority to insolvency practitioners for payment of their remuneration and expenses is required in the context that remuneration is also subject to legal uncertainty, an issue in which was discussed in more detail in Chapter 8 of this report.[20]

11.23 The Turnaround Management Association (TMA) recommended that consideration be given to adopting the recommendations in the Whittaker Report regarding circulating assets or making other reforms streamline

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18 BLS LCA, *Submission 30*, pp. 42–43; *Leyland DAF v Talbot* [2004] UKHL 9; *Insolvency Act 1986* (UK) s 176ZA; see also Kordamentha, *Submission 14*, p. 7.

19 Association of Independent Insolvency Practitioners (AIIP), *Submission 20*, p. 17; see also DyeCo Solvency and Turnaround, *Submission 13*, p. 5.

20 Mr Michael Murray and Professor Jason Harris, *Submission 18*, p. 17.

circulating asset provisions. The TMA suggested that the policy intent behind the priority afforded to employees (and administrators) be reconsidered and consideration be given to whether there is a more efficient manner to achieve those policy goals.[21]

11.24 The Australian Restructuring Insolvency and Turnaround Association (ARITA) noted that it and many registered liquidators and restructuring lawyers take the view that the purpose of section 561 of the Corporations Act is to protect employees from the secured creditor and not to give employees entitlements a super priority over liquidation costs and section 556 priorities. Hence, ARITA suggested that the law be amended to ensure that the approved remuneration and reasonable expenses of liquidation should be paid out of any circulating assets before the distribution to employees or creditors with security over such circulating assets.[22]

11.25 KordaMentha also argued that the purpose of Section 561 is to protect employees from a secured creditor with security over circulating assets, not to give employees a super priority over the costs of the liquidation and the normal Section 556 priorities. KordaMentha suggested it does not make sense that if there is no secured creditor, a liquidator's costs and remuneration are paid in priority to employees, but the existence of a secured creditor on the appointment, somehow displaces that priority such that a liquidator's general costs are subordinated to employee claims.[23]

11.26 McGrath Nicol raised similar concerns about circulating assets and encouraged further legislative clarity, such as:

- Improving statutory clarity on the scope of circulating assets and priority;
- issuing guidance on expectations for practitioners dealing with the FEG Recovery Program;
- using legislative reform in preference to complex legal appeals; and
- FEG funding expansive requests for information from insolvency practitioners.[24]

11.27 In contrast to the above suggestions, the Department of Employment and Workplace Relations (DEWR) held a different view. DEWR noted that the preference for employees over circulating assets described in Sections 433 and 561 of the Corporations Act is a modern iteration of a provision in insolvency legislation dating back to the Preferential Payments in the *Bankruptcy Amendment Act 1897* (UK). DEWR indicated that the priority entrenches the

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21 TMA, *Submission 38*, p. 18.

22 Australian Restructuring Insolvency and Turnaround Association (ARITA), *Submission 36*, pp. 80–82.

23 KordaMentha, *Submission 14*, p. 7.

24 McGrath Nicol, *Submission 67*, p. 8.

principle that a secured party should not enjoy the realisation of floating assets (e.g. receivables, trading stock) generated on the back of employee labour before employee claims are satisfied. This preference only applies where 'free' asset realisations are insufficient to meet employee claims.[25]

11.28 DEWR noted that while considering some aspects of circulating assets, the Whittaker Review did not address some of the complexity and uncertainty with Section 561 of the Corporations Act.[26] To resolve the uncertainty, DEWR suggested that the committee consider reforms to ensure the legislation effectively achieves the longstanding policy objective that certain employee entitlements have priority ahead of the claims of circulating security interest holders. Such reforms would strengthen the recoverability of FEG and reduce the impost borne by the taxpayer. DEWR indicated that to ensure that circulating assets are preserved for the benefit of priority employee creditors, areas for reform may include:

- the definition of circulating assets within the meaning of the PPS Act;
- the uncertain operation of sections 433 and 561 of the Corporations Act;
- inefficiencies of liquidating trusts with corporate trustees;
- codify the High Court's 2019 decision in *Re Amerind*;[27]
- whether the priority regime set out in the Corporations Act should apply to partnerships;
- whether the treatment of trade-on losses should be aligned with trade-on profits; and
- in relation to pooling orders:
  - whether pooling orders should apply to secured debts.
  - whether, where a group subject to a class order goes into liquidation, they should be treated as a pooled group; and
  - whether the persons who have standing to apply for a pooling order should be clarified.[28]

11.29 The BLS LCA suggested that recommendations on moving circulating asset provisions to the Corporations Act might be considered as part of the broader review of harmonisation of insolvency laws.[29]

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[25] DEWR *Submission 52*, p. 7; *Buchler v Talbot* [2004] UKHL 9 at [32, 50-56]; see also Mr Henry Carr, Branch Manager, Senior Executive Lawyer, DEWR, *Committee Hansard*, 1 March 2023, pp. 46–47.

[26] Mr Henry Carr, Branch Manager, Senior Executive Lawyer, DEWR, *Committee Hansard*, 1 March 2023, pp. 46–47.

[27] *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth & Ors* [2019] HCA 20.

[28] DEWR, *Submission 52*, pp. 12–13.

[29] BLS LCA, answers to questions on notice, 23 December 2022 (received 14 February 2023), p. 37.

The BCA National Training Case

11.30 In April 2023, the NSW Supreme Court decision, *In the matter of BCA National Training Group Pty Ltd (in liq)* [2023] NSWSC 366 (the BCA National Training Case) clarified some aspects of the relative priority for employees and liquidators over circulating assets.[30]

11.31 This matter, between Mr Tonks as liquidator of BCA National Training Group Pty Ltd (in liq) (BCA NT) and the Commonwealth of Australia represented by DEWR, disputed the application of Sections 556 and 561 of the Corporations Act in the distribution of funds in the winding up of the company. Mr Tonks contended that his remuneration and expenses ranked in priority to claims of preferred creditors under paragraphs 556(1)(e), (g) or (h), while the Commonwealth argued that preferred creditor claims must be paid out first under Section 561.[31]

11.32 The NSW Supreme Court decision favoured the liquidator. Justice Black highlighted that a primary contention made by the Commonwealth failed because there was 'no contest between claims of a secured creditor and the claims of preferred creditors over the Company's circulating assets and no application of circulating assets to meet a claim of the secured creditor in a manner inconsistent with section 561 of the Act'.[32]

11.33 Key points from the NSW Supreme Court decision are as follows:

- The case highlights the contingent nature of section 561 of the Corporations Act.
- Section 556 provides the priority regime which deals with contests between liquidator's remuneration and expenses and employee preferred creditor claims, not section 561.
- Section 561 deals with contests between the secured creditor's claim to circulating assets and employee preferred creditors' claims. Section 561 may be a priority regime, but only in respect of access to circulating assets, as between the secured creditor with security over circulating assets and preferred creditors, only upon the insufficiency of assets.[33]

30 *BCA National Training Group Pty Ltd (in liq)* [2023] NSWSC 366.

31 *BCA National Training Group Pty Ltd (in liq)* [2023] NSWSC 366, p. 3.

32 Danielle Funston and Melissa Jeremiah, Maddocks, In the matter of *BCA National Training Group Pty Ltd (in liq)* [2023] NSWSC 366, paragraph 50, 18 April 2023 https://www.maddocks.com.au/insights/in-the-matter-of-bca-national-training-group-pty-ltd-in-liq-2023-nswsc-366 (accessed 20 April 2023). p. 3.

33 Danielle Funston and Melissa Jeremiah, Maddocks, In the matter of *BCA National Training Group Pty Ltd (in liq)* [2023] NSWSC 366, 18 April 2023 (accessed 20 April 2023). p. 1.

Committee view

11.34 The committee notes the Whittaker Review recommendations on restructuring circulating asset provisions 341 to 341A in the PPS Act were widely supported at the time of that review.

11.35 However, the Whittaker Review did not make recommendations on circulating asset provisions in sections 556 and 561 of the Corporations Act. As noted above, section 561 protects employees from a secured creditor with security over circulating assets and, in doing so, may have given employees priority over liquidators in the past. The committee notes that liquidators have argued that the law should be amended to provide them with priority over employees in such cases, citing similar changes in the UK. The committee notes that the DEWR has argued for employees to retain priority. The committee also observes that some aspects have been clarified by the recent NSW Supreme Court decision in the BCA National Training Case.

11.36 The committee considers that if the relative priority of employees and liquidators over circulating assets under section 561 of the Corporations Act is to be considered further, that should be done as part of a comprehensive review because:

- the current policy position behind section 561 is based on a principle that dates back to the Industrial Revolution;
- the Whittaker Review did not consider or make a recommendation on the Corporations Act circulating asset provisions; and
- such a policy issue needs the kind of detailed consideration and consultation that a comprehensive review can provide in light of recent court decisions.

Recommendation 23

11.37 The committee recommends that the comprehensive review consider the relative priority of employees, liquidators, and secured creditors, including the priority over circulating assets under section 561 of the *Corporations Act 2001*. The committee further recommends that this be a high priority topic for the comprehensive review.

Other mechanisms relating to creditors' priority

11.38 This section covers existing and proposed mechanisms for establishing creditors' priority raised during the inquiry for employees and subcontractors. The four mechanisms are:

- the Fair Entitlements Guarantee;
- independent (employee-like) contractors;
- worker entitlement funds; and
- security of payment reforms for subcontractors.

The Fair Entitlements Guarantee

11.39 The Fair Entitlements Guarantee (FEG) is a legislative safety net scheme of last resort with assistance available for eligible employees. The FEG is established by the *Fair Entitlements Guarantee Act 2012* (FEG Act), regulated by the Fair Entitlements Guarantee Regulations 2022, and is administered by the DEWR.[34] The intention of the FEG, as set out in the Explanatory Memorandum to the bill, is to:

> …fulfil a significant community need to protect the entitlements of Australian employees who would otherwise stand to lose their entitlements if they lose their jobs due to insolvency of their employer. While alternative measures for protecting employee entitlements are available on a limited scale (for example, redundancy trust funds in the construction industry) these are insufficient to adequately protect employees.
>
> The primary objective of the Bill is to provide a scheme for the provision of financial assistance (called an 'advance') to former employees where the end of their employment is linked to the insolvency or bankruptcy of their employer. After making an advance, the Commonwealth assumes the individual's right to recover the amount that was advanced through the winding up or bankruptcy process of their employer.[35]

11.40 The FEG eligibility requirements include that:

- the person's employment has ended;
- the end of the employment is linked to the insolvency of their employer;
- the employer is in liquidation or bankruptcy; and
- the person has unpaid employment entitlements that cannot be obtained from another source.[36]

11.41 Financial assistance under FEG (called an FEG advance) is available for the following employee entitlements— all of which are subject to a maximum weekly wage that caps the weekly rate at which outstanding employee entitlements are paid (currently $2,585 per week):

- unpaid wages (up to 13 weeks);
- unpaid annual leave;
- unpaid long service leave;
- payment in lieu of notice (up to 5 weeks); and
- redundancy pay (up to 4 weeks per full year of service).[37]

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34 DEWR, *Submission 52*, p. 3.

35 Fair Entitlements Guarantee Bill 2012, *Explanatory Memorandum*, p. 1, https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r4908 (accessed 9 June 2023).

36 Fair Entitlements Guarantee Bill 2012, *Explanatory Memorandum*, p. 1

37 DEWR, *Submission 52*, p. 4.

11.42 The FEG does not cover unpaid superannuation guarantee contributions required to be paid by employers under superannuation law.[38]

11.43 The FEG and its predecessor programs have advanced approximately $2.98 billion (as of 30 June 2022) to around 236,000 claimants. Liquidations (as distinct from bankruptcies) account for more than 99.5 per cent of expenditure on FEG advances.[39]

11.44 The FEG also has a recovery program that undertakes the following activities:

- Providing recovery funding for liquidators to enable recovery efforts, including legal proceedings, to recover FEG advances that liquidators would not otherwise have resources to pursue.
- Acting as an active creditor, the FEG seeks to minimise or prevent FEG claims from arising, increase returns to the Commonwealth and positively influence outcomes in liquidations through early intervention and active monitoring of insolvencies.
- Using policy, governance and reporting to influence and enhance legal frameworks and policy settings.[40]

11.45 Since 2000-01, overall dividend recoveries for the FEG and its predecessor programs total approximately $615 million. Since the establishment of the FEG Recovery Program in 2015, DEWR has recovered approximately $426 million in dividends. $232.6 million of these recoveries are directly attributable to the Recovery Program, amounting to 54 percent of overall recoveries over this period. These directly attributable recoveries represent a return on investment of 514% for the Recovery Program over its lifespan.[41]

11.46 DEWR noted that the *Corporations Amendment (Strengthening Protections for Employee Entitlements) Act 2019* (SPEE Act) was enacted in response to evidence that certain employers and parties associated with them were deliberately structuring their business affairs using sharp corporate practices to avoid paying employee entitlements when their business entered winding up, resulting in inappropriate reliance on the FEG to pay outstanding employee entitlements. DEWR noted that:

> These practices hurt all Australians – including small business creditors through lost payments for goods and services already supplied, employees through lost wages and superannuation entitlements, and ultimately Australian taxpayers through not only [the] burden borne by the FEG, but also through lost taxation revenue. In addition, those who pursue these practices gain an unfair advantage over honest competitor businesses who

38 DEWR, *Submission 52*, p. 4.

39 DEWR, *Submission 52*, p. 3.

40 DEWR, *Submission 52*, p. 5.

41 DEWR, *Submission 52*, p. 5.

> comply with their legal obligations to pay their debts. This has a broader economic impact.[42]

11.47 The SPEE Act addressed concerns about sharp corporate practices by:

- Strengthening the operation of provisions at Part 5.8A of the Corporations Act to better deter the avoidance of employee entitlements and to protect such entitlements from agreements or transactions that would operate to defeat their recovery.
- Allowing contributions to be sought from certain entities in a corporate group or entities with a closely connected economic relationship, for the payment of outstanding employee entitlements of an insolvent company, in limited circumstances.
- Introducing new provisions to disqualify company directors and other officers with a track record of involvement in corporate contraventions and insolvencies where the FEG has been inappropriately relied on.[43]

11.48 DEWR suggested that to further advance the last resort objectives of the FEG, it would be useful to examine whether:

- the threshold for the director disqualification provisions remains appropriate;
- the requirements for making employee entitlements contribution orders are appropriate; and
- amendments are necessary to prevent novel uses of schemes of arrangements from compromising the integrity of the FEG.[44]

The Ovato case

11.49 The Australian Manufacturing Workers' Union (AMWU) and the Australia Council of Trade Unions raised concerns about a case in which a company called Ovato had made novel uses of schemes of arrangement to shift the burden of employee entitlements onto the FEG.[45] The AMWU summarised its concerns as follows:

> In 2020, citing the COVID-19 pandemic and digitalisation trends as both negatively impacting revenue, the company initially sought negotiation with the AMWU and its members to navigate the pressures of maintaining operations and remain solvent. Facilitated by the Fair Work Commission, the AMWU, its members and Ovato agreed to reduce the work volumes of the company, with workers agreeing to reduce work hours by 40%, with the commensurate loss of pay. Negotiations went on for months in early 2020.

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42 DEWR, *Submission 52*, p. 8.

43 DEWR, *Submission 52*, p. 9.

44 DEWR, *Submission 52*, pp. 11–12.

45 Australian Manufacturing Workers' Union (AMWU), *Submission 69*, pp. 2–7; Australia Council of Trade Unions, answers to questions on notice, 1 March 2023 (received 8 March 2023).

> While workers assisted by agreeing to reduce hours, forfeiting overtime and making necessary adjustments to ensure the viability of the Company, Ovato secretly sought advice from highly resourced advisors to restructure its finances in a manner that would allow it to reduce its redundancy obligations to its employees and readjust their balance sheet. The subsequent restructuring allowed the company to effectively offload the obligation to pay redundancy entitlements from the company to Fair Entitlement Guarantee (FEG) Scheme.
>
> In November 2020, this restructure was announced by Ovato to the ASX. This had not been disclosed to the AMWU who were negotiating in good faith to secure the future of the company.[46]

11.50 In its submission, DEWR provided information on the issues arising from Ovato case. Members' schemes of arrangement, such as that used in Ovato, are typically utilised outside of insolvency contexts to effect change of control transactions, such as acquisitions and mergers. The novel use of members' schemes of arrangement to undertake a restructuring, such as that in the Ovato Group, exposed shortcomings in the legal framework design to prevent misuse of the FEG. This poses significant challenges to the integrity of the FEG and exposes the Commonwealth to financial risks. DEWR made the following observations about the Ovato case:

> In 2020, the Ovato Group implemented a restructure that aimed to consolidate its printing production capacity, improve its operating efficiencies and reduce its cost base, making it more sustainable and enabling a return to profitability.
>
> As part of the restructure, four members' schemes of arrangement transferred assets and liabilities within Ovato Group companies, resulting in unviable entities that were left with employee entitlement liabilities and then wound up. This was done with the express intention of relying on FEG to fund these liabilities, while assets were shifted to other entities within the Ovato Group that continued to trade. 205 employees retained in the wound-up entities were made redundant, with the bulk of their unmet employee entitlements funded through FEG - $16.4 million in FEG advances was paid to 205 claimants. On 13 October 2022 the liquidator for Ovato Group paid a dividend of $1.875 million to the department, representing a return of 11% of FEG advanced.
>
> On 21 July 2022 voluntary administrators were again appointed to the Ovato Group, which comprised 59 corporate entities. At the date of the appointment of the voluntary administrators, the Ovato Group employed approximately 485 employees. On 14 September 2022, the IVE Group completed its acquisition of substantially all of the printing and finishing assets of the Ovato Group. A number of former Ovato Group employees will transfer their employment to the IVE Group. However, those not transferring to IVE Group have already (or will be) made redundant and will seek assistance from FEG to be paid their unmet employee entitlements. As at 30 November 2022, the department has received FEG claims from 177

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46 AMWU, *Submission 69*, p. 3.

redundant employees seeking payment of up to $12.47 million in unpaid employment entitlements, with further claims anticipated over coming months.[47]

11.51 The Australian Securities and Investments Commission (ASIC) advised that it had been monitoring schemes of arrangement to identify whether the novel features of the Ovato schemes of arrangement are being repeated. To date, ASIC has not identified any similar schemes that have been proposed and does not plan to publish any further guidance at this stage.[48]

Independent (employee-like) contractors

11.52 In its submission, DEWR noted that independent contractors who do not hold a security interest in an insolvent company's assets would be ordinary unsecured creditors in a liquidation. The debts owed to ordinary unsecured creditors do not enjoy the priority afforded to employee entitlements under the Corporations Act. In a practical sense, independent contractors will find it more challenging than employees to recover any outstanding payments owed by an insolvent principal. DEWR noted the example of the winding up of Foodora in 2018, in which there were reports that independent contractors accepted payments that fell short of the full amounts owing to them due to the difficulties and delays associated with taking action to pursue money they were owed.[49]

11.53 DEWR noted in its submission that the government is considering reforms to strengthen protections for independent employee-like contractors. Before the federal election in May 2022, the government committed to empowering the Fair Work Commission to inquire into and set minimum standards in employee-like work, such as independent contracting in the gig economy. The government is currently consulting stakeholders on how to implement this commitment.[50]

Worker entitlement funds

11.54 A Worker Entitlement Fund (WEF) is for employees' long service leave, sick leave or redundancy payments. These WEFs are also referred to as redundancy trusts or redundancy funds. Although WEFs operate in a variety of ways, their purpose is to manage employee entitlements and provide portability and

47 DEWR, *Submission 52*, p. 12.

48 ASIC, answers to questions on notice, 1 March 2023 (received 11 April 2023).

49 DEWR, *Submission 52*, pp. 7–8.

50 DEWR, *Submission 52*, p. 8.

protection.[51] WEFs recognise the transitory nature of employment in certain industries.[52]

11.55 WEFs provide for the portability of worker entitlements that may not otherwise exist, particularly in project-based industries like construction, where workers may have dozens of employers during their careers. WEFs are typically established as joint ventures between industry parties (that is, unions and employer associations) and often involve the creation of a trust with a corporate trustee. The directors of the trustee companies are usually drawn from industry parties with representatives of employers and employees.[53] An entity can apply to the Commissioner of Taxation for endorsement to be an approved WEF or to operate an approved WEF.[54]

11.56 An employer can make regular contributions to a WEF on behalf of their employees. When an employee ceases employment with an employer who is contributing, then the employee may be entitled to receive a payment from the WEF. This is dependent upon the types of contributions and the terms of the applicable awards and industrial agreements.[55]

11.57 Examples of WEFs include:

- Incolink;
- Australian Construction Industry Redundancy Trust:
- Contracting Industry Redundancy Trust;
- Building Employees Redundancy Trust;
- Plumbing & Pipe Trades Entitlement Fund; and
- Tasbuild.

11.58 Incolink[56] participated in the inquiry, drawing attention to the use of WEFs to protect workers when insolvencies occur. Incolink noted that because of the

51 Australian Business Register, *Approved Worker Entitlement Fund (AWEF)*, https://www.abr.business.gov.au/Help/AWEF (accessed 21 May 2023).

52 Australian Taxation Office (ATO), *Worker entitlement funds*, https://www.ato.gov.au/Individuals/Jobs-and-employment-types/In-detail/Payments-from-worker-entitlement-funds---information-for-individuals/ (accessed 21 May 2023).

53 Senate Education and Employment Legislation Committee, *Fair Work Laws Amendment (Proper Use of Worker Benefits) Bill 2019 [Provisions]*, October 2019, p. 5.

54 Australian Business Register, *Approved Worker Entitlement Fund (AWEF)*, https://www.abr.business.gov.au/Help/AWEF (accessed 21 May 2023).

55 Australian Business Register, *Approved Worker Entitlement Fund (AWEF)*, https://www.abr.business.gov.au/Help/AWEF (accessed 21 May 2023).

56 Incolink is not a managed investment scheme, however, it is regulated by: ASIC and the Corporations Act, The ATO and the *Fringe Benefits Tax Assessment Act 1986* (as a constitutional corporation and an approved worker entitlement fund), the *Trustee Act 1925* and general trust law; Incolink, answers to questions on notice, 21 February 2023 (received 5 April 2023).

high number of creditors and the priority rules that apply to creditors when a business can no longer trade, benefits that were owed to workers often go left unpaid, unless a WEF is available.[57]

11.59 Incolink noted the WEFs are complementary to the FEG in that they:

- cover some of the gaps between an employee's actual entitlements, which can often be significantly higher than the coverage of entitlements by the FEG; and
- can provide rapid support to employees, while the FEG processes can take many months.[58]

11.60 Certain contributions made to an approved WEF are exempt from fringe benefits tax (FBT) (also known as an exempt benefit). Contributions to an approved WEF are defined by Commonwealth, state and territory laws and may include redundancy payments, long service leave, and sick leave.[59]

11.61 Incolink proposed reforms to make legislative changes to fair work and fringe benefits legislation to enable employers to make annual leave contributions to WEFs:

> The idea is that all contributions of whatever nature (redundancy, insurance premiums for IPT and PSLi, training and support levies, and other member benefits) will be exempt from FBT, provided that it is part of an agreement (not necessarily an [Enterprise Bargaining Agreement (EBA)], and the contribution is to fulfill the employer’s obligation under that agreement. It should be noted that there are many employers who see the benefit of making contribution on behalf of their workers to provide them with the needed safety net but also it allows employers to transfer their entitlement liability to a third party such as Incolink. This way, each industry can maintain a single fund that deals with all product lines and allows for contributions from both EBA and non-EBA arrangements, therefore expanding the scope of each fund and increasing the contribution pool for investments back into each industry.[60]

Security of payment reforms for subcontractors

11.62 The Murray Review of the Security of Payments in 2017 identified legislative best practices with a view to improving consistency in the security of payment legislation and the level of protection afforded to construction industry

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57 Incolink, *Submission 66*, p. 3.

58 Incolink, *Submission 66*, p. 3.

59 Australian Business Register, *Approved Worker Entitlement Fund (AWEF)*, https://www.abr.business.gov.au/Help/AWEF (accessed 21 May 2023).

60 Incolink, *Submission 66*, p. 5.

subcontractors to ensure they obtain payment for work they have completed, or for goods and services they have supplied.[61]

11.63 Over the past 18 years, every state and territory government has progressively enacted security of payment legislation to facilitate prompt progress payments. Other than Western Australia (WA) and the Northern Territory (NT), all jurisdictions have based their legislation on the New South Wales (NSW) legislation and have come to be referred to as the 'East Coast model'. The legislative regimes that operate in WA and the NT are based on a different model, referred to as the 'West Coast model'. There are significant differences, not only between the two models but also within those jurisdictions that have adopted the East Coast model.[62]

11.64 The Murray Review identified significant problems associated with the current security of payment legislative regimes, such as:

- None of the existing state and territory legislation (except for Queensland) provides any effective security of payment where a party higher up the contractual chain becomes insolvent.
- The legislative regimes are unduly complex, and this has discouraged their usage and caused confusion.
- There are questions about the process of appointing adjudicators; the adequacy of the profession's qualifications, training, and grading; and the variable quality of adjudication decisions.
- There is an imbalance of bargaining power within the contractual chain. Passing on contractual risks has resulted in the imposition of unfair contract terms to prevent payment to the party carrying out construction work.
- There are suggestions that head contractors' intimidation and retributive conduct discourage subcontractors from pursuing their entitlements.
- Late payment continues to be a major issue for the construction industry.[63]

11.65 The Murray Review considered that identifying an effective security of payment regime, consideration of the issues and stakeholders' feedback was underpinned by the following three policy considerations:

- Preserving the cash flow of the party that has carried out construction work or provided related goods and services by enshrining its right to receive prompt payment of progress claims.

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61 John, Murray AM with assistance from the Department of Jobs and Small Business, *Review of Security of Payment Laws, Building Trust and Harmony*, December 2017, p. xiii.

62 John, Murray AM with assistance from the Department of Jobs and Small Business, *Review of Security of Payment Laws, Building Trust and Harmony*, December 2017, p. xiii.

63 John, Murray AM with assistance from the Department of Jobs and Small Business, *Review of Security of Payment Laws, Building Trust and Harmony*, December 2017, pp. xiii–xiv.

- Providing an adjudication process that ensures disputed payment claims are quickly and efficiently determined so that prompt payment can be made.
- Protecting payments made in respect of a progress claim so that the party who receives the payment holds the payment for those to whom it is rightfully due.[64]

11.66 The Murray Review concluded that a national approach was required and that to implement the third policy consideration on protecting payments, a cascading statutory trust system should be implemented:

> …the overwhelming majority of construction work and materials is carried out and/or supplied by subcontractors, many of whom operate as small businesses. It is therefore incongruous that so little protection is given to secure payments to these contractors who operate at the base of the contractual chain. Moneys paid to a head contractor represent payment not only for its project management but also for the construction work and construction materials carried out and supplied by subcontractors. Such payments should be passed promptly down the contractual chain and not used by the head contractor for its own purposes. Similarly, payments made by a head contractor to a subcontractor should also be passed down to the sub-subcontractors engaged by the subcontractor, and so on down the contractual chain. The Review concluded that the most effective way that payments can be secured from misuse and the risk of head contractor insolvency is by implementing a cascading statutory trust. Only such a statutory trust would secure the payments of all subcontractors, including the most vulnerable at the base of the contractual chain.[65]

11.67 The Murray Review recommended the Australian Government take a lead role in establishing a nationally consistent approach using a deemed statutory trust model for all parts of the contractual payment chain for construction projects over $1 million[66] based on the model recommended by the 2012 NSW Collins inquiry.[67] Recommendation 81 of the Murray Review set out how the cascading trust system could work:

> The legislation should provide that all cash retentions are to be held on trust:
>
> a) In the case of a principal, the cash retentions should be held on trust for the head contractor.

64 John, Murray AM with assistance from the Department of Jobs and Small Business, *Review of Security of Payment Laws, Building Trust and Harmony*, December 2017, p. xiv.

65 John, Murray AM with assistance from the Department of Jobs and Small Business, *Review of Security of Payment Laws, Building Trust and Harmony*, December 2017, p. xv.

66 John, Murray AM with assistance from the Department of Jobs and Small Business, *Review of Security of Payment Laws, Building Trust and Harmony*, December 2017, pp. xv–xvi, 275, 316; See recommendations 85 and 86.

67 Bruce Collins QC, 'Independent Inquiry into Construction Industry Insolvency in NSW', *Final Report*, November 2012, p. 355.

b) In the case of a head contractor, cash retentions should be held on trust for the subcontractors.

c) In the case of a subcontractor, the cash retentions should be held on trust for the sub-subcontractor.[68]

11.68 The DEWR website indicates that the Australian Government is working with the states and territories through the Building Ministers' Forum to consider and respond to the findings and recommendations of the Murray Review.[69] It has been reported in the media that:

- The Government intends to consider and respond to the Murray Review recommendations within the current term of Government following a deal with Senator David Pocock.[70]
- Funding allocated to the National Construction Industry Forum[71] may be used to progress the security of payments consultation.[72]

11.69 The Construction, Forestry, Maritime, Mining and Energy Union (CFMMEU) strongly supported the government taking action to implement the Murray Review recommendations on statutory trusts and explained the need for such a mechanism:[73]

> The problem is that cashflow is often relied on by the head contractor as working capital. In other cases, it's more sinister than that. Money is diverted to other projects where they are doing their own developments. It's used to pay debts on projects that have gone bad previously. In some cases, it's phoenixed off into shelf companies, for the purposes of making sure that they don't have to pay people that have actually done work.

68 John, Murray AM with assistance from the Department of Jobs and Small Business, *Review of Security of Payment Laws, Building Trust and Harmony*, December 2017, pp. 275, 316.

69 DEWR, *Review of Security Payments Laws*, https://www.dewr.gov.au/workplace-relations-australia/consultations/review-security-payment-laws (accessed 21 May 2023).

70 Michael Bleby, 'David Pocock strikes deal on payments to subcontractors', *Australian Financial Review*, 28 November 2022, https://www.afr.com/property/commercial/david-pocock-strikes-deal-on-payments-to-subcontractors-20221127-p5c1nf (accessed 13 June 2023).

71 In 2022, the *Fair Work Legislation Amendment (Secure Jobs, Better Pay) Act* 2022 amends the *Fair Work Act 2009* (the FW Act) to establish an ongoing National Construction Industry Forum (the NCI Forum) as a statutory advisory body to provide advice to government on a broad range of issues relating to work in the building and construction industry including workplace relations, industry culture, skills and training, safety, gender equity, and productivity. DEWR, *Bargaining and workplace relations, National Construction Industry Forum*, https://www.dewr.gov.au/secure-jobs-better-pay/resources/national-construction-industry-forum (accessed 21 May 2023).

72 Michael Bleby, '*Builder battle brews with government over subbie payment reforms*', *Australian Financial Review*, 10 May 2023, https://www.afr.com/property/commercial/builder-battle-brews-with-government-over-subbie-payment-reforms-20230505-p5d5wa (accessed 13 June 2023).

73 Construction, Forestry, Maritime, Mining and Energy Union (CFMMEU), *Submission 68*, pp. 9–10.

> The problem is that the people who have actually done the physical work of erecting the buildings, the workers and their employers, which are largely subcontractors, don't get paid. Possession, in this industry, is nine-tenths of the law. That is where we see head contractors unreasonably holding progress payments, holding retentions, and disbursing them outside of the project. We think that the case has been well made that there should be a system of cascading statutory trusts to protect the progress payments and the retention payments of subcontractors in the industry.[74]

11.70 The National Electrical and Communications Association supported the urgent implementation of the Murray Review recommendations, suggesting that the government:

> Remove the confusion and inconsistency between current laws by enacting a single framework for security of payment that will apply consistency across Australia.
>
> Prepare the draft legislation for consultation with industry and other stakeholders.
>
> Ensure that the draft legislation reflects the recommendations in the Murray Report including provision for cascading statutory trusts in favour of subcontractors and sub-sub-contractors.[75]

11.71 The CFMMEU addressed concerns about the administrative costs of the proposed cascading trusts, drawing attention to the findings of the Murray Review:[76]

> The fundamental point that needs to be underscored is that the concept of a deemed statutory trust is the only proposal that will provide a cost-effective and fair means of dealing with a party's entitlement to be paid. Insofar as industry participants reject the concept of a deemed statutory trust because of increased administrative burden, then the evidence from the various previous inquiries that had considered this very issue, suggests otherwise. Both the WA Law Reform Commission and the Collins Inquiry specifically addressed the issue of administrative burden and concluded that this would not be the case. Similarly, in his Final Report, Commissioner Cole expressed the view that the arguments that opponents to a deemed statutory trust had advanced in relation to the increased administrative burden were 'overstated'.[77]

11.72 The CFMMEU also drew attention[78] to the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) working paper in 2018 on cascading deemed

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74 Mr David Noonan, National Secretary, CFMMEU (Construction and General Division), *Committee Hansard*, 21 February 2023, p. 24.

75 National Electrical and Communications Association, *Submission 53*, p. 5.

76 CFMMEU, answers to question on notice, 21 February 2023 (received 15 March 2023).

77 John, Murray AM with assistance from the Department of Jobs and Small Business, *Review of Security of Payment Laws, Building Trust and Harmony*, December 2017, p. 310.

78 CFMMEU, answers to question on notice, 21 February 2023 (received 15 March 2023).

statutory trusts in the construction sector. The ASBFEO found that for medium businesses (20 employees), the cost is small at 0.1 per cent of annual revenue. The costs are moderate for businesses with 2–10 employees at around 2 per cent of annual revenue but are higher for a sole operator at 3.5 to 4 per cent of annual revenue. Based on those findings, the ASBFEO recommended that:

> Statutory trusts be implemented to protect payments to subcontractors in the event of their contractor's insolvency and to decrease payment times.
>
> While we support cascading deemed statutory trusts for commercial projects with a value of at least $1million, consideration should be given to a higher project value to avoid capture of the private residential housing sector.
>
> Imposing statutory trusts on very small business is not warranted given their limited resources. We recommend setting a floor to exclude low value sub-contracts within a project. Consideration should be given to a floor value between $100,000 to $200,000 to exclude small business operators.[79]

Franchising insolvency issues

11.73 Franchising is a significant business architecture in Australia with an estimated market size of $172 billion per annum. There are approximately 1,200 different franchise systems, over 800,000 franchised businesses and the sector employs more than 500,000 people. Franchisees are the operators of individual franchise business, while franchisors establishing the franchise business model and are the owners of the franchise system. Franchise arrangements are regulated by the Australian Competition and Consumer Commission (ACCC) under the *Franchising Coded of Conduct*.[80]

11.74 Franchisees can be dependent on the franchisor's good faith and competent business operation and may therefore face significant issues if a franchisor becomes insolvent. Professor Jenny Buch noted that:

> Franchisees invest significant sunk costs in their business, which cannot currently be recovered from an insolvent franchisor. The franchisees do not see the insolvency coming in the same way as unpaid employees or late-paid trade creditors may do. They can rarely take proactive action to protect their rights and assets.[81]

11.75 Specific issues that arise for franchisee when the franchisor becomes insolvent include:

- Franchisees do not get the same voice as franchisor employees and creditors during a liquidation;

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[79] Australian Small Business and Family Enterprise Ombudsman (ASBFEO), *Cascading deemed statutory trusts in the construction sector*, working paper, November 2018, p. 4; See also CFMMEU, answers to question on notice, 21 February 2023 (received 15 March 2023).

[80] Emeritus Professor Jenny Buchan, *Submission 77*, pp. 2–3, 5.

[81] Emeritus Professor Jenny Buchan, *Submission 77*, pp. 2–4.

- being unable to use intellectual property licences that are essentially to the operation of the individual franchises;
- franchisor control or involvement in leases for premises;
- lenders taking security of franchisor's and franchisee's assets need to operate franchises;
- when liquidators are winding up a franchisor, a franchisee may face many uncertainties relating to leases, franchise agreements, supplier contracts, marketing funds and IP licences; and
- liquidators can disclaim onerous contracts.[82]

11.76 Professor Buchan made the following suggestions for reform to address some of the above issues:

- requiring franchise marketing funds to be held in trust;
- entrenching *ipso facto* right for franchisees, so that they can leave the franchise brand and trade independently;
- expand directors' duties in a franchise network to duties towards franchisees;
- recognise and eliminate unjust enrichment of franchisors creditors;
- where franchisors sell franchises while insolvent, make defrauded franchisees priority creditors;
- allow franchisee representation at creditors meetings;
- require liquidators to select competent buyers of the franchise chain, not simply anyone who can satisfy some of the franchisor's creditors demands; and
- expand the FEG to include the employees of franchisees of insolvent franchisors.[83]

Committee view

Fair Entitlements Guarantee

11.77 The committee is concerned about the potential for other companies to pursue novel uses of schemes of arrangement to undertake a restructuring, such as that in the Ovato Group, which exposed shortcomings in the legal framework design to prevent misuse of the FEG. The committee suggests that the government should develop reforms to improve the framework designed to prevent the misuse of the FEG by such schemes of arrangement. The committee considers that areas suggested for reform by DEWR are a good starting point.

11.78 The committee notes evidence from ASIC that it has not detected any further attempts to use such approaches. Hence, the committee suggests that it is open to the government to address such issues through the proposed comprehensive

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82 Emeritus Professor Jenny Buchan, *Submission 77*, pp. 5, 7, 10.

83 Emeritus Professor Jenny Buchan, *Submission 77*, pp. 11–13.

review or, if it becomes apparent that the need for reform is more urgent, then to pursue such reforms separately from the proposed comprehensive review.

Recommendation 24

11.79 The committee recommends that the government develop reforms to improve the framework designed to ensure the policy objective of access to the Fair Entitlements Guarantee as a scheme of last resort, both to prevent misuse by novel schemes of arrangement, phoenixing, and other practices and to ensure capture of all individuals with valid entitlements.

Independent employee-like contractors

11.80 The committee notes that before the 2022 Federal election, the then government committed to empowering the Fair Work Commission to inquire into and set minimum standards in 'employee-like work', such as independent contracting in the gig economy. The committee further notes that the government is currently considering reform options and consulting stakeholders on how to implement this commitment.

11.81 The committee welcomes the proposed reforms and encourages the government to consider the impact of insolvency on independent employee-like contractors.

Worker entitlement funds

11.82 The committee notes the potential of worker entitlement funds to protect employees' entitlements if the employer becomes insolvent. Worker entitlement funds can be complementary to the FEG in that they can deploy support more quickly and cover some of the gaps between the FEG coverage of entitlements and the actual entitlements owed.

11.83 The committee considered with interest Incolink's proposed reforms to make legislative changes to fair work and fringe benefits legislation to enable employers to make annual leave contributions to worker entitlement funds, in addition to the existing categories of entitlement, which are employee long service leave, sick leave or redundancy payments. The committee has not had the opportunity to examine the benefits and costs of such a proposal. Views diverged amongst committee members as to the need for further consideration of this matter. Some consider it to be worthy of such, but note that as the proposal has a broader focus than insolvency, it may be more appropriately considered in a standalone consultation process (as opposed to part of the proposed comprehensive review of insolvency). Other committee members have significant concerns with these kinds of arrangements.

Security of payment reforms

11.84 The committee notes the Murray inquiry recommendations that the Australian Government take a lead role in establishing a nationally consistent approach using a deemed statutory trust model to all parts of the contractual payment chain for construction projects over $1 million. The committee further notes that the Australian Government is working with the states and territories through the Building Ministers' Forum to consider and respond to the findings and recommendations of the Murray Review.

11.85 Evidence put to this inquiry supports the proposed cascading trust approach. Hence, the committee supports the government continuing to pursue the Murray Review reforms.

Franchising insolvency issues

11.86 The committee notes the significant issues that franchisees face over and above other creditors when franchisors become insolvent. The committee is grateful for the suggestions for reform put forward by Professor Buchan. Unfortunately, the committee has not had the opportunity to seek further evidence from other submitters and witnesses of franchising insolvency issues. Therefore, the committee is not able to make formal recommendations. However, the committee does consider that the issue and suggestions raised are worthy of further consideration by the comprehensive review or the government.

Recommendation 25

11.87 The committee recommends that the comprehensive review consider and report on franchising insolvency issues.

Chapter 12
Secured assets and creditors and the PPS Act

Introduction

12.1 Chapter 11 set out four types of assets available to the liquidator. This chapter covers secured assets and creditors and personal property securities.

12.2 A secured creditor has a security interest (such as a mortgage) over some or all of a company's assets. Secured assets can be physical land and buildings secured by a mortgage or personal property securities.

12.3 Secured creditors have rights, if a company fails to meet its obligations under a security interest and can:

- Appoint an independent and suitably qualified person (a receiver) to take control of and realise some or all of the secured assets in order to repay the secured creditor's debt. This right continues after the company goes into liquidation.
- Ask the liquidator to deal with the secured assets for them and account to them for the proceeds and costs of collecting and selling those assets.[1]

12.4 A secured creditor is entitled to vote at creditors' meetings for the amount the company owes them less the amount they are likely to receive from realisation of the secured assets (i.e. their shortfall). The secured creditor can participate in any dividend to unsecured creditors for their shortfall.[2]

12.5 If the secured creditor wants to ensure their security interest over personal property other than land is enforceable and given priority in an insolvency, they should register the security on the Personal Property Securities Register (PPSR)[3]

12.6 The *Personal Property Securities Act 2009* (PPS Act) established a single, national set of rules for secured credit using personal property. The PPS Act also provides the legislative basis for the PPS Register. This chapter covers the following:

- background on the PPS Act and PPS Register;
- the Whittaker Review of the PPS Act; and
- other contemporary issues raised by submitters and witnesses that have direct implications for corporate insolvency, including:

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1 Australian Securities and Investments Commission (ASIC), *Liquidation: A guide for creditors*, https://asic.gov.au/regulatory-resources/insolvency/insolvency-for-creditors/liquidation-a-guide-for-creditors/#secured-creditors-rights (accessed 22 May 2023).

2 ASIC, *Liquidation: A guide for creditors*, (accessed 22 May 2023).

3 ASIC, *Receivership: A guide for creditors*, (accessed 22 May 2023).

- o awareness, ease of use, and accuracy of the PPS Register; and
- o vesting of security interests.

Background on personal property securities

12.7 The PPS Act, as the Whittaker Review[4] put it, 'revolutionised the law and practice of secured transactions in Australia,' establishing 'an entirely new regime for the creation, legal effect, and enforcement of security interests in personal property.'[5] The approach was based on principles developed and implemented in several overseas jurisdictions, such as the United States, Canada, and New Zealand. The approach 'largely ignores the form parties choose for their transaction or who has title to the property, and instead focuses on the transaction's commercial substance to determine whether it should be treated as a security interest.'[6]

12.8 The PPS Act replaced several complex and fragmented sets of rules with a single set of rules. Previously rules were scattered across more than 70 Commonwealth, state and territory statutes and the general law. The PPS Act was intended to reduce borrowing costs and increase the range of property available to secure finance, especially for smaller businesses. The new rules apply consistently and predictably to all types of security interest and all types of personal property, regardless of the location or nature of the personal property or the grantor.[7] The PPS Act objectives are to 'provide greater certainty for Australian businesses, credit providers and consumers and so to reduce of secured finance and to make it easier for businesses and consumers to use their assets as security'.[8]

12.9 The PPS Act applies to security agreements covering personal property regardless of the form of the transaction or the grantor's identity (that is, a corporation, an individual or another entity). It uses a consistent set of rules to determine the priority of secured creditors. Under the PPS Act, there is little difference between corporate or personal insolvency or between corporate and non-corporate grantors of security interests. However, there are aspects of the PPS Act, such as the priority rules, vesting and circulating asset provisions

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4 The Whittaker Review is discussed further from paragraph 12.13 below.

5 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, p. 3.

6 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, p. 3.

7 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, p. 11.

8 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, p. vii; see also Attorney-General's Department (AGD), *Submission 33*, pp. 1–2.

contained within the PPS Act and *Corporations Act 2001* (Corporations Act), which have direct implications for corporate insolvency.[9]

12.10 The PPS Act uses the terminology of 'grantor' and 'secured party'. The grantor is the person or entity with an interest in the personal property (for example, the owner, purchaser, or lessee of the property). The grantor then grants an interest over this to the secured party (for example, a lender such as a bank). While a secured party is not compelled to register its security interest on the PPS Register, it should do so to avail itself of additional protections afforded by the PPS Act.[10]

12.11 Perfection of a security interest requires a secured party to take some step to publicise the existence of its security interest or run the risk that the security interest may not be fully effective.[11] The PPS Act allows a secured party to take steps to publicise the existence of its security interest. This concept is known as 'perfection'. Perfection places third parties and the world at large on notice that a security interest exists and allows outsiders to determine whether an item of personal property might be subject to an encumbrance. Failure to 'perfect' risks the security interest not being fully effective and may prevent a creditor from attaining the highest possible creditor priority under the PPS Act's priority rules. The PPS Act recognises three methods of perfection: possession, control, or registration on the PPS Register. Perfection by registration is the most common form of perfection.[12]

12.12 Data from the Australian Financial Security Authority (AFSA) shows the usage of the PPS Register. On 30 September 2022, the total registrations on the PPS Register were 10,104,944, with the entire current registrations with the collateral type 'commercial property' being 7,949,775.[13]

The Whittaker Review

12.13 The section summarises the establishment, conduct, findings, recommendations, and implementation of the Whittaker Review of the PPS Act.

12.14 Section 343 of the PPS Act required the Minister to cause a review of the operation of the PPS Act to be undertaken and completed within three years after the registration commencement time.[14] The PPS Act came into full

9 AGD, *Submission 33*, pp. 1–2.

10 AGD, *Submission 33*, p. 2.

11 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, p. 39.

12 AGD, *Submission 33*, pp. 2–3.

13 AGD, *Submission 33*, p. 2.

14 *Personal Property Securities Act 2009*, No. 130 of 2009, registered 21 December 2009 Section 343; see also Subsection 306(2) For the purposes of this Act, the registration commencement time is at: (a)

operation on 30 January 2012. Mr Bruce Whittaker conducted a statutory review of the PPS Act in 2014, and the final report (the Whittaker Review) was tabled in Parliament on 18 March 2015.[15]

12.15 The Whittaker Review received 171 submissions and responses from a wide range of stakeholders and conducted extensive consultation on:

- the effect of the reforms introduced by the PPS Act;
- the level of awareness and understanding of the PPS Act;
- the incidence and causes of non-compliance with the PPS Act;
- opportunities for minimising regulatory and administrative burdens, including cost;
- opportunities for further efficiencies;
- the scope and definitions of personal property;
- the desirability of introducing thresholds for the operation of the PPS Act regime in respect of particular types of personal property; and
- the interaction of the PPS Act with other legislation.[16]

Summary of Whitaker Review submissions, findings, and recommendations

12.16 The Whittaker Review described the general tenor of submissions to the review as suggesting that much can be done to simplify the content of the PPS Act to make it more accessible to users and easier to work with. Simplifying the PPS Act would, help it to achieve its objectives, as simpler and clearer rules could lead to more predictable outcomes. More predictable outcomes would also give financiers greater confidence in the PPS Act and their ability to take effective security interests under it. That, in turn, would assist borrowers in using their assets as collateral and enhance their ability to raise cost-effective finance.[17]

12.17 Appearing before the committee, Mr Whittaker summarised the two overarching themes of his recommendations:

> The first of the two, and by far the more important, was the need to simplify the legislation. We're not the first country to have adopted legislation of this type, but our act is at least twice as long as the corresponding legislation in the other jurisdictions and contains a very substantial amount of complexity that many commentators thought—and I also believed—wasn't necessary and, if anything, made the act much more difficult to work with, which in

the start of the first day of the month that is 26 months after the month in which this Act is given the Royal Assent; or (b) an earlier time determined by the Minister.

15 AGD, *Personal property securities*, https://www.ag.gov.au/legal-system/personal-property-securities, accessed 16 March 2023.

16 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, pp. vii–viii, xi.

17 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, p. 3.

> turn was preventing the act from achieving its desired objectives. So, many of my recommendations went to finding ways to simplify the operation of the act and, in particular, to simplify the operation of the register that is set up under the act. The second of the two overarching themes was to have the act better reflect the way things actually work in real life in Australia in the financial marketplace. The legislation that we adopted was based fairly heavily on legislation from other jurisdictions, where commercial practices are, at times, very different, but those differences weren't reflected in the way the act was drafted, so many of my recommendations go to reshaping the act so that it better reflects the way life works on the ground here in Australia.[18]

12.18 Overall, the Whittaker Review made 394 recommendations addressing the following topics:

- the reach of the PPS Act;
- creating an effective security interest;
- perfection of a security interest by registration;
- dealings in collateral;
- enforcement of security interests;
- insolvency of grantors;
- interaction with other laws;
- other matters relating to the content of the PPS Act; and
- next steps.[19]

Government action and implementation of the Whittaker review

12.19 No formal government response to the Whittaker Review had been issued at the time of drafting this report. This section summarises the government actions to date, and a small number of the 394 recommendations that have been addressed.

12.20 The Attorney-General's Department (AGD) indicated that since the Whittaker Review was completed, it had:

- provided advice to the previous government on a proposed approach to responding to the review;
- examined each of its 394 recommendations;
- conducted several consultations on the review;
- conducted ongoing engagement with stakeholders regarding the operation of the PPS Act;
- undertook targeted consultations with:
  - sections of the finance industry in October 2020;
  - agribusiness and agribusiness financiers in December 2020; and
  - states and territories at officer level in February 2021; and

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18 Mr Bruce Whittaker, Private capacity, *Committee Hansard*, 13 December 2022, p. 64.

19 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, Annexure E, pp. 502–530.

- briefed the current government on the review.[20]

12.21 AFSA and AGD summarised actions taken to date to implement the Whittaker Review recommendations as follows:

- 2015 and 2017 legislative amendments to the definition of a PPS Lease (recommendations 19, 21, 22, and 23);
- reducing the complexity of the PPS Register website through a review and redesign (recommendations 85); and
- several initiatives to increase awareness of the PPS Register (addressing recommendations 85, 150, 166, 391, and 392).[21]

12.22 In response to questions on notice, Mr Whittaker indicated that he was not aware of any obstacles or barriers that would make it impossible to implement his recommendations. Mr Whittaker observed that while some recommendations are more complex and could take more time than others, this should not delay the implementation of the other recommendations. Mr Whittaker further clarified that nearly all the recommendations can be implemented without fresh referrals from the States, and the government would only need to engage with the States on a small number of recommendations.[22]

12.23 Mr Whittaker also identified that two of his recommendations may no longer be necessary:

- Recommendation 19: relating to the definition of a PPS lease in section 13 of the PPS Act, has already been implemented by the *Personal Property Securities Amendment (Deregulatory Measures) Act 2015*.
- Recommendation 238: which was aimed at clarifying the meaning of the term 'grantor' in the PPS Act, has arguably been superseded by case law (see *Samwise Holdings Pty Ltd v Allied Distribution Pty Ltd* [2018] SASCFC 95).[23]

Stakeholder views on implementing the Whittaker Review

12.24 There were mixed views expressed by inquiry participants on whether they would like to see the Whittaker Review recommendations implemented.[24]

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20 AGD, answers to questions on notice, 13 December 2022 (received 20 January 2023); Ms Jenna Priestly, Assistant Secretary, Commercial and Copyright Law Branch, AGD, *Committee Hansard*, 1 March 2023, pp. 51, 53.

21 Australian Financial Security Authority (AFSA), *Supplementary submission 7.1*, pp. 42–44; AGD, answers to questions on notice, 13 December 2022 (received 20 January 2023).

22 Mr Bruce Whittaker, answers to questions on notice, 13 December 2022 (received 3 February 2023).

23 Mr Bruce Whittaker, Private capacity, answers to questions on notice, 13 December 2022 (received 3 February 2023), p. 3.

24 See for example: Mr Michael Murray and Professor Jason Harris, *Submission 18*, p. 10; Business Law Section, Law Council of Australia (BLS LCA), *Submission 30*, pp. 12, 30–31; Society of Corporate Law Academics (SCoLA), *Submission 37*, p. 3; BLS LCA, *Submission 30*, p. 30.

Accordingly, this section discusses both the supporting views and issues raised by stakeholders.

12.25 The Australian Credit Forum (ACF) supported the Whittaker Review recommendations being considered and implemented. The ACF noted that the PPS Act has been beneficial to creditors and is achieving its purpose, while agreeing with the Whittaker Review that there is opportunity to improve the PPS Act. The ACF suggested the PPS Act and its day-to-day operation can be simplified so that it continues to protect when utilised correctly by creditors. The ACF noted that the expectations of trade creditors achieving the protections of a priority secured creditor have not been realised by the PPS Act, specifically with respect to defending unfair preference claims.[25]

12.26 Mr Michael Murray and Professor Justin Harris supported implementing the Whittaker Review's recommendations to simplify the PPS registration process (by reducing the collateral classes) and to reform the system of amendment demands so that asset sales in insolvency are not held up by frivolous and vexations registrations that are not based on perfected security interests.[26]

12.27 At the same time, Mr Murray and Professor Harris suggested some caution may be warranted, noting that many business users of the PPS Register will have implemented systems to work effectively with the current processes under the PPS Act. Hence, there may be significant costs of changing the PPS Act to implement the hundreds of recommendations in the report.[27] The Business Law Section of the Law Council of Australia (BLS LCA) noted similar concerns:

> Another barrier to implementation of the Whittaker Review recommendations may be that some of the recommendations relating to the functionality of the PPSR (which are the most useful from a practical perspective) may involve changes to the software and systems underpinning the PPSR. Those changes may be costly and time-consuming for government, and costly and time consuming for users of the PPSR who would have to adapt their own systems as a consequence of these changes being implemented.[28]

12.28 The BLS LCA suggested that while it may be helpful to revisit the recommendations of the Whittaker Review, a wholesale re-examination of the PPS Act may not be warranted. The BLS LCA also observed that the Whittaker Review identified several changes that could be made to both the PPS Act and

25 Australian Credit Forum (ACF), *Submission 22*, p. 4.

26 Mr Michael Murray and Professor Jason Harris, *Submission 18*, p. 10.

27 Mr Michael Murray and Professor Jason Harris, answers to questions on notice, 22 December 2022 (received 10 February 2023), p. 21.

28 BLS LCA, answers to questions on notice, 23 December 2023 (received 14 February 2023), p. 37.

the PPS Register, which would likely result in significant practical improvements.[29]

12.29 The Society of Corporate Law Academics (SCoLA) indicated that the Whittaker Review of the PPSA contains a thorough evaluation of the PPS Act and makes hundreds of recommendations. Commercial practice may have developed since the review was undertaken in 2014, so implementing some recommendations may not be necessary. However, the simplification of the PPS Register and the process to remove redundant or inappropriate registrations should be a matter of priority.[30]

12.30 The Turnaround Management Association Australia (TMA) had a slightly different view, suggesting that the Whittaker Report recommendations should be examined as part of a wider law reform process.[31]

12.31 The Australian Institute of Credit Management (AICM) members recommended implementing modest changes in order to improve the efficiency of the PPS Register would not substantially alter the system. Significant changes were not favourable amongst AICM members as they expect the cost and time to adjust would outweigh the benefits that could be achieved.[32]

Awareness, ease of use and accuracy of the PPS Register

12.32 Some of the Whittaker Review recommendations on awareness, ease of use, and accuracy of the PPS Register have been implemented. However, submitters and witnesses indicated that there are continuing concerns, which are discussed below.

12.33 The Whittaker Review noted that, despite education efforts on the operation of the PPS Act, the regime was still poorly understood:

> The apparent lack of awareness or interest among the small business community regarding the need to come to grips with the new regime appears to have been a harbinger of things to come. Almost all of the first-round submissions made the point that much of small business was still either entirely unaware of the existence of the Act, or did not understand the extent to which the Act can impact on their business activities.[33]
>
> This lack of understanding does not appear to be limited to specific industry sectors. It was identified as an issue not only in submissions from

29 BLS LCA, *Submission 30*, p. 30.

30 SCoLA, answers to questions on notice, 23 December 2022 (received 17 February 2023), p. 8.

31 Turnaround Management Association Australia (TMA), *Submission 38*, p. 16.

32 Australian Institute of Credit Management (AICM), *Submission 9*, p. 4.

33 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, p. 25.

> organisations that span the economy generally, but also from organisations from a wide range of specific industries or sectors. [34]

12.34 To address the above issues, the Whittaker Review devoted Chapter 10 to the subject and concluded that:

> Many of the recommendations in this report are targeted at making the Act simpler to understand. The Act deals with a complex area of commercial activity, however, and will never be an easy read. If the Act is to achieve its potential, Government will need to coordinate an effective education campaign in support of the re-launch of the Act that will hopefully follow on from this report.[35]

12.35 As a witness during this inquiry, Mr Whittaker indicated that the complexity of the PPS Register makes it very difficult, even for people with extensive legal training to sometimes understand how to make an effective registration. For small businesses that do not have the knowledge or access to legal advice, it can be even more challenging for them to make registrations in a way that can leave them confident that they have done it correctly.[36]

12.36 The WA Small Business Development Corporation submitted that the PPS Register needs to be reviewed and improved to protect small businesses' assets and prevent creditors from accessing third-party assets. The process of registering personal property, it argued, needs to be overhauled and significantly simplified to encourage more small businesses to register their assets and protect their business from unfair preference claims made in administrations under the Corporations Act.[37]

12.37 KordaMentha submitted that even though the PPS Act has been in place for a decade, some creditors are either still not aware of it or still getting registrations wrong. KordaMentha argued that the terminology used in the PPS Act is particularly bespoke and not used in the general business world, so it is not surprising that creditors have had difficulty engaging with its provisions.[38]

12.38 Subcontractors Alliance and Subbies United indicated that because of the difference in bargaining power, trade contractors could not take advantage of the PPS Act as the trade contracts require clear title to everything provided. There is also the problem that reservation of title clauses (in most cases) become

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[34] Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, p. 26.

[35] Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, p. 29.

[36] Mr Bruce Whittaker, Private capacity, *Committee Hansard*, 13 December 2022, pp. 64–65.

[37] WA Small Business Development Corporation, *Submission 28*, p. 7.

[38] KordaMentha, *Submission 14*, p. 3.

inoperable as soon as the goods and materials supplied are affixed upon the land.[39]

12.39 BlueRock noted that using the PPS Register to validate security interests unfairly favours general security holders over specific security holders. The parties that tend to make mistakes or fail to register their interests are overwhelmingly smaller parties. Retention of Title holders do not tend to have possession or control over their collateral, so registration is the only way to perfect their interest, but it is unforgiving if errors are made.[40]

12.40 The Australian Banking Association (ABA) argued that the PPS Act had created complexity for secured creditors to perfect their interests. The ABA indicated that difficulty navigating the requirements under the PPS Act, meant that creditors' interests are often impacted by minor errors, for example:

> …registrations in relation to trusts are often incorrectly made against the corporate trustee and not the trust's ABN. Additional uncertainty is caused where security is granted by a trustee of a trust without an ABN that later acquires an ABN; and
>
> any defect in a registration may result in a registration vesting upon an insolvency appointment or a security interest being unperfected, notwithstanding the expectation of all parties that the security interest was granted. For example, registering against an ABN instead of an ACN, or missing one digit for a serial numbered good. Currently, there is limited scope to apply to court to rectify these situations.[41]

12.41 Deloitte and the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) noted the important protections that the PPS Act and PPS Register could provide. Both drew attention to significant losses for creditors from inaccurate registrations exacerbated by the PPS register complexity. Hence, they encouraged simplification of the PPS Register.[42]

12.42 The recent work of the Behavioural Economics Team of the Australian Government (BETA) to improve accuracy in PPS registrations highlights the complexity of the PPS Register. BETA found that 22.3 per cent of PPS Register transactions made by users who completed the original form were incorrect, and 12.8 per cent of transactions were inaccurate even after behavioural interventions. The ASBFEO identified the following example, which highlights the potential consequences of inaccurate PPS registrations:

> Forge Group Power Pty Ltd (in liq) (receivers and managers appointed) v General Electric International Inc [2016], which highlights the severe

39 Subcontractors Alliance and Subbies United, *Submission 56*, p. 5.

40 BlueRock, *Submission 8*, p. 3.

41 Australian Banking Association (ABA), *Submission 23*, p. 4.

42 Deloitte, *Submission 32*, p. 6; Australian Small Business and Family Enterprise Ombudsman (ASBFEO), *Submission 31*, p. 10.

> consequences of failing to register a security interest, but also the complexity of PPSA terminology and difficulties for foreign companies to engage in the PPSR process. In this case, General Electric lost assets worth US$44 million because they did not register them on the PPSR.[43]

12.43 The Association of Independent Insolvency Practitioners (AIIP) also identified continuing concerns about awareness of the PPS Register amongst SMEs. The AIIP suggested that the lack of awareness led to additional costs in liquidations where liquidators are often on a stand-still in anticipation of a claim to assets by creditors with a PPS registration who may not understand the time-pressure or process of a liquidation. The AIIP suggested reforms to require creditors to make claims for PPS registered assets with a specified period.[44]

12.44 Similarly, the Australian Restructuring and Insolvency and Turnaround Association (ARITA) recommended a change to the PPS Act and insolvency law more generally to allow an external administrator to notify claimants on the PPS Register to verify their claims within a set period, failing which their claims will be treated as unsecured. ARITA noted that it had made a similar submission to the Whittaker Review and that the Whittaker Review Recommendation 365 referred the issue to the government. ARITA explained that the suggested change would help navigate situations where liquidators cannot identify which property is subject to security interests:

> Whilst the PPS Act and its intention may be reasonably clear, in practice the conduct of parties and the PPS Register itself does not afford liquidators the benefit of clarity in relation to PPS claims. Insolvency practitioners can spend considerable time and cost in determining such claims from the PPS Register, in trying to obtain information from PPS claimants about their interests, and in dealing with those who claim to have interest, but whose interest cannot be readily verified.
>
> These problems arise from the unsatisfactory state of the PPS Register, creditors' inadequate use of it, and the fact that the register allows 'stale' interests to persist.[45]

12.45 Mr Whittaker noted that he did not make a recommendation on ARITA's proposal because he viewed it to be more a question of corporations law policy than personal property securities policy. However, Mr Whittaker indicated that he did not see significant impediments to the ARITA proposal, but noted there

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43 ASBFEO, *Submission 31*, p. 10; Behavioural Economics Team of the Australian Government, *Prompting accuracy: using behavioural insights to support accurate registrations*, March 2022, p. 4; See also KPMG, *Submission 55*, p. 16.

44 Association of Independent Insolvency Practitioners (AIIP), *Submission 20*, pp. 7–8.

45 Australian Restructuring and Turnaround Association (ARITA), *Submission 36*, pp. 51–52; *Supplementary Submission 36.1*, pp. 39–40; Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, pp. 441–442.

may be some practical difficulties with issues such as unquantified contingent claims.[46]

12.46 The BLS LCA commented on ARITA's proposal noting that it would solve many problems but might also be considered heavy-handed, given it involves effectively taking away people's property rights.[47]

12.47 KordaMentha supported proposed reforms such as ARITA's recommendation above and noted difficulties in using the PPS Register to identify relevant security interests.[48] KordaMentha submitted that:

> The purpose of the PPSR was for it to act as a 'noticeboard' of security interests in a particular company so all creditors could understand what assets may have been 'pledged' by a company. Through our formal appointment processes, it is necessary for us to correspond with all PPSR registrants to determine the validity of their security interests in assets of the particular company we have been appointed to. The number of registrations we find to be no longer valid (in many cases because the registrant has just forgotten to remove them) suggests the 'noticeboard' concept is not working to give a 'true picture' of a company's pledged assets.[49]

12.48 My Whittaker provided some context to the above challenges with the PPS Register, noting that:

> …it would have been even more difficult for the liquidator if the PPSA had not been in force, because pre PPSA there could have been lessors and vendors of equipment and there would have been no way for the liquidator to even know who they were, let alone ask them to provide evidence of their claim. So the PPSA had improved the liquidators' position beyond where it would have been had the PPSA not been in force, but it certainly does highlight the challenges that the liquidators are going to face even with a PPSA-style regime.[50]

Vesting of security interests

12.49 Submitters and witnesses identified the vesting of security interests in the PPS Act and Corporations Act as a contemporary issue with direct implications for corporate insolvency. This section discusses the following:

- background on the move from retention of title to the PPS Act; and
- Corporations Act Provisions.

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46 Mr Bruce Whittaker, Private capacity, *Committee Hansard*, 13 December 2023, p. 66.

47 BLS LCA, answers to questions on notice, 23 December 2022 (received 14 February 2023), p. 37.

48 KordaMentha, *Submission 14*, p. 3; see also McGrath Nicol, *Submission 67*, p. 2.

49 KordaMentha, *Submission 14*, p. 3.

50 Mr Bruce Whittaker, Private capacity, *Committee Hansard*, 13 December 2023, p. 66.

The move from retention of title to the PPS Act

12.50 Liquidators can access assets for which the insolvent company has a title or security interest. Historically, suppliers often included a Retention of Title (ROT) clause in their terms and conditions to protect their assets until customers paid.[51] Such arrangements often fell outside the boundaries of secured transactions law.[52]

12.51 However, since the introduction of the PPS Act, the above ROT strategy may be ineffective, as suppliers must now comply with the registration requirements of the PPS Act. The PPS Act significantly enhanced the capacity for liquidators to access assets that have not been perfected as a security interest because those assets vest with the insolvent company.[53] Perfection of a security interest under the PPS Act can be described by AFSA as follows:

> A 'perfected' security interest normally has priority over an 'unperfected' one. In most cases a perfected security interest is one that's registered on the PPS [Register].
>
> This has three main benefits:
>
> - It gives your security interest priority over unperfected interests in the same property
> - It means you[r] security interest will continue if the grantor becomes insolvent
> - You will be able to enforce your security interest against third parties
>
> If a grantor defaults on their agreement, goes out of business or becomes insolvent, you may be able to claim the property described in your registration to cover what they owe you. But if someone else has a higher priority security interest in the same collateral, they have the first right to seize it and get their money back.[54]

12.52 Section 267 of the PPS Act applies to both corporate and individual grantors. It provides that if a security interest is unperfected (or not perfected correctly) at the time of the insolvency event, it is ineffective. Hence, the security interest will vest in the insolvent grantor, and the secured party with the vested security interest will not be able to benefit from recourse against the specific property.

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51 Mr Michael Murray and Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Pub. Thomas Reuters, July 2022, p. 552.

52 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, pp. 3, 11.

53 Mr Michael Murray and Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Pub. Thomas Reuters, July 2022, pp. 552–553.

54 Australian Financial Security Authority (AFSA), *Which security interest has priority?* https://www.ppsr.gov.au/managing-and-maintaining/enforce-your-registration/which-security-interest-has-priority (accessed 17 March 2023).

The secured party remains free to pursue its (now unsecured) claim against the grantor through the insolvency process.[55]

12.53 The above change from the previous ROT regime to the PPS Act is the underlying source of many of the concerns expressed about the PPS Act and are a recurring theme in many of the matters discussed in the main body of the Whittaker Review report:

> These have not just been theoretical concerns. Two submissions from individual small businesses (one of which was submitted on a confidential basis) explained how they had lost assets in a customer's administration because they had not appreciated that their ownership of the assets was no longer sufficient to protect them under the new rules. Both submissions expressed surprise and dismay at the fact that this could be possible.[56]

12.54 Dr Richard Winter and Dr Sagi Peari described Section 267 of the PPS Act as a harsh provision, because there is no way to seek an extension of time for registration of an unregistered security interest. Dr Winter and Dr Peari argued that the PPS Act changes overturned well understood business expectations based on what was fundamental to law and commerce for centuries. They suggested the following reforms:

> (a) removal of the title vesting provisions in the PPS Act and Corporations Act to the extent that they apply to secured parties that are SMEs; or
> (b) allow for secured parties that are SMEs, whose title has moved in an insolvency, to be compensated by allowing their claim to be retained as a secured claim but rank in priority behind all other registered securities (and critically still rank in front of any unsecured creditors); or
> (c) allow for another head of compensation to be included in the PPS Act and Corporations Act for such owners by statutorily recognising their loss as a form of unjust enrichment and giving such claims priority over unsecured creditors and equity.[57]

12.55 The Whittaker Review considered section 267 and related provisions in sections 267A, 268 and 269 on vesting security interests in the grantor in the event of insolvency. The Whittaker Review also considered whether there should be a mechanism to rectify an incorrect registration given the complexity of the Register and the occurrence of incorrect registrations causing loss of security interests in liquidations. Challenges arising from the potential to fabricate or backdate security agreements in the face of insolvency were noted. Respondents to the Whittaker Review consultations were evenly divided on a proposal to enable court orders to rectify incorrect PPS registrations. Mr Whittaker noted that other recommendations to simplify the PPS Register might mitigate the

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55 AGD, *Submission 33*, pp. 3–4.

56 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, pp. 11–12, 27.

57 Dr Richard Winter and Dr Sagi Peari, *Submission 1*, pp. 2–4.

problem. Hence, Recommendations 158, 328 and 329 of the Whittaker Review recommended that the Act not be amended.[58]

Corporations Act provisions

12.56 A security interest in personal property may be correctly registered on the PPS Register at the time of the insolvency event, but the security interest may still vest in an insolvent corporate grantor under section 588FL of the Corporations Act.[59] The Whittaker Review summarised the issue arising with the Corporations Act vesting provisions:

> Section 588FL of the Corporations Act provides that a security interest granted by a company can vest in the grantor if an insolvency event occurs in relation to the grantor, even if the security interest was perfected. This can happen if the security interest:
>
> • was only perfected at the critical time by registration;
>
> • had been granted in the previous 6 months; and
>
> • was not perfected within 20 business days of the day on which the security agreement came into force.
>
> Section 588FL is a successor to what had previously been s 266 of the Corporations Act. That section had provided a similar rule in relation to company charges.[60]

12.57 A related provision, section 588FM, enables a company, or any person interested, to apply to the Court for an order fixing a later time for the purposes of subparagraph 588FL(2)(b)(iv) of the Corporations Act.

12.58 The Whittaker Review noted that all respondents bar one to its consultation on repealing section 588FL, supported repeal. Even though section 588FL is a successor to a previous provision in the Corporations Act, the submissions argued that the need for the provision had been overtaken by s 267 of the PPS Act and that it is unnecessary doubling up to retain section 588FL as well. Some also made the point that section 588FL is not reflective of the unifying

58 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, pp. 244–245, 404–407.

59 AGD, *Submission 33*, p. 4; see also Mr Michael Murray and Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Pub. Thomas Reuters, July 2022, pp. 552–553, 601.

60 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, pp. 438–439; see also AGD, *Submission 33*, p. 4; Dr Richard Winter and Dr Sagi Peari, *Submission 1*, p. 2, Mr Michael Murray and Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Pub. Thomas Reuters, July 2022, pp. 552–553.

principle that underpins the Act because it applies to only certain types of the grantor (that is, only to companies).[61]

12.59 Recommendation 362 of the Whittaker Review recommended that section 588FL be repealed based on the following findings:

> First, there are other compelling reasons under the Act why a secured party will want to perfect its security interest as early as possible – in particular, to set its priority position, to reduce the risk that a buyer or lessee could take the collateral free of the security interest, and to remove the risk that the security interest could vest in the grantor under s 267. A secured party that does not register promptly is likely to do so only out of inadvertence, so imposing a further deadline under s 588FL will not result in the registration being made any earlier than might otherwise have been the case. Secondly, the deadline under the section does make it very difficult to register effectively for some types of security interests, as described above. Thirdly, the section runs contrary to the Act's unifying principle, because it applies only to companies, not to all grantors.[62]

12.60 Mr Michael Murray and Professor Jason Harris suggested repealing the vesting rules in sections 588FL and 588FM of the Corporations Act and leaving vesting rules to the PPS Act. If section 588FL is not repealed, Mr Murray and Professor Harris suggested that the law be amended to ensure that security interests granted by insolvency practitioners are not automatically invalidated by section 588FL, which requires a court extension of time before executing the agreement.[63] SCoLA also supported repealing sections 588FL and 588FM of the Corporations Act and leaving vesting rules to the PPS Act.[64]

12.61 TMA supported Whittaker Review recommendation 362 and noted that section 588FL has resulted in a significant number of court applications for extensions of time to file financing statements under section 588FM. TMA argued that section 588FL has achieved little benefit, and the provision complicates the PPS Act regime. In addition, TMA notes that section 588FL has created an additional issue where administrators of a company seek to obtain funding secured by new personal property security granted by the company after the date of the administration:

> A line of cases including K J Renfrey Nominees Pty Ltd (atf Renfrey Family Trustee) v OneSteel Manufacturing Pty Ltd (subject to deed of company arrangement) [2017] FCA 325 have held or assumed that section 588FL

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61 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, pp. 438–439.

62 Mr Bruce Whittaker, 'Review of the Personal Property Securities Act 2009', *Final Report*, 27 February 2015, pp. 438–439.

63 Mr Michael Murray and Professor Jason Harris, *Submission 18*, p. 10.

64 SCoLA, *Submission 37*, p. 3; see also Mr Bruce Whittaker, Private capacity, *Committee Hansard*, 13 December 2023, pp. 66.

> applies to security interests granted after the "critical time", and accordingly that such security interests would automatically vest on creation…
>
> However, in the recent case of Antqip Hire Pty Ltd (in liq) [2021] NSWSC 1122 Brereton JA suggested that this previous understanding was incorrect.[65]

12.62 If the government does not adopt recommendation 362, TMA suggests that section 588FL is amended to make clear that Brereton JA's interpretation of section 588FL is correct to avoid the need for further cautionary section 588FM applications to be made by administrators.[66]

12.63 The BLS LCA suggested that given the proposed reforms to section 588FL require amendments to the Corporations Act, it may be that consideration is given to the reworking of those provisions as part of broader considerations into harmonising insolvency legislation.[67]

Committee view

Whittaker Review

12.64 The committee observes that although a few recommendations of the Whittaker Review have been implemented to address awareness, ease of use and accuracy of the PPS Register, concerns remain in these areas. The committee notes words of caution from some stakeholders that changes to the PPS Register may impose one-off costs on businesses. The committee has not had access to data to compare one-off costs to ongoing costs. However, the committee considers that, on balance, over the long-term ongoing costs may be higher than one-off changeover costs in some cases. Therefore, the committee recommends that the government respond to the Whittaker Review and consider adopting its recommendations where the benefits outweigh the costs. The committee considers that these changes should proceed without waiting for the comprehensive review.

Recommendation 26

12.65 The committee recommends that the government provide a formal response to the Whittaker Review which was completed in 2015.

Vesting of security interests

12.66 The committee observes that the change from the retention of title regime to vesting rules under the PPS Act and the Corporations Act created a significant dislocation to long-standing business practices of many suppliers. Despite the

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65 TMA, *Submission 38*, pp. 16–18.

66 TMA, *Submission 38*, pp. 16–18.

67 BLS LCA, answers to questions on notice, 23 December 2023 (received 14 February 2023), p. 37.

PPS Act being in place for a decade, understanding of the implications of that change appears to be patchy.

12.67 The committee notes that the Whittaker Review considered vesting rules under Section 267 of the PPS Act and whether there should be a mechanism to correct an incorrect PPS Registration to prevent unintentional vesting when insolvency occurs. The committee observes that the Whittaker Review recommended not making such a change based on the following:

- an evenly divided response to a consultation process; and
- an expectation that the problems may be alleviated by other recommended simplifications of the PPS Register.

12.68 The committee considers that given the continuing concerns about awareness, ease of use, and accuracy of the PPS Register, it may be appropriate to reconsider whether it is reasonable to have a mechanism to rectify an incorrect PPS registration that may result in the loss of the security interest due to the security interest vesting with the grantor on a grantor's insolvency under section 267.

12.69 The committee heard that even where a security interest in personal property is correctly registered on the PPS Register during an insolvency event, the security interest may still vest in an insolvent corporate grantor under section 588FL of the Corporations Act. The Whittaker Review recommendation 362 recommended that section 588FL be repealed. Respondents to the Whittaker Review and submissions to this inquiry generally supported the Whittaker Review recommendation. The committee therefore supports the implementation of recommendation 362 of the Whittaker Review.

Chapter 13
Voidable transactions and unfair preferences

Introduction

13.1 The previous two chapters discussed unsecured and secured assets that belong to a company at the commencement of liquidation (chapters 11 and 12). This chapter discusses voidable transactions and unfair preferences, which are another source of assets that liquidators may use to pay creditors (typically unsecured creditors). The structure of the chapter is as follows:

- The first section summarises the main types of voidable transactions, the principles behind the regime, and a timeline indicating how far each type of voidable transaction reaches back.
- The next section focusses on the operation of unfair preferences and suggestions for reform in this area, noting the significant amount of feedback received by stakeholders on this type of voidable transaction.
- The final section discusses the important insolvency decision of the High Court case of *Bryant v Badenoch integrated Logging Pty Ltd*.[1]

Voidable transactions

13.2 The voidable transactions framework is set out in Part 5.7B of the Corporations Act 2001 (Corporations Act). The provisions enable a liquidator to apply to the Court to grant orders that certain transactions entered into with creditors of a company in liquidation are void. If such an order is granted, the creditor will often be required to repay the company an amount equal to or part of the money it had been paid by the company.[2] There are several types of transactions that are voidable as follows:

(1) unfair preferences;
(2) uncommercial transactions;
(3) transactions with the purpose of obstructing creditors' rights;
(4) unfair loans;
(5) unreasonable director-related transactions;
(6) creditor defeating dispositions; and
(7) circulating security interests.[3]

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1 *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2.

2 Taline Charter, Marc Bosnic: *Certainty: the peak indebtedness rule is no longer*, Minter Ellison, https://www.minterellison.com/articles/certainty-the-peak-indebtedness-rule-is-no-longer (accessed 14 June 2023).

3 Mr Michael Murray & Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Pub. Thomas Reuters, July 2022, pp. 554–557, 583.

13.3 The purpose of the voidable transactions provisions is to support the *pari passu* principle of equal distribution of assets among creditors and to mitigate transactions that compromise that principle in the period immediately before liquidation begins. Transactions in the period immediately before liquidation may have intentionally or unintentionally benefited some creditors. The common law does not generally provide for voidable transactions even when a company is insolvent. Hence, the law on voidable transactions is predominantly determined by Part 5.7B of Division 2 of the *Corporations Act 2001* (Corporations Act). Some types of voidable transaction (types 1–3, unfair preferences, uncommercial transactions, and transactions with the purpose of obstructing creditors' rights) require the liquidators to prove the company was insolvent.[4]

13.4 The timeframes over which the liquidator can pursue voidable transactions vary with the transaction type and whether related entities or directors were involved, as set out in Figure 13.1.

13.5 The relation back day is the date by which the prescribed period begins whereby transactions entered into by the company may be considered void. More formally, the relation-back day is a concept that specifies the commencement time of the liquidation that varies across 15 scenarios set out in section 91 of the Corporations Act. In many of those scenarios, the relation-back day refers to the date that a court application was filed for winding up or a special resolution was passed by the company for voluntary liquidation.[5]

13.6 The *Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020* implemented a suite of reforms to corporations and tax laws aimed at combating illegal phoenix activity. These included the following reforms to the Corporations Act:

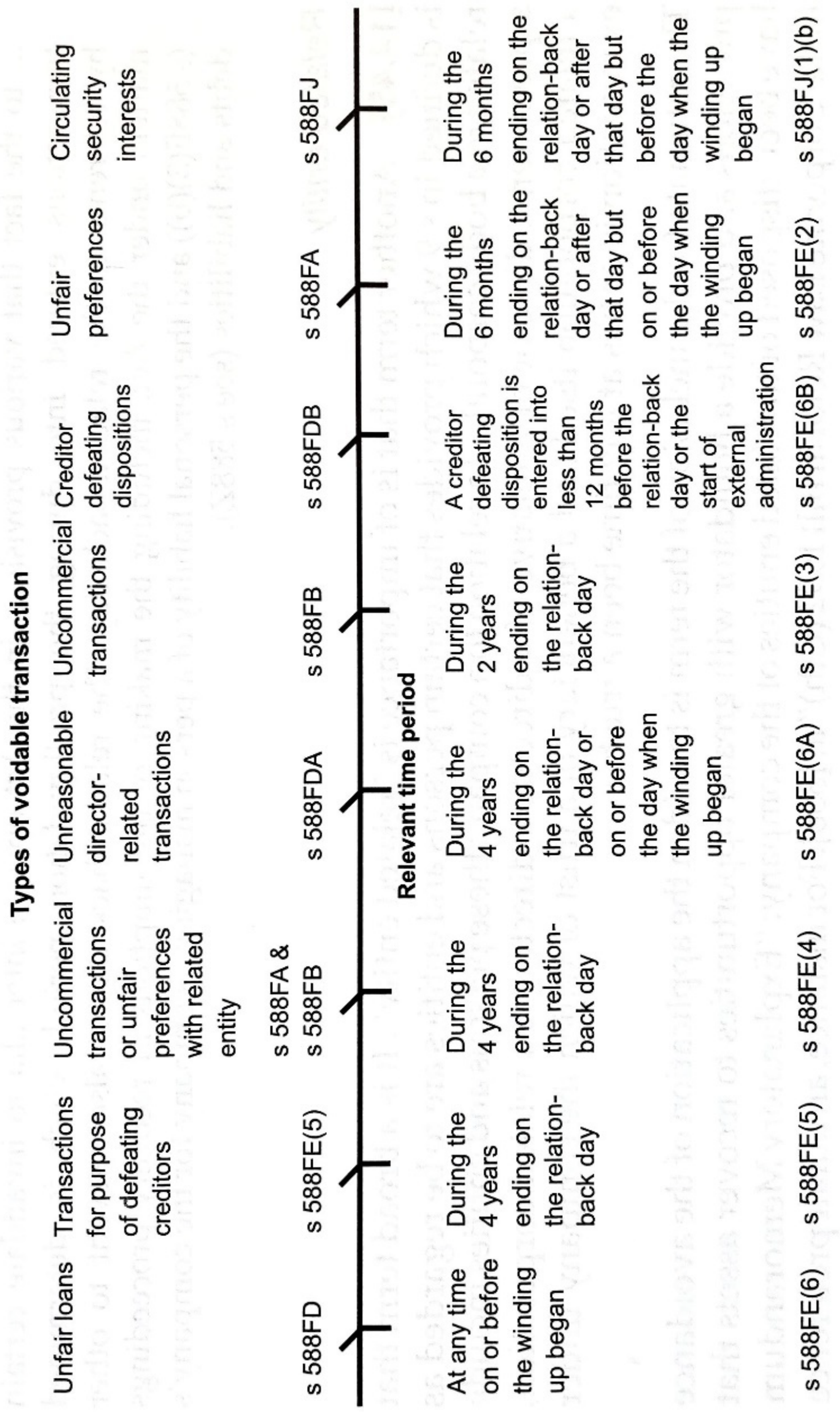
- New voidable transaction provisions to enable liquidators to apply to ASIC or the court to recover, for the benefit of a company's creditors, company property disposed of, via a voidable creditor-defeating disposition (CDD).
- A power for the Australian Securities and Investments Commission (ASIC) to make orders for the return of assets.
- New criminal offence and civil penalty provisions for company officers who do not prevent CDDs or facilitate illegal phoenix activity through CDDs.
- Provisions to prevent directors from improperly backdating resignations or ceasing to be a director when it would leave the company with no directors.[6]

4 Mr Michael Murray & Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Pub. Thomas Reuters, July 2022, pp. 554–557.

5 Mr Michael Murray & Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Pub. Thomas Reuters, July 2022, pp. 554–557.

6 Department of the Treasury (Treasury), *Submission 34*, p. 9.

Figure 13.1 Timeline for voidable transactions



Source: Mr Michael Murray & Professor Jason Harris, Keay's Insolvency: Personal and Corporate Law and Practice, Eleventh Edition, Pub. Thomas Reuters, July 2022, p. 557.

13.7 The reforms relating to CDDs were tested *Victoria in Re IntelliComms Pty Ltd* (in liq) [2022] VSC 228. The Supreme Court of Victoria held that the Sale Agreement entered into by Intellicomms Pty Ltd was a CDD within the meaning of section 588FDB(1) of the Corporations Act, and therefore voidable pursuant to section 588FE(6B) of the Act.[7]

Unfair preferences

Background

13.8 Liquidator recovery of payments made by insolvent debtors has been part of Australian insolvency laws for over 100 years.[8] The right to recover a preferential payment to a creditor is fundamental in insolvency law. The rationale for recovery rights is that the creditor has jumped the queue in obtaining payment of its debt and it should repay the money and stand in line with other creditors. Preferences are intended to promote equality among creditors and to deter a race to the courthouse.[9]

13.9 The corporate insolvency law provisions on unfair preferences were inherited and adapted from the *Bankruptcy Act 1966*. However, corporate liquidators pursue unfair preferences more frequently than bankruptcy trustees. Unfair preferences are the subset of voidable transactions that fit the following definition:

> A transaction is an unfair preference if the company and the creditor are parties to the transaction and the transaction results in the creditor receiving from the company, in relation to an unsecured debt owed to the creditor, a greater amount than it would have received in relation to the debt in a winding up of the company.[10]

13.10 For a preference to exist, the burden of proof is on the liquidator (on the balance of probabilities) based on the following four conditions:

- The transaction must satisfy the definition of 'transaction' in section 9 of the Corporations Act.
- The liquidator must establish that the company was insolvent at the time of the transaction.
- The transaction must have occurred within:
  - six months of the relation-back day; or

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7 Treasury, *Submission 34*, p. 8.

8 Mr Steven Golledge SC, Barrister, *Submission 6*, p. 1.

9 Mr Michael Murray & Professor Jason Harris, *Submission 18*, p. 10; Mr Michael Murray & Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Pub. Thomas Reuters, July 2022, pp. 211–212.

10 Mr Michael Murray & Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Pub. Thomas Reuters, July 2022, pp. 560–561.

- if the creditor of the transaction was a related entity of the company, four years from the relation-back day.

- The creditor received more than it would have received in a winding up.[11]

Concerns about unfair preference claims in practice

13.11 Mr Steven Golledge SC submitted that while the unfair preference laws serve the worthy principle of ensuring that some creditors do not receive an advantage over others by chance or design, in practice, that objective is rarely achieved. Complexity is the most significant reason for the ineffectiveness of unfair preference laws. The extent to which unfair preferences are pursued depends on the appetite of the liquidators and the availability of litigation funding, with not all creditors being subject to claims. To avoid legal costs that exceed the claim, creditors and liquidators often settle. As a result, much of the recovered money is absorbed by the liquidator's costs and fees, with limited returns to creditors. Mr Golledge concluded that while paying liquidators' fees is appropriate, the unfair preference claim process is not in practice meeting the objective of providing better returns to creditors.[12]

13.12 Mr Michael Murray and Professor Jason Harris also noted that many preference claims might be absorbed by liquidator's fees. While that is not unlawful or inappropriate, it may not meet the policy objective.[13] Mr Murray and Professor Harris drew attention to the consideration of this issue by the courts:

> …even if the proceedings were pursued to seek to recover the liquidators' costs or funding which had been devoted to the conduct of the proceedings, it seems to me that that is a proper purpose, where liquidators would less readily accept appointment, and litigation funders would less readily fund proper proceedings in liquidation, if liquidators could not recover their remuneration or litigation funders could not recover the funding which they provided.[14]

13.13 ASIC noted the role of unfair preferences in funding liquidations and indicated it might be appropriate to consider reforms that balance the tension between the competing interests of creditors and liquidators:

> ASIC is aware of tension between liquidators and company creditors over the unfair preference laws. Registered liquidators have stated that recovery of unfair preferences is a source of funding that enables further investigation and asset recovery action, payment of liquidator remuneration and

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11 Mr Michael Murray & Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Pub. Thomas Reuters, July 2022, pp. 560–566.

12 Mr Steven Golledge SC, Barrister, *Submission 6*, pp. 1–2. Also see Australian Institute of Credit Management (AICM), *Submission 9*, p. 5; and Southern Steel Group, *Submission 27*, p. 4.

13 Mr Michael Murray and Professor Jason Harris, *Submission 18*, p. 11.

14 *Re Cardinal Group Pty Limited (in liq)* [2015] NSWSC 1761 at [34]; Mr Michael Murray and Professor Jason Harris, *Submission 18*, p. 11.

> increases the likelihood of dividends to creditors. Creditors raise concerns that they are penalised for actively managing collection of amounts owed to them when they are required to pay back such payments as unfair preferences if the company is wound up.[15]

13.14 The Business Law Section of the Law Council of Australia (BLS LCA) summarised the tension between a creditor subject to unfair preference claims and the whole creditor group:

> The primary difficulty most people have with the unfair preference regime is that it takes money from people who have done nothing wrong. That is both incongruent (for most stakeholders) with ordinary business relationships and an affront to ordinary rules of law. However, the difficulty with those complaints is that, in insolvency, there are always people who miss out, and the system must decide a fair and equitable way to distribute the loss.[16]

13.15 KPMG noted that while the unfair preference provisions of the Corporations Act play an important role in discouraging individual creditors and related parties from seeking to better their position in the face of impending insolvency, the costs of recovering small claims often means there is no net benefit to creditors.[17]

13.16 Several other submitters shared their concerns about the objectives of the unfair preference claims not being met due to the complexity, cost, and the use of such claims to fund liquidator's fees.[18]

13.17 McGrath Nicol acknowledged that in its insolvency work, the process of formulating and recovering a preference claim has become more complicated and time-consuming, with an associated increase in both liquidator and legal fees. Accordingly, it advised that as a result, there is often a minimal return of availing company funds to creditors.[19]

13.18 On the use of unfair preferences for liquidator fees, ARITA submitted:

> The insolvency profession is frequently unfairly maligned with a belief that unfair preference recoveries are only undertaken to get those insolvency professional’s fees paid. Unfair preference recovery plays an important role in funding an insolvency process, such funding is necessary to ensure insolvency practitioners can maximise returns to creditors. As the Chapter 11 Review Commission in the United States reads: 'the notion that money

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15 Australian Securities and Investments Commission (ASIC), *Submission 29*, p. 56.

16 Business Law Section, Law Council of Australia (BLS LCA), *Submission 30*, p. 33.

17 KPMG, *Submission 55*, p. 24.

18 AICM, *Submission 9*, p. 2; Australian Credit Forum (ACF), *Submission 22*, p. 5; Australian Restructuring Insolvency & Turnaround Association (ARITA), *Submission 36*, p. 54; Society of Corporate Law Academics (SCoLA), *Submission 37*, p. 3; Scanlan Carroll, *Submission 59*, p. 8.

19 McGrath Nicol, *Submission 67*, p. 3.

> paid to professionals belongs to creditors is true only if the creditors could realize that value without the professionals'.[20]

13.19 In their respective submissions, the AICM and ACF submitted that unfair preference claims punish creditors who follow normal business processes to obtain payment and favour those that are inactive. The organisations were of the view that unfair preference claims also have more effects on creditors who work closely to support their customers to support the viability of their business.[21]

13.20 Submitters and witnesses also raised concerns that some liquidators issued unfair preference claims to a wide range of creditors rather than carefully targeting relevant claims.[22] ARITA indicated that while it was aware of allegations of such practices by some liquidators, it is prohibited by ARITA's Code of Professional Practice. ARITA indicated that it takes enforcement action against such practices and noted it has not had any genuine and verifiable complaints against its members in the last decade.[23]

13.21 Chartered Accountants Australia and New Zealand (CA ANZ) indicated that unfair preference claims are not as easy for liquidators to pursue as people may assume:

> It is very hard to get these preference proceedings on foot to an evidentiary level, because we don't want to be starting frivolous claims and we want to make sure our claims are viable. But to obtain that information is a long, drawn-out process, hampered not by the liquidator but by getting that information from third parties. That may include getting ASIC involved to obtain information from people that aren't complying with notices or going through the court process and getting notices to produce.[24]

13.22 The Institute of Public Accountants (IPA) indicated that there is a breadth of information that practitioners take into consideration when weighing up a preference recovery:

> …when assessing a potential preference claim, you look at the steps that have been taken by that creditor to recover the claim and you look at the email communications or the correspondence that passes between the

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20 ARITA, *Submission 36*, p. 55; American Bankruptcy Institute, *Commission to study the reform of Chapter 11 2012-204 — Final Report and Recommendations*, p. 57.

21 AICM, *Submission 9*, p. 2; ACF, *Submission 22*, p. 5; See also ARITA, *Submission 36*, p. 54.

22 Mr Michael Murray and Professor Jason Harris, *Submission 18*, p. 11; AICM, *Submission 9*, 7; Mr Grant Morris, National Credit Manager, Southern Steel Group, *Committee Hansard*, 21 February 2023, p. 69; Ms Anna Taylor, Legislation Chairperson, ACF, *Committee Hansard*, 28 February 2023, pp. 14, 15; Mr Nick Pilavidis, Chief Executive Officer, AICM, *Committee Hansard*, 28 February 2023, p. 11.

23 ARITA, *Submission 36*, p. 56.

24 Mr Andrew Barnden, member, registered liquidator and trustee in bankruptcy, Chartered Accountants Australia and New Zealand (CA ANZ), *Committee Hansard*, 28 February 2023, p. 38.

> parties and the conversations that have been transpiring. Have they looked to enter into a repayment program? What are the reasons that they've provided for non-payment? How far has it gone beyond what may be argued as a reasonable debt recovery? Does it now extend to litigation, issuing stat demands, settlement on the court of a winding-up notice?[25]

Possible reforms of unfair preference laws

13.23 The committee received several recommendations for reforms on unfair preference laws which are summarised and discussed in the preceding sections as follows:

- related parties;
- defences for creditors;
- claim periods;
- thresholds for preference claim amounts;
- Australian Taxation Office (ATO) indemnity; and
- interactions with safe harbour provisions.

Related entities

13.24 The term 'related entity' is defined in section 9 of the Corporations Act which provides that certain persons and entities are to be regarded as related to a body corporate. In relation to a company these persons and entities include:

> … a promoter, a director or a relative of a director, a director of a related corporation, a related corporation itself and a beneficiary of a trust of which the company under examination is or has at any time been a trustee.[26]

13.25 The Harmer Review held that creditors who were related entities should not be treated equally because they may be more aware of the company's financial status and may be able to influence the owners and managers to obtain an advantage over other creditors. The main difference in the law is that liquidators may pursue unfair preferences of related parties over four years before the insolvency formally began (compared to six months for un-related creditors).[27]

13.26 Several inquiry participants suggested that unfair preferences should be confined to creditors who are related entities to the insolvent company.[28]

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[25] Mr Adrian Hunter, registered liquidator, Institute of Public Accountants, *Committee Hansard*, 28 February 2023, pp. 47–48.

[26] Mr Michael Murray & Mr Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Thomson Reuters, p. 558.

[27] Mr Michael Murray & Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Thomas Reuters, July 2022, pp. 558–559.

[28] Mr Steven Golledge SC, Barrister, *Submission 6*, pp. 2–3; AICM, *Submission 9*, p. 2; ACF, *Submission 22*, p. 5; Mr Grant Morris, National Credit Manager, Southern Steel Group, *Committee Hansard*, 21 February 2023, p. 69.

Mr Steven Golledge SC indicated that the benefits of such a reform would include:

- unrelated third-party creditors would not be subject to claims that do not meaningfully enhance the position of all creditors;
- favourable treatment of related entities would be discouraged; and
- inappropriate phoenixing may be more difficult.[29]

13.27 Mr Steven Golledge SC identified that a substantial part of the costs and complexity of insolvency litigation accrues in the proof or denial of insolvency. Removing those costs would increase returns to creditors. Hence, Mr Golledge suggested that in a preference case against a related party, a liquidator should not be required to show that the company was insolvent at the time of the transaction.[30]

13.28 ARITA proposed a different approach, suggesting that all related party transactions be automatically designated as unfair preference payments, with the onus on the related party to demonstrate to the liquidator that the payment was not an unfair preference.[31]

Defences for creditors

13.29 The BLS LCA drew attention to the differences between Australia's current defence provisions, historical provisions, and provisions of other jurisdictions:

- The Harmer Review proposed that all payments close to the appointment of an insolvency practitioner should be considered as preferences.
- The United Kingdom (UK) and Hong Kong require the knowledge or intention of the debtor company to be established.
- Australian states all initially adopted the UK predecessor legislation.
- In 1841, New South Wales (NSW) removed the requirement to establish the debtor's intention.
- The NSW system was adopted when harmonised Commonwealth legislation was introduced.[32]

13.30 Currently, the defences for creditors of unfair preference claims are the same as those for the broader category of voidable transactions. If a liquidator has proven a voidable transaction, a creditor may subsequently seek to defend the claim using defences set out in section 588FG of the Corporations Act. The defences relate to:

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29 Mr Steven Golledge SC, Barrister, *Submission 6*, pp. 2–3; see also Professor Christopher Symes, *Submission 25*, p. 2.

30 Mr Steven Golledge SC, Barrister, *Submission 6*, pp. 2–3; see also Professor Christopher Symes, *Submission 25*, p. 3.

31 ARITA, *Submission 36*, p. 7.

32 BLS LCA, *Submission 30*, pp. 33–40.

- acting in good faith in becoming a party to the transaction,
- having no reasonable grounds for suspecting the company was insolvent at the time of the transaction;
- a reasonable person in the same circumstance would have no grounds for suspecting insolvency; and
- showing that the creditor provided valuable consideration under the transaction.[33]

13.31 The Turnaround Management Association (TMA) suggested consideration be given to overseas examples (UK, Singapore, South Africa) of subjective and more difficult tests that require the liquidator to establish the debtor's intent or state of mind. The TMA also identified the contrasting example of the US bankruptcy regime, which determines whether a transaction had a preferential effect in practice.[34]

13.32 The Australian Institute of Credit Management (AICM) suggested amending the legislation to require actual knowledge of insolvency rather than the current threshold of suspicion of insolvency. The AICM argued that such an approach would allow credit professionals to play a positive role in maximising the options available for their customers to avoid formal insolvencies, such as providing extended time and repayment arrangements.[35] The Australian Credit Forum (ACF) supported changing the test from suspicion of insolvency to actual knowledge of insolvency.[36]

13.33 The AICM also identified that the ambiguity of available defences and calculation methods further penalises creditors with legal fees and protracted negotiations. AICM, therefore, recommended clarifying the appropriate defences to ensure clear and reasonable defences are available, enabling claims to be resolved with less requirement for court mediation and legal fees on both sides.[37]

13.34 Other submitters supported current defences. For example, DyeCo submitted that the current defences leave appropriate risks with creditors:

> …creditors are making lending decisions to extend credit to another company and therefore should bear that risk, similarly they are also bearing a risk if they meet the elements of an unfair preference, ie they have

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33 Mr Michael Murray & Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Thomas Reuters, July 2022, pp. 588–589.

34 Turnaround Management Association (TMA), *Submission 38*, pp. 19–20.

35 Australian Institute of Credit Management (AICM), *Submission 9*, pp. 5–6.

36 Australian Credit Forum (ACF), *Submission 22*, p. 5; see also Southern Steel Group *Submission 27*, p. 3.

37 AICM, *Submission 9*, p. 6.

knowledge or ought to have suspected the insolvency and received more than they would in the winding up of the company.[38]

13.35 Scanlan Carroll submitted on the importance of apply the defence correctly:

> The vast majority of directors of businesses may not appreciate the strict definition of 'insolvent', namely, if a company cannot pay its debts if and when they fall due, this will be considered 'insolvency'. Many businesses experience cash flow issues, and would be deemed insolvent should this test be strictly applied. Many trade creditors would be caught under the preference payment provisions, and will fail to establish the good faith defence as an awareness of cash flow issues can be deemed as a reasonable suspicion that the company is insolvent, when the two are vastly different. Broad scope education may assist in this regard. [39]

13.36 To assist creditors when they are subject to claims, ARITA suggested the development of an unfair preferences rights guide that is approved by the regulator.[40]

Claim periods

13.37 There are two time periods relevant to unfair preferences. Firstly, a liquidator could pursue unfair preferences against unsecured credits if the transaction occurred within six months prior to the relation back day or four years prior to the relation back day in the event the creditor is a related entity of the company.[41] One suggestion put to the committee by Mr Murry and Professor Harris involved a shorter time-period combined with a more automatic process to reduce costs:

> …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.[42]

13.38 DyeCo Solvency & Turnaround (DyeCo) did not support reducing the timeframe as they were of the view that it may be abused by directors of failing companies.[43]

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38 DyeCo Insolvency & Turnaround, *Submission 13*, p. 6.

39 Scanlan Carroll, *Submission 59*, pp. 2–3.

40 ARITA, *Submission 36*, p. 7.

41 Mr Michael Murray & Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Thomas Reuters, July 2022, p. 557.

42 Mr Michael Murray and Professor Jason Harris, *answers to questions on notice*, 12 December 2022 (received 10 February 2023).

43 DyeCo Insolvency & Turnaround, *Submission 13*, p. 6.

13.39 Secondly, liquidators once appointed may bring a claim for preference payments within the three-year time period prescribed, which is currently three years with the potential for extensions.[44] ACF suggested that such claim periods for unfair preference claims should be reduced to one year.[45] AICM cited data indicating that approximately only 10 per cent of administrations were expected to take more than 12 months to complete. Hence, AICM suggested that the time to claim (which is currently 3 years as outlined above) be reduced to 12 months.[46] This suggested change was supported by the ACF and Mr Grant Morris.[47]

Thresholds on preference claim amounts and clawback time.

13.40 There is no limit on the value of unfair preference payments that a liquidator can recover. Where a liquidator adopts a simplified liquidation process, a liquidator's ability to recover payments from unrelated creditors that receive payments from the company is different. In a simplified liquidation, a payment or series of payments made to an unrelated creditor are not recoverable as an unfair preference unless:

- the payment(s) is/are made at any time from three months before the liquidation is taken to have begun until the date the liquidator is appointed, and
- the total of the payment(s) received from the company during this period is more than $30,000.[48]

13.41 Under the proposed reforms announced by the Morrison Government in the 2022–23 Budget, transactions that either amounted to less than $30,000 or that were made more than three months before the company entered external administration would not have been able to be clawed back—provided the transactions involved unrelated creditors and are made within the ordinary course of business. These unenacted changes were broadly consistent with the unfair preference rules that apply under the simplified liquidation process implemented in 2021.[49]

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44 BLS LCA, *Submission 30*, p. 28.

45 ACF *Submission 22*, p. 5.

46 AICM, *Submission 9*, p. 5.

47 ACF, *Submission 22*, p. 5. Mr Grant Morris, National Credit Manager, Southern Steel Group, *Committee Hansard*, 21 February 2023, p. 69.

48 ASIC, Liquidation: A guide for creditors, https://asic.gov.au/regulatory-resources/insolvency/insolvency-for-creditors/liquidation-a-guide-for-creditors/ (accessed 15 June 2023).

49 Treasury, *Submission* 34, p. 14; see also The Hon Michael Sukkar MP, Assistant Treasurer, Minister for Housing and Minister for Homelessness, Social and Community Housing, *Simpler and fairer insolvency processes*, Media Release, 30 March 2022.

13.42 SCoLA and KPMG supported aligning the liquidation unfair preference provisions with the simplified liquidation unfair preference provisions. SCoLA further suggested including unfair preferences within the administrative recovery notice power of ASIC to help reduce costs of recovery.[50]

13.43 Financial Counselling Australia and the Small Business Dept Helpline supported expanding the $30,000 limit to all creditor voluntary liquidations and court liquidations.[51] AICM members welcomed the restricted circumstances for recovery of preference claims under the simplified liquidation reforms.[52]

13.44 Dyeco supported the implementation a minimum sum on the preference amount.[53] The Association of Independent Insolvency Practitioners (AIIP) preferred a threshold of $10,000.[54] ARITA suggested that a $4000 threshold may be a more appropriate and would align with the recently adjusted minimum amount for statutory demands.[55] IPA also offered a similar view:

> There's currently a $30,000 threshold limit under the simplified liquidation process, and there is no limit in relation to the regular creditors voluntary or court liquidation process. There are probably avenues for harmonisation between the two legislations or the two insolvency streams. …You start to get a threshold limit where it becomes uncommercial and unreasonable for a liquidator to prosecute those matters, so $10,000 would probably be an appropriate limit, in my view.[56]

13.45 CA ANZ, CPA Australia, and the IPA did not support the proposed three-month clawback time:

> Registered liquidators already have significant time pressures to complete the statutory requirements in external administrations. This time can rapidly expire waiting on a response from the Australian Taxation Office or if matters must be taken through the court system.
>
> Limiting to a six-month period would also assume that the registered liquidator has the cooperation of the director, access to the company's records and sufficient resources and capacity to adequately investigate and assess each payment made to a creditor during the six months prior to the date of insolvency. Without adequate time to undertake thorough investigations, a reduced timeframe may have the unintended consequence

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50 SCoLA, *Submission 37*, p. 3; KPMG, *Submission 55*, pp. 7, 24.

51 Financial Counselling Australia and the Small Business Dept Helpline, *Submission 58*, p. 4.

52 AICM, *Submission 9*, p. 3.

53 DyeCo Insolvency & Turnaround, *Submission 13*, p. 6.

54 Associations of Independent Insolvency Practitioners (AIIP), *Submission 20*, p. 8.

55 ARITA, *Submission 36*, p. 8.

56 Mr Adrian Hunter, registered liquidator, IPA, *Committee Hansard*, 28 February 2023, pp. 45–46; See also, CA ANZ, CPA Australia, and IPA, answers to questions on notice, 23 February 2023 (received 21 March 2023).

of registered liquidators needing to send claims to all creditors paid in the 6 months prior to the relation back date.[57]

Interaction with safe harbour provisions

13.46 The Safe Harbour Review (discussed in chapter 7) observed that creditors who assist a debtor during a safe harbour may still be subject to unfair preference claims.[58] Some submitters and witnesses proposed that such creditors should have some protections against unfair preference claims.[59]

13.47 Treasury's 2021 Review of the Insolvent Trading Safe Harbour (Safe Harbour Review) set out the rationale for calls for creditors who assist in safe harbour restructuring to be immune from unfair preference claims:

> While safe harbour can be used without the knowledge of creditors, there are occasions where directors may need the support of key creditors to implement their restructuring plans. To obtain creditor support, management of a distressed company may provide financial information to a creditor which evidences a suspicion of the company's insolvency. This in turn may create evidence of a creditor's knowledge to be used in an unfair preference claim by a liquidator, should the company enter a formal process. Accordingly, a creditor will often be reluctant to engage in such discussions, which may frustrate implementation of the restructuring plan. Some creditors submitted they should be released from remitting preference payments received from a company during a period where its directors are relying on safe harbour.[60]

13.48 King & Wood Mallesons (KWM) suggested changes to the role of unfair preferences where debts are incurred whilst a safe harbour is in place. The Corporations Act does not explicitly address the interaction between the voidability of transactions entered into as part of a safe harbour plan. KWM argued that a safe harbour would be unable to achieve its objective if transactions to explore remediation options during a safe harbour were liable to be set aside as voidable transactions. If the purpose of safe harbour is to balance the rigidity of the insolvent trading laws, then the unfair preference laws should not in turn maintain an inflexible regime unable to be remedied by the safe harbour provisions.[61]

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57 CA ANZ, CPA Australia, and IPA, answers to questions on notice, 23 February 2023 (received 21 March 2023).

58 Department of the Treasury (Treasury), *Review of the Insolvent Trading Safe Harbour*, November 2021, pp. 24–25, 72, 79–80.

59 AICM, *Submission* 9, pp. 6–7; Southern Steel, *Submission 27*, p. 4; Subcontractor Alliance and Subbies United, *Submission 56*, p. 18; Scanlon Carroll, *Submission 59*, pp. 2–3, 5.

60 Treasury, *Review of the Insolvent Trading Safe Harbour*, 23 November 2021, p. 79.

61 King & Wood Mallesons, *Submission 45*, pp. 7, 9.

13.49 Scanlon Carroll noted that prior to the introduction of the Safe Harbour, creditors may otherwise have had an avenue for relief against a director if payments were clawed back under the preference payments provision. Hence, Scanlon Carroll suggested that:

> The reciprocal protections needed for creditors during the Safe Harbour period could include reducing the ability for voidable transactions and clawbacks to be applicable, automatic application of a running account during the 6 month period, or the good faith receipt defence remaining available. This would need to be restricted to arms-length transactions and perhaps further restricted just to trade creditors, to ensure that directors themselves cannot take advantage of further protection and enter into voidable transactions.
>
> Allowing creditors automatic application of the running account (for the 6 month period only) if services are continued while Safe Harbour is utilised would mean that the liquidator's starting point would be the balance of amounts paid in excess of goods and services provided, and would again limit protracted litigation.[62]

Stakeholder concerns and observations about reforms

13.50 The BLS LCA suggested that care should be taken in recommending or implementing any reforms to the unfair preference regime that might have the effect of incentivising directors to dispose of company assets before liquidator appointments.[63]

13.51 BlueRock indicated that, in its view unfair preference laws work well and may only need minor adjustments. BlueRock submitted:

> Unfair preference claims are routinely criticised as being unfair themselves, with some groups going so far as to advocate for their abolition, but our position is that these claims go to the very heart of insolvency law and are a critical function in ensuring proportionate distributions to creditors.
>
> To illustrate the importance of these claims, consider a landscape without them. Directors of companies approaching insolvency would then hold all of the power when considering which creditors will get paid and which creditors will be left with nothing, including secured creditors.[64]

13.52 CA ANZ argued that the unfair preference regime is designed to protect all creditors and that the insolvency regime might not work well without it:

> The counterfactual that is not being spoken about is that if we don't deal with unfair preferences, then those creditors that have the financial nous will have suspicion of insolvency looming and chase the debt due to them. That's why it's an unfair preference: that creditor gets paid ahead of the other 10 creditors who don't have that financial nous. The unfair preference

62 Scanlon Carroll, *Submission 59*, p. 2, 5.

63 BLS LCA, *Submission 30*, pp. 12, 34.

64 BlueRock, *Submission 8*, p. 3.

> regime is a form of protection for all creditors. We need to be looking at both sides of this coin. The best practice question is about the registered liquidator using their experience and using their knowledge to issue only the correct claims.[65]

13.53 Deloitte raised concerns that repealing the unfair preference regime would benefit larger organisations with better credit control policies and more leverage.[66] ARITA noted that large retail property landlords get daily trading data from their tenants and can see their financial performance. In contrast, most stock suppliers to that retailer would have no such insight. The landlord may be able to use this knowledge to force payments of debts while product suppliers would not be able to manage their credit exposure.[67]

13.54 The Safe Harbour Review noted that unfair preference claims significantly contribute to how liquidations are funded, which in their absence, would need to be funded by other means. That raises a question about the role of the state and the private profession in the insolvency system, what the insolvency profession should be asked to do in winding up companies, and who bears the cost of that. Hence, the Safe Harbour Review suggested that any removal or tweaking of unfair preferences requires further consideration (from a public policy and practical perspective) as to how liquidations could be funded.[68]

13.55 Associate Professor Mark Wellard observed that unfair preferences might be an appropriate topic for a comprehensive review because some of the challenges with unfair preference claims are a consequence of insolvent trading well before a liquidator is appointed:

> In my submission, our economy needs our company directors, but use of a corporate form has to be for reasonable risk-taking, not excessive or reckless incurring of debt. In my view, the disenchantment we often hear about our insolvency system, whether it's liquidator remuneration or proceeds of preference claims not getting to creditors, is caused more by the reality that many company balance sheets are leveraged into oblivion well before a liquidator arrives on the scene. In short, you cannot get something from nothing.
>
> If we want to improve returns to unsecured creditors, the prevalence of insolvent trading might be a good place to start. At the very least, in my view, it has to be front and centre in a root-and-branch review. It is an issue that, in my view, now extends beyond the mere enforcement outcomes of regulators. For financially distressed SMEs that end up in liquidation,

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65 Ms Jill Lawrence, Senior Policy Advocate, CA ANZ, *Committee Hansard*, 28 February 2023, p. 49.

66 Deloitte, *Submission 32*, p. 6.

67 ARITA, *Submission 36*, p. 54.

68 Treasury, *Review of the Insolvent Trading Safe Harbour*, 23 November 2021, p. 79.

antecedent—that is, pre-appointment insolvent trading—appears to be mainstream rather than exceptional.[69]

Committee view

13.56 The committee acknowledges the importance of the principles underlying the design of unfair preference and voidable transaction provisions—namely, to ensure that assets in a liquidation are distributed equally among the creditors and that no one creditor receives preferential treatment unless permitted by law. However, the evidence that the committee has received indicates that unfair preference provisions may not provide an overall benefit to creditors and may not provide efficient wind-up mechanisms for debtors.

13.57 The committee notes that evidence it has received suggests that the interaction of unfair preference laws and the ineffectiveness of prohibitions on insolvent trading are leading to unintended consequences. Many insolvencies are formalised so late that few assets remain for liquidation—the companies are deeply insolvent. As a result, often the funds liquidators obtain from unfair preference claims only cover the liquidator's fees and expenses. These problems are exacerbated for small companies whose narrow business and capital structures present few opportunities for restructuring.

13.58 The committee welcomes suggestions from submitters and witnesses on reforming aspects of unfair preferences claims, including (but not limited to) related entities, defences for creditors, claim periods, caps, and interactions with safe harbour provisions. The committee is particularly concerned about the interaction of the safe harbour provisions and unfair preference claims. The committee agrees that those suggestions should be considered in examining possible reforms to unfair preference provisions.

13.59 However, the committee observes that while potentially beneficial, those reforms may not address the fundamental practical problems arising from deeply insolvent liquidations. If unfair preference claims were made less onerous for creditors, liquidators' costs and fees would need an alternative funding source, or insolvencies would need to be formalised much sooner so that assets are less depleted and deep insolvencies are less common. There are significant policy, economic, and cultural challenges in finding alternative funding (as discussed in chapter 9) and in formalising insolvencies sooner to prevent deep insolvencies from occurring. However, if either of those were to be addressed, the unfair preference provisions may not present as many challenges as they do presently.

13.60 Therefore, the committee considers that there are better prospects of finding a long-term sustainable solution for unfair preference claims through the comprehensive review.

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69 Associate Professor Mark Wellard, Private capacity, *Committee Hansard*, 1 March 2023, p. 12.

Recommendation 27

13.61 The committee recommends that the comprehensive review consider unfair preferences and voidable transactions as a core aspect of potential insolvency reform.

The Badenoch (Gunns) decision

13.62 During the inquiry a High Court case made a significant alteration to the unfair preference regime. This section discusses the High Court's decision in *Bryant v Badenoch Integrated Logging Pty Ltd*[70] (Badenoch (also referred to as the Gunns decision)) and its implications, including the following areas:

- a summary of the High Court case;
- the peak indebtedness rule and continuing business relationships; and
- issues identified by participants in the inquiry.

The High Court case

13.63 The use of the peak indebtedness rule in the determination of unfair preference claims where the transactions subject to the claim may have formed part of a continuing business relationship (such as a running account) was considered by the Court in Badenoch. Significantly, the High Court established that the peak indebtedness rule does not form part of subsection 588FA(3) of the Corporations Act.[71]

13.64 Division 2 of Part 5.7B of the Corporations Act provides for the recovery of property or compensation for the benefit of creditors of an insolvent company. One such basis upon which this may take place, set out in section 588FA of the Corporations Act, is that a transaction may have been an unfair preference given by a company.

13.65 Subsection 588FA(3) refers specifically to the context of transactions forming part of a continuing business relationship. Materially, it provides that where such transactions form an integral part of this continuing business relationship, then:

- for the purposes of establishing an unfair preference, all transactions forming part of the relationship are to be considered as if they constituted a single transaction (paragraph 588FA(3)(c)); and
- the transaction may only be considered to be an unfair preference if this single transaction results in the creditor receiving more than the creditor would receive from the company in respect of the debt in the course of a winding up of the company (paragraph 588FA(3)(c) read together with paragraph 588FA(1)(b)).

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[70] *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2.

[71] *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2, pp. 7–8.

Background

13.66 Gunns Limited (in liquidation) and its wholly owned subsidiary Auspine Limited (together Gunns) conducted a timber felling business located in Tasmania, which operated sawmills and plantations across several states of Australia. The respondent, Badenoch Integrated Logging Pty Limited (Badenoch) provided logging and transport services to Gunns in accordance with an agreement which had been entered into in 2003 and renewed in 2008 for a further five-year period. Under the agreement, Badenoch supplied Gunns with a specified amount of timber per annum. In turn, Badenoch provided an invoice to Gunns at the end of each calendar month, with payment due on the last working day of the following month.[72]

13.67 Badenoch continued to supply its services to Gunns through the latter's decline in financial position, despite it receiving late or partial payments. To protect its position, Badenoch took steps such as threatening to cease supply and ceasing supply for short periods, issuing letters of demand, negotiating a payment plan, and seeking a bank guarantee. In August 2012, the agreement was terminated on the basis that Badenoch would continue to supply some services to Gunns until a new contractor could commence operation.[73]

13.68 On 25 September 2012 (the relation back day), while Badenoch was still supplying services to Gunns, liquidators were appointed to the company. After their appointment, the liquidators applied to the Court to have a series of 11 payments made by Gunns to Badenoch from 26 March to 25 September 2012 (relation back period) in connection with the agreement declared void under section 588FE of the Corporations Act (the section relating to voidable transactions).[74]

13.69 At trial, the primary judge determined that nine of the 11 payments were voidable as unfair preferences and could therefore be subject to a court order returning those payments to the company. In doing so, the judge applied the peak indebtedness rule in considering the continuing business relationship under subsection 588FA(3).[75] This matter was appealed to the Full Court of the Federal Court, which determined that the peak indebtedness rule should not have been applied. The Full Court overturned the primary judge's decision in respect of two further payments, meaning that while seven of the payments were voidable as unfair preferences, four were not.[76]

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72 *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2, pp. 11–12.

73 *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2, p. 12.

74 *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2, pp. 12–13.

75 *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2, pp. 38–40.

76 *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2, pp. 41–44.

13.70 On appeal, the High Court was asked to consider whether the so-called peak indebtedness rule is part of, or is excluded by, subsection 588FA(3) of the Act. Other questions put to the Court concerned the proper approach to determining whether a 'transaction is, for commercial purposes, an integral part of a continuing business relationship' as referred to in paragraph 588FA(3)(a); and whether certain payments in this case fell within the meaning of a 'continuing business relationship' for the purposes of paragraph 588FA(3)(a). The High Court delivered a unanimous decision on 8 February 2023. The substantive decision was delivered by Justice Jagot.[77]

The peak indebtedness rule and continuing business relationships

13.71 The peak indebtedness rule previously allowed a liquidator to choose the starting date within the relevantly prescribed statutory period,[78] to prove the existence of an unfair preference given by the company to a creditor.[79] In Badenoch the Court described the peak indebtedness rule, originally sourced in the judgment of Chief Justice Barwick in *Rees v Bank of New South Wales*,[80] as follows:

> The rule, if it may be called such, merely reflects that a liquidator discharging their functions and powers under ss 477 and 478 of the Corporations Act to collect the assets of a company in liquidation would seek to identify any unfair preference in the prescribed period ending on the relation-back day in the context of a running account by comparing the position at the end of that period with the position at the point of peak indebtedness; the effect of so doing will be to maximise both the likelihood of ascertaining an unfair preference and the amount of any unfair preference.[81]

13.72 Having regard to the Explanatory Memorandum and relevant case law, the High Court articulated that in incorporating the running account principle, for which subsection 588FA(3) is the statutory embodiment, it cannot be assumed or inferred that the legislature also intended to incorporate the peak indebtedness rule in that provision.[82] It further stated that where courts had concluded that the peak indebtedness rule is to be read into subsection 588FA(3), they had:

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77 *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2, pp. 9–11.

78 Pursuant to subsection 588FE(2), the prescribed statutory period on this case was six months from the relation-back date.

79 *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2, p. 9.

80 *Rees v Bank of New South Wales* (1964) 111 CLR 210.

81 *Bryant v Badenoch Integrated Logging Pty Ltd*, [2023] HCA 2, p. 57.

82 *Bryant v Badenoch Integrated Logging Pty Ltd*, [2023] HCA 2, p. 45.

…wrongly assumed that the 'running account principle' included the 'peak indebtedness rule', did not involve full argument on or reasoning about the issue, or must now be considered to be wrong in that respect.[83]

13.73 The High Court reasoned that the peak indebtedness rule would not serve the purpose of Pt 5.7B of the Act, which is to ensure equality of distribution amongst creditors of the same class.[84] It stated:

> The purpose of the 'running account principle' is not to maximise the potential for the claw back of money and assets from a creditor, but that is the effect of the 'peak indebtedness rule'. The 'running account principle' recognises that a creditor who continues to supply a company on a running account in circumstances of suspected or potential insolvency enables the company to continue to trade to the likely benefit of all creditors. The prescription of periods within which all transactions in a continuing business relationship are deemed to be a 'single transaction' and, accordingly, may be netted off against each other to determine any unfair preference serves this purpose.[85]

13.74 Instead, in order to determine whether an unfair preference has been given in this context, liquidators must consider all transactions relevant to the continuing business relationship during the time period in order to determine whether the ultimate effect is that the debt owed by the company has increased or decreased.[86]

13.75 In respect of the second question put before it, the Court held that answering the statutory question under subsection 588FA(3)(a) of whether a transaction is, for commercial purposes, an integral part of a continuing business relationship is 'one of characterisation of the facts involving an objective ascertainment, on the whole of the evidence, of the business character (for commercial purposes) of the transaction in issue'.[87] The Court agreed with the Full Court's position that the first four of the 11 payments could be properly considered as forming an integral part of the continuing business relationship, and upheld the unfair preference claim against the remaining seven.[88]

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83 *Bryant v Badenoch Integrated Logging Pty Ltd*, [2023] HCA 2, p. 76.

84 *Bryant v Badenoch Integrated Logging Pty Ltd*, [2023] HCA 2, p. 68.

85 *Bryant v Badenoch Integrated Logging Pty Ltd*, [2023] HCA 2, p. 70.

86 *Bryant v Badenoch Integrated Logging Pty Ltd*, [2023] HCA 2, p. 57.

87 *Bryant v Badenoch Integrated Logging Pty Ltd*, [2023] HCA 2, p. 85.

88 *Bryant v Badenoch Integrated Logging Pty Ltd*, [2023] HCA 2, pp. 7–8.

Potential implications for running account versus one-off supply

13.76 Associate Professor Mark Wellard identified some implications of the High Court's decision for continuing business relationships (using the running account principle) versus one-off supply relationships. The following paragraphs summarise these possible implications.

13.77 To determine whether an unfair preference may exist under a continuing business relationship, it is necessary to find the net preference by comparing the level of indebtedness at a starting point with a level of indebtedness at the endpoint (the relation-back day). Prior to the High Court's decision, liquidators used the time of peak indebtedness as the starting point. Associate Professor Wellard observed that now that the High Court has removed the peak-indebtedness rule, the relevant starting point for assessing unfair preference claims in a continuing business relationship is the later of:

- the start of the six-month period before the relation-back day; or
- the beginning of the continuing business relationship.[89]

13.78 Associate Professor Wellard explored the potential implications of the High Court's decision through three hypothetical scenarios. Firstly, under Scenario A (see Figure 13.2), the potential unfair preference was $40,000 before the High Court's decision and now would be $10,000. Hence, the High Court's decision means that fewer continuing business relationship transactions will be subject to unfair preference claims by liquidators. All the scenarios discussed here assume that the supplier creditor is not a related entity and is not able to use defences for voidable transactions.[90]

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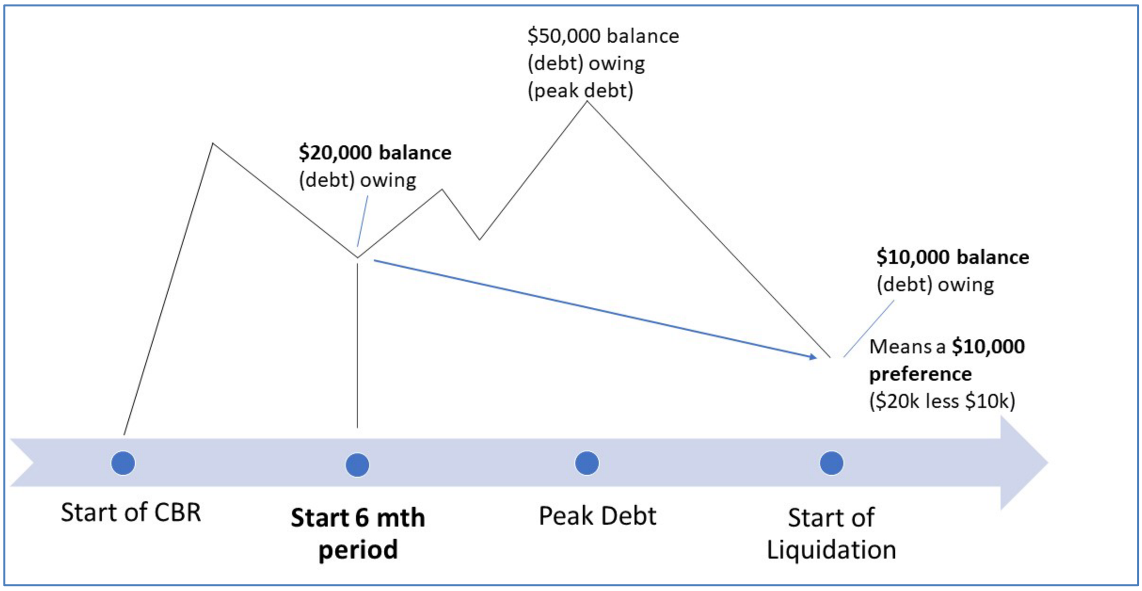
[89] Associate Professor Mark Wellard, The High Court's decision in *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2, The decision, anomalies and policy considerations, additional information, 23 March 2023, pp. 1–6; Associate Professor Mark Wellard, Academic Member, SCoLA, *Committee Briefing Hansard*, 23 March 2023, additional information, pp. 1–2.

[90] Associate Professor Mark Wellard, The High Court's decision in *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2, The decision, anomalies and policy considerations, additional information, 23 March 2023, pp. 1–10 and reference therein to pages 58 and 77 of the decision; Associate Professor Mark Wellard, Academic Member, SCoLA, *Committee Briefing Hansard*, 23 March 2023, additional information, pp. 1–3.

Figure 13.2 Scenario A: continuing business relationship starting before the start of the six-month period



Source: Associate Professor Mark Wellard, The High Court's decision in Bryant v Badenoch Integrated Logging Pty Ltd [2023] HCA 2, The decision, anomalies and policy considerations, additional information, 23 March 2023, p. 4.

13.79 Secondly, Scenario B (see Figure 13.3) shows a continuing business relationship beginning after the start of the six-month period. Before the High Court's decision, the peak indebtedness rule could identify a potential unfair preference of $50,000. Associate Professor Wellard observed that in the absence of the peak indebtedness rule if the start of the continuing business relationship was used, the debt at that time would be zero. Hence, there may be zero transactions subject to unfair preference claims. Therefore, a supplier creditor in Scenario B may have fewer unfair preference claims than a supplier creditor in Scenario A.[91]

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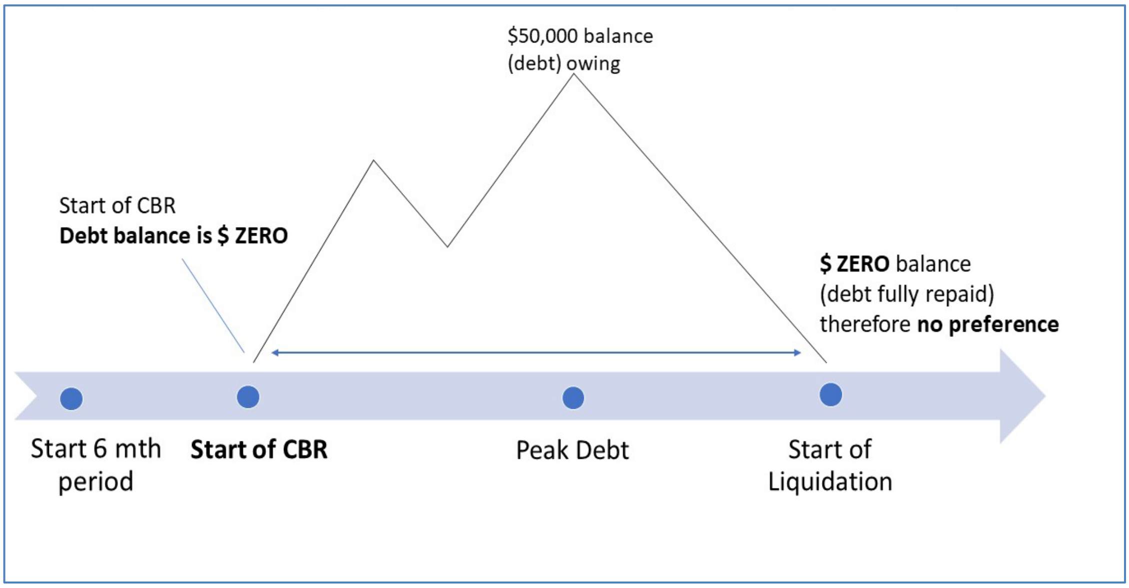
[91] Associate Professor Mark Wellard, The High Court's decision in *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2, The decision, anomalies and policy considerations, additional information, 23 March 2023, pp. 1–10 and reference therein to pages 58 and 77 of the decision; Associate Professor Mark Wellard, Academic Member, SCoLA, *Committee Briefing Hansard*, 23 March 2023, additional information, pp. 1–3.

Figure 13.3 Scenario B: continuing business relationship starting after the start of the six-month period



Source: Associate Professor Mark Wellard, The High Court's decision in Bryant v Badenoch Integrated Logging Pty Ltd [2023] HCA 2, The decision, anomalies and policy considerations, additional information, 23 March 2023, p. 7.

13.80 Thirdly, Scenario C (see Figure 13.4) sets out a one-off supply and repayment relationship, beginning after the start of the six-month period. Associate Professor Wellard observed that there is no continuing business relationship in this scenario, so the running account principle does not apply, and the whole transaction may be subject to an unfair preference claim by a liquidator. While considering that it is helpful to incentivise suppliers to operate a running account to support the customer through tough times, Associate Professor Wellard suggested further reform may be required to simplify the law and improve efficiency, noting that:

> So we do have, in my view, a serious question as to whether there is a new anomaly and a situation where we are now treating two creditors differently. In fact, the continuing business relationship principle now is not simply levelling the field by giving you that netting arrangement; it is actually putting you in a better position than the one-off supplier.
>
> Whichever way you choose the starting point, you're going to end up with anomalies; that's the takeaway point. I'm very sympathetic to the view taken by the court that the peak debt rule, or the language of the provision, is not justified or sustained. But whichever starting point you choose, you're going to end up with, in my view, some anomalies.[92]

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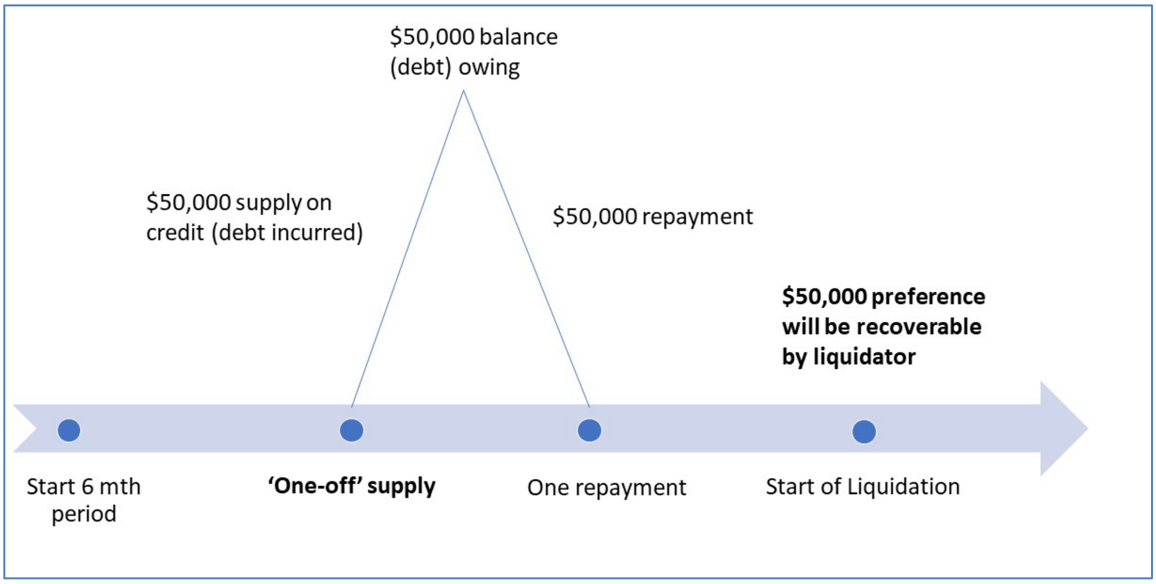
92 Associate Professor Mark Wellard, Academic Member, SCoLA, *Committee Briefing Hansard*, 23 March 2023, additional information, pp. 3–4, 8–9; Associate Professor Mark Wellard, The High Court's decision in *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2, The decision, anomalies and policy considerations, additional information, 23 March 2023, pp. 1–10.

Figure 13.4 Scenario C: one-off supplier and repayment starting during the six-month period



Source: Associate Professor Mark Wellard, The High Court's decision in Bryant v Badenoch Integrated Logging Pty Ltd [2023] HCA 2, The decision, anomalies and policy considerations, additional information, 23 March 2023, p. 8.

13.81 Mrs Robyn Erskine, Director of INSOL International, welcomed the High Court's decision and acknowledged the issues raised by Associate Professor Wellard. Mrs Erskine indicated that it may take some time to step back, digest the decision, and find a simpler way forward that stakeholders are comfortable with. Mrs Erskine stated that:

> I've always felt that the peak indebtedness rule was arbitrary and unfair, and this decision rights something that had grown up over a period of time. I think, if we all put our hands on our hearts and said, 'Did we really understand where the peak indebtedness rule came from?' there'd not be many people who could actually do that. So, to me, it's a good decision.[93]

13.82 Mrs Erskine also noted the importance of incentivising creditors to continue supplying goods and services and that unfair preferences can be a disincentive if creditors are concerned about a customer's viability. Commenting on calls to remove the unfair preference regime to enhance such incentives, Mrs Erskine noted that the unfair preference regime provides a more level field for creditors and commented that without an unfair preference regime:

> …you're going to have the consequence of the survival of the fittest. You're going to have the creditors that are savvy and have the resources, financially, to be able to engage the best lawyers in town, and they will get

93 Mrs Robyn Erskine, Director, INSOL International, *Committee Briefing Hansard*, 23 March 2023, additional information, pp. 5, 8.

> their money, and the other creditors who are less sophisticated and don't have the resources will be left behind. They won't get paid.[94]

13.83 Associate Professor Anil Hargoven suggested that a comprehensive review may need to consider whether the *pari passu* principle on the equal treatment of creditors remains a foremost policy principle in insolvency. The *pari passu* principle significantly influences the choices on reform options for unfair preferences, and it may not always align with practice. Associate Professor Hargovan indicated that some options for unfair preference reform following the High Court's decision might include:

- retaining the status quo following the High Court's decision, but with fine-tuning to reflect the US approach, which incentivises creditors and removes the need to consider each transaction;
- the much simpler automatic avoidance scheme, which takes a stricter approach and automatically captures all transactions within a shorter period as unfair preferences; or
- a concession scheme with minimum preference thresholds.[95]

Comments by other submitters and witnesses

13.84 Several submitters and witnesses commented on the Badenoch case and its implications for unfair preference laws.[96]

13.85 BlueRock (a multidisciplinary professional services firm), referring to the Full Federal Court's decision[97] (before the High Court had decided), indicated that it considered the removal of the peak indebtedness rule to be:

> …undesirable to the industry, as the trade creditors with those continuing business relationships are exactly the type of creditors that an unscrupulous director would choose to preference with a view to maintaining a business relationship subsequent to a liquidation. Regardless of the way the High Court decides the appeal, this rule should be codified.[98]

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94 Mrs Robin Erskine, Director, INSOL International, *Committee Briefing Hansard*, 23 March 2023, additional information, p. 5; see also Professor Anil Hargovan, Executive Member, SCoLA, *Committee Briefing Hansard*, 23 March 2023, additional information, p. 8; Associate Professor Mark Wellard, Academic Member, SCoLA, *Committee Briefing Hansard*, 23 March 2023, additional information, p. 8.

95 Associate Professor Anil Hargovan, Executive Member, SCoLA, *Committee Briefing Hansard*, 23 March 2023, additional information, pp. 7–8, 9.

96 BlueRock, *Submission 8*, p. 4; Turnaround Management Association Australia, *Submission 38*, p. 20; Commercial Bar Association of Victoria, *Submission 43*, p. 4; Mr Michael Brennan, Liquidator and Bankruptcy Trustee, Offermans, *Committee Hansard*, 21 February 2023, p. 43; ACF, *answers to questions on notice*, 21 February 2023 (received 21 March 2023), p. 11.

97 *Badenoch Integrated Logging Pty Ltd v Bryant, in the matter of Gunns Limited (In Liq) (receivers and managers appointed)* [2021] FCAFC 64.

98 BlueRock, *Submission 8*, p. 4.

13.86 In contrast, Mr Michael Brennan from Offermans welcomed the clarity provided by the High Court's decision and noted that:

> I can see there was a real imbalance there. Liquidators could pick the most advantageous peak indebtedness. From my understanding of that case, that will mean that liquidators, for any claim to be brought, will have to be able to show that there was a real preferential effect of the transaction, taking into account the credits and debits through the relation back period.[99]

13.87 ACF also welcomed the High Court's decision and indicated that it now expects the number of preference claims to be reduced and that there will be greater consideration of the trading relationship by insolvency practitioners.[100]

Committee view

13.88 The committee observes that the High Court's decision in the Badenoch case is a significant development in the law for unfair preference claims. The removal of the peak indebtedness rule provides clarity on the future operation of the running account principle. The committee notes Associate Professor Wellard's observations that the High Court's decision may identify other areas for reform in striking an appropriate balance on unfair preference claims between one-off and continuing business relationships. The committee welcomes suggestions by Mrs Erskine and Associate Professor Hargovan that the High Court's decision and its implications may require some time to reflect on and digest. The committee considers that it would be appropriate to consider any further reform of the running account principle for unfair preferences as part of a comprehensive review.

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[99] Mr Michael Brennan, Liquidator and Bankruptcy Trustee, Offermans, *Committee Hansard*, 21 February 2023, p. 43.

[100] ACF, *answers to questions on notice*, 21 February 2023 (received 21 March 2023), p. 11.

Chapter 14
Property held in trust

14.1 The treatment of trusts in insolvency has 'long been identified as an area for improvement with historical calls for reform'[1] including by the Harmer Report. However, reform in this area has been limited and no dedicated statutory regime has been enacted to regulate trusts. Despite this, company structure has increased in popularity and usage, making the complexities, inconsistencies and expense created by the absence of a dedicated statutory regime more obvious, particularly in the context of insolvency.

14.2 Inquiry participants made clear that a broader regime of trust law reform is required, particularly in respect of insolvency, which could be the subject of consideration in a comprehensive review. However, the committee was informed that there may be certain issues that could be dealt with in the more immediate future.

14.3 This chapter will outline the manner in which trusts currently operate and are regulated in Australia, particularly in the context of corporate insolvency. It will then consider the various calls for reform and make recommendations about future steps.

Trusts in the Australian economy

14.4 In the trust structure, ownership of any trust assets are split: the trustee retains the legal interest, which allows them to deal with trust property in accordance with the terms of the trust deed in the interests of the beneficiary/ies, who hold the beneficial or equitable interest.[2] This structure delivers some asset protection and tax benefits,[3] while installing a corporate entity in the position of trustee which confers the benefit of limited liability.[4] The trust structure creates two distinct economic entities, being the trustee and the trust, but under the law, the trust itself does not have legal personality separate from that of the trustee.

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1 Business Law Section, Law Council of Australia (BLS LCA), *Submission 30*, p. 35.

2 Mr Michael Murray and Professor Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice*, Eleventh Edition, Thomas Reuters, July 2022, p. 551.

3 Mr Michael Brereton, President, Australian Restructuring Insolvency and Turnaround Association (ARITA), *Committee Hansard*, 14 December 2022, p. 12; Mr Richard Fisher, Consultant, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 18.

4 Mr Fisher, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 18.

14.5 In 1988, the Harmer Review noted that trading trusts had 'become a popular device for conducting trade and commerce in Australia'.[5] More than 30 years later, the committee was told that trading trusts remain 'a popular and ubiquitous feature of Australian commercial life, including as a useful alternative to the *Corporations Act* company'.[6]

14.6 Statistics presented to the committee illustrate the representation of trusts across the economy. The Australian Small Business and Family Enterprise Ombudsman (ASBFEO), for example, told the committee that of the 2.5 million actively trading enterprises in Australia, about 950,000 are incorporated, meaning that the vast majority of enterprises are alternatively structured, including through trading trusts.[7] Dr Nuncio D'Angelo pointed to data from the Australian Taxation Office (ATO), Australian Securities and Investments Commission (ASIC) and the ASX that demonstrates the prevalence of trusts in Australia:

> …the ATO's most recent published annual figures—those for 2019-20—show that tax returns were lodged by over 927,000 trusts, having total assets of almost $2.2 trillion, total liabilities of over $1.4 trillion, and total annual business income of almost $400 billion. According to ASIC data, there are some 3,650 registered managed investment schemes, many if not most of which will be structured as unit trusts with a corporate trustee. This does not include the many commercial unit trusts that are not required to be registered with ASIC. Finally, turning to the ASX, at the end of last year the market capitalisation of listed real estate investment trusts was $137 billion, and of listed infrastructure trusts just over $62 billion.[8]

Previous consideration of trusts in insolvency law

The Harmer Report

14.7 In 1988, the Harmer Report identified a need for clarification in the existing law to provide more certainty in relation to corporate trading trusts in insolvencies and made 10 recommendations in this respect. These recommendations relate to the following broad themes:

- administration of the business and affairs of an insolvent corporate trustee;[9]

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5 Australian Law Reform Commission (ALRC), *General Insolvency Inquiry*, Report No 45, Vol 1, 1988, p. 108.

6 Dr Nuncio D'Angelo, Private capacity, *Committee Hansard*, 28 February 2023, p. 52. See, for example, Mr Michael Brereton, President, Australian Restructuring Insolvency and Turnaround Association (ARITA), *Committee Hansard*, 14 December 2022, p. 12; Mr Fisher, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 18.

7 The Hon Bruce Billson, Ombudsman, Australian Small Business and Family Enterprise Ombudsman (ASBFEO), *Committee Hansard*, 13 December 2022, pp. 27–28.

8 Dr Nuncio D'Angelo, *Committee Hansard*, 28 February 2023, p. 52.

9 ALRC, *General Insolvency Inquiry*, Report No 45, Vol 1, 1988, 109–110.

- power to deal with property;[10]
- limitations on the right to indemnity;[11]
- removal of the company as trustee;[12]
- exercise of the right of indemnity;[13]
- distribution of proceeds among trust creditors;[14] and
- extended application of the trust provisions.[15]

14.8 The Harmer Report emphasised that 'the principles for winding up an insolvent non-trustee company should apply to an insolvent corporate trustee yet at the same time maintain consistency with the general principles of trust law'.[16]

14.9 Evidence to the committee (as discussed further below) suggests that some thirty-five years later, the Harmer Report's recommendations in respect of insolvent corporate trustees have not been implemented.[17] No clear reasoning for this inaction was provided to the committee.

Treasury consultation – October 2021

14.10 Clarifying the treatment of trusts in insolvency law was the subject of a Department of the Treasury (Treasury) consultation process in 2021.[18] A consultation paper was published on 15 October 2021, which called for submissions by 10 December 2021 to consider:

- whether the treatment of corporate trusts in insolvency law required clarification;
- the benefits of such reform; and
- the most appropriate way to extend Australia's statutory insolvency regime to these entities.[19]

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10 ALRC, *General Insolvency Inquiry*, Report No 45, Vol 1, 1988, 110–111.

11 ALRC, *General Insolvency Inquiry*, Report No 45, Vol 1, 1988, 111–113.

12 ALRC, *General Insolvency Inquiry*, Report No 45, Vol 1, 1988, 113–114.

13 ALRC, *General Insolvency Inquiry*, Report No 45, Vol 1, 1988, 115.

14 ALRC, *General Insolvency Inquiry*, Report No 45, Vol 1, 1988, 116–118.

15 ALRC, *General Insolvency Inquiry*, Report No 45, Vol 1, 1988, 119–120.

16 ALRC, *General Insolvency Inquiry*, Report No 45, Vol 1, 1988, p. 108.

17 MinterEllison, *Submission 4*, p. 1; Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 53; Drs Garry Hamilton and David Morrison, *Submission 5*, p. 1.

18 Department of the Treasury (Treasury), *Clarifying the treatment of trusts under insolvency law*, https://treasury.gov.au/consultation/c2021-212341.

19 Treasury, *Clarifying the treatment of trusts under insolvency law*, Consultation paper, 15 October 2021, p. 2.

14.11 Table 14.1 below sets out the 14 consultation questions that were put forward for discussion in the consultation paper.

Table 14.1 Questions arising out of Treasury consultation paper on trusts, 15 October 2021

- Question 1: Should the corporate insolvency framework be amended so that it expressly provides for the external administration of insolvent trusts with a corporate trustee? If so, what external administration processes should the amendments apply to?
- Question 2: What benefits would a legislative framework deliver?
- Question 3: Is there potential for detrimental or unforeseen impacts if the statutory regime is extended?
- Question 4: Should legislation expressly set out when a trust is deemed to be insolvent?
- Question 5: What is the most appropriate way to prescribe when a trust is taken to be insolvent?
- Question 6: Should the power of an insolvency practitioner to administer the trust assets and liabilities be expressly provided for in legislation?
- Question 7: Should the law provide that, subject to a contrary order by a court, the same insolvency practitioner may administer both the company, and the assets and liabilities attributable to any trusts for which the company is trustee?
- Question 8: Should the affairs of a trustee company and each trust it administers be resolved separately in external administration?
- Question 9: Should there be a statutory order of priority in the winding up of a trust?
- Question 10: Should a statutory order of priority replicate the regime for companies? Do additional factors need to be considered where a corporate trust structure is involved?
- Question 11: Should there be additional limits on the enforceability of ejection clauses and/or clauses that seek to limit a trustee’s right to indemnity, in situations involving insolvency or external administration?
- Question 12: What would be the impacts of any such limits?
- Question 13: Are there any other issues that need to be considered in light of the questions above?
- Question 14: What is the most appropriate model by which a statutory regime could be expressed in the legislation?

Source: Treasury, Clarifying the treatment of trusts under insolvency law, 15 October 2021, pp. 5–7.

14.12 The consultation process received 29 submissions, including four confidential submissions. To the committee's knowledge, no further public discussion took place in relation to this consultation prior to the end of the 46th Parliament. Treasury told the committee that the government is currently awaiting the outcome of this inquiry before taking any further action.[20]

Regulation of trusts in insolvency

14.13 The absence of clarity around the regulation of trusts, particularly in the context of insolvency, was raised as an ongoing issue and a cause of time inefficiency, complexity, and expense.[21]

14.14 Doctor's Garry Hamilton and David Morrison highlighted the impact of the failure to adopt the recommendations of the Harmer Review. They stated:

> More than three decades have now passed since the Harmer Report and the inattention to the matters originally raised by it has resulted in the continuing problems confronting practitioners and the courts. It is important that amendments are made because the problem is ongoing, and it is imposing unnecessary costs.[22]

14.15 A number of inquiry participants, including Professor Harris and Mr Murray[23] and the Society of Corporate Law Academics (SCoLA)[24] endorsed the recommendations of the Harmer Review with respect to insolvency in trusts. The Business Law Section of the Law Council of Australia (BLS LCA) and the Australian Restructuring Insolvency and Turnaround Association (ARITA) shared this view, endorsing the recommendations with a few amendments to address intervening events.[25]

14.16 As to trusts generally, Dr Nuncio D'Angelo told the committee that despite the prevalence of trusts across the economy, 'the law does not fully recognise them as commercial entities and does not properly protect people who invest in or do business with them'.[26] Dr D'Angelo said that 'nowhere is this [absence of regulation] more obvious than when it comes to insolvency'.[27]

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20 Mr Tom Dickson, Assistant Secretary, Corporations, Department of the Treasury (Treasury), *Committee Hansard*, 13 December 2022.

21 Mr Dickson, Treasury, *Committee Hansard*, 13 December 2022, p. 5; Drs Garry Hamilton and David Morrison, *Submission 5*, p. 5; Australian Institute of Credit Management (AICM), *Submission 9*, p. 5; Association of Independent Insolvency Practitioners (AIIP), *Submission 20*, p. 9.

22 Dr Garry Hamilton and Dr David Morrison, *Submission 5*, p. 5.

23 Professor Jason Harris and Mr Michael Murray, *Submission 18*, p. 11.

24 Society of Corporate Law Academics (SCoLA), *Submission 37*, p. 4.

25 BLS LCA, *Submission 30*, p. 35; ARITA, *Submission 36*, p. 57.

26 Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 52.

27 Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 52.

14.17 Dr D'Angelo explained that there is no dedicated statutory regime that protects stakeholders' rights or informs the allocation of assets when trusts become insolvent. In the absence of such a regime, insolvent trusts must be dealt with through the insolvency of the trustee, be it through the *Bankruptcy Act 1966* for natural persons or the *Corporations Act 2001* (Corporations Act) for companies.[28] Dr D'Angelo said that provisions in both regimes are being applied to trust insolvencies despite the fact that they were never designed to deal with trusts:

> As a result, insolvency officials have to apply an overlay of trust law principles to work out parties' rights and the appropriate allocation of assets and losses. This is a somewhat slippery and perilous task. Those principles are mostly case law rather than statutory and are quite ancient, developed by the courts at a time when trusts did not engage in commerce or become insolvent as they do today.[29]

14.18 Dr D'Angelo said that 'trust law itself can be quite complex, arcane and opaque', leading to 'copious litigation' which has 'forced the courts to fill the statutory vacuum by developing, in the usual stuttering, piecemeal fashion, a sort of common law of insolvency for trusts'.[30] Dr D'Angelo added that the process by which a body of common law is developed 'is slow and painstaking, and occasionally misfires'.[31] He explained that 'it is not a directed process and is not necessarily policy-based…it is essentially backward-looking and conservative'.

14.19 Dr D'Angelo said that as a result of the absence of a statutory framework with respect to trusts in insolvency, outcomes have arisen 'that are baffling and inconsistent with what would have been the result of the insolvent entity being a company'.[32] He submitted that this has also led to inconsistent decisions in different jurisdictions as '[c]ourts across the nation, at both state and federal level, have handed down conflicting decisions on various questions'.[33] As a result, Dr D'Angelo explained, '[t]he market is left in a state of ongoing uncertainty[34] and concluded that 'it is simply not appropriate to leave the resolution of the many complex issues in the insolvency of trusts to a process that is so slow, random and uncertain'.[35]

14.20 A similar sentiment was expressed by Drs Hamilton and Morrison who posited that legislative intervention is necessary to establish the framework to address

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28 Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 52.

29 Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 53.

30 Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 53.

31 Dr Nuncio D'Angelo, *Supplementary Submission 19.1*, p. 3.

32 Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 53.

33 Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 53.

34 Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 53.

35 Dr Nuncio D'Angelo, *Supplementary Submission 19.1*, p. 3.

existing issues: no one case is likely to touch on all issues to allow for judicial interpretation and thus the creation of a comprehensive body of law to deal with the issues that arise.[36]

14.21 The Hon Reginald Barrett AO provided the committee with his submission to the 2021 Treasury consultation process. Judge Barrett identified that the High Court's decision in *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth*[37] (*Carter Holt*) 'resolved some important issues about cases in which an insolvent company's activities are confined to trusteeship of a single trading trust', however, 'other uncertainties remain'.[38] One such uncertainty, which Judge Barrett noted was raised in the *Carter Holt* decision itself, is in relation to 'complications that may arise in cases where a corporate trustee has carried on business as trustee of more than one trust or as trustee of a trust and on its own account'. He explained:

> At [56] [of the Court's judgment in *Carter Holt*] it is noted that questions might arise about the correct order of priority between trust creditors after payment of the priority debts or about the marshalling of claims where a creditor has access to more than one fund…

14.22 Echoing the sentiment expressed by Drs D'Angelo, Hamilton and Morrison, Judge Barrett asserted that '[s]uch difficulties and doubts cannot be left to random and piecemeal resolution as particular controversies are litigated at final appeal level'. He added:

> Inconsistent views often emerge in court decisions. Two generations of lawyers pored over the uncertainty generated by the fundamentally conflicting 1983 decisions of intermediate appellate courts in *Re Enhill Pty Ltd* [1983] 1 VR 561 and *Re Suco Gold Pty Ltd (1983) 33 SASR 99* until the matter was taken in hand by the High Court in *Carter Holt*.
>
> Nor is it satisfactory that passing observations of judges not central to courts' decisions should be the source of necessarily speculative views as to what the law might be.
>
> Because the trading trust structure, with a company as trustee, has long been entrenched in Australian commercial life, liquidators, creditors, and others interested in the orderly administration of insolvent corporate trustees should be given by legislation the certainty and confidence that the current legal environment denies them.[39]

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36 Drs Garry Hamilton and David Morrison, *Submission 5*, p. 1. See also, Dr Nuncio D'Angelo, answers to questions on notice, 28 February 2023 (received 21 March 2023), pp. 2–3.

37 *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth* (2019) 268 CLR 524.

38 The Hon Reginald Barrett AO, *Submission 72*, p. 1.

39 The Hon Reginald Barrett AO, *Submission 72*, p. 1.

14.23 It was noted during the inquiry that at present, the power to legislate with respect to trusts is vested in the states.[40] Therefore, in order to enact legislation in this space, the Commonwealth may need to seek a referral of the relevant powers from the States. Dr D'Angelo identified that the Corporations Act, which includes provisions that regulate managed investment schemes (which are configured as trusts with a corporate trustee), 'was enacted and operates with the benefit of State referrals of power'.[41]

14.24 Dr D'Angelo told the committee that in his view, a great deal of the market and the profession supports legislative reform that would see trusts treated as companies. He explained:

> The premise here is you have two entities that behave in the same way, do all the same things and put people at risk in the same way. There's no policy reason why those risks should be addressed any differently, simply because the parties have chosen one vehicle over another. The only reason we have that difference is a historical overhang—that is, parliament hasn't caught up to the fact that these entities are being used as if they were companies…there's no sensible, at least in my mind, policy reason why investors and creditors of companies should be treated any differently to trusts, when they both engage in the same risk-taking, profit-making activities.[42]

Proposals for legislative reform

14.25 Dr D'Angelo put to the committee that 'the overwhelming preponderance of opinion' appears to support legislative reform to address these issues by modifying the Corporations Act. He observed that there is no support for a standalone 'Insolvency of Trusts Act' nor a shorthand 'deeming' of trusts to be companies.[43]

14.26 Dr D'Angelo supported amendments to the Corporations Act that would seek to ensure that:

> …in insolvency, commercial trusts and their stakeholders are dealt with in a manner that reflects the treatment of companies and their stakeholders, insofar as legally possible given their legal and structural differences.[44]

14.27 Such legislative reform could either:

(a) amend relevant specific parts of the *Corporations Act* individually so that they have 'dual operation' with respect to companies and relevant trusts; or

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40 Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 54; Dr Nuncio D'Angelo, *Supplementary Submission 19.1*, p. 4; Drs Garry Hamilton and David Morrison, *Submission 5*, p. 8, Schedule A.

41 Dr Nuncio D'Angelo, *Supplementary Submission 19.1*, p. 4.

42 Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 54. See also, Mr Stephen Golledge SC, *Submission 6*, p. 4; AICM, *Submission 9*, p. 5.

43 Dr Nuncio D'Angelo, *Supplementary Submission 19.1*, p. 7.

44 Dr Nuncio D'Angelo, *Supplementary Submission 19.1*, p. 7.

(b) consolidate all the necessary provisions into a new Chapter (say, a new Chapter 5AA Dealings with Relevant Trusts and their External Administration) that contains all the provisions needed for dealing expressly with relevant trusts.[45]

14.28 Three possibilities for legislative reform were provided to the committee. Firstly, draft legislation was submitted by Drs Garry Hamilton and David Morrison which would be inserted into Chapter 5 of the *Corporations Act*.[46] This proposal would legislate for (among other things):

- the winding up of an insolvent corporate trustee that has traded in its trustee capacity only;[47]
- the winding up of an insolvent corporate trustee that has traded in capacities other than a trust of a single trading trust;[48]
- the administration of the affairs of a corporate trustee.[49]

14.29 Drs Hamilton and Morrison's draft legislation also suggests provisions to be inserted in the relevant state and territory Acts that would provide for the conferral of the relevant powers to the Commonwealth.[50]

14.30 Secondly, Judge Barrett provided an indicative outline of core provisions of a legislative regime for dealing with trusts in insolvency.[51] In Judge Barrett's view, under such a statutory regime:

> …the estate of the company in its own right and the estate (or estates) of the company as trustee are administered separately but concurrently by a single and adequately empowered liquidator, with the assets and liabilities applicable to each such estate being dealt with in the way contemplated by the *Corporations Act* (including as to order of application of assets) as if the separate estate were itself a company. The regime should be constructed around the basic principle that the company is liable for all debts, including those incurred as trustee, but with a right of indemnity out of trust property for the debts properly incurred as trustee, which debts are to be met out of the trust property until that property is exhausted and thereafter out of non-trust property.[52]

14.31 Thirdly, Dr D'Angelo recommended the insertion of a new Chapter 5AA into the Corporations Act entitled *Dealings with Relevant Trusts and their External*

45 Dr Nuncio D'Angelo, *Supplementary Submission 19.1*, p. 7.

46 Drs Garry Hamilton and David Morrison, *Submission 5*, pp. 8-20.

47 Drs Garry Hamilton and David Morrison, *Submission 5*, p. 5.

48 Drs Garry Hamilton and David Morrison, *Submission 5*, p. 11, Schedule B.

49 Drs Garry Hamilton and David Morrison, *Submission 5*, p. 17, Schedule D.

50 Drs Garry Hamilton and David Morrison, *Submission 5*, p. 19, Schedule E.

51 Drs Garry Hamilton and David Morrison, *Submission 5*, pp. 2-6.

52 Drs Garry Hamilton and David Morrison, *Submission 5*, p. 5.

Administration and provided the committee with a framework.[53] The primary objective of the framework is to:

> equate or align, as far as legally possible, the legal risks and outcomes in insolvency faced by arm's length parties who do business with trustees of commercial trusts, with those of parties who deal with Corporations Act companies acting in their own right, but without otherwise interfering with the essential nature of the trust or the many benefits that accrue to those who use and deal with them as business vehicles.[54]

14.32 Dr D'Angelo said that the overall objective of his proposed legislative reform is underpinned by the following themes:

> (a) in Australia, trusts operate as unincorporated business entities and, in that form, can and do engage in the same commercial activities as *Corporations Act* companies, and on a very substantial scale across the economy;
>
> (b) arm's length parties who conduct business with trusts face all the same risks as those who deal with companies (including the risk of their insolvency), plus a range of additional legal risks unique to the trust form;
>
> (c) legal and other risks faced by those dealing with companies, both at the frontend (ie at the time of dealing) and at the back-end (ie in insolvency), are managed and ordered by sophisticated legislation that reflects prevailing socioeconomic and political philosophies and policy positions, while risks faced by those dealing with trusts are not;
>
> (d) there is no obvious policy reason why this should be so, and (to my knowledge) there has never been a deliberate executive or legislative determination that it should be so. The difference can only be explained by regulatory lag, an unintended consequence of the rapid growth in use of the trust as an unincorporated business vehicle in recent decades;
>
> (e) in my view, the primary objective of any reform should be to equate or align, as far as legally possible, the legal risks and outcomes in insolvency faced by arm's length parties who deal with trustees of commercial trusts with those of parties who deal with *Corporations Act* companies acting in their own right, but without otherwise interfering with the essential nature of the trust or the many benefits that accrue to those who use and deal with them as business vehicles.

14.33 Dr D'Angelo identified two significant considerations that would need to be kept in mind in undertaking any regime of reform. The first relates to concerns from critics of such reform that argue that 'trusts are different animals and shouldn't be treated like companies'.[55] In response to this Dr D'Angelo emphasised that in any legislative reform, the benefits of the trust structure

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53 Dr Nuncio D'Angelo, *Supplementary Submission 19.1*, Schedule, pp. 10-18.

54 Dr Nuncio D'Angelo, *Supplementary Submission 19.1*, p. 2.

55 Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 55.

should not be interfered with.[56] Dr D'Angelo explained that trusts 'have valuable benefits, and we don't want to interfere with those…No one wants to annihilate the benefits that trusts deliver…particularly in structural flexibility.'[57]

14.34 Secondly, Dr D'Angelo stressed that any reform would have to be cognisant of the two different types of trustees, being both natural persons and corporate trustees. Dr D'Angelo highlighted to the committee that while legislative reform concerning trusts with corporate trustees could be carried out by changes to the Corporations Act, such an action 'would not be appropriate for trusts with a natural person as a trustee'.[58] Dr D'Angelo added, '[o]f course, if recommendations to merge the two regimes are adopted (with appropriate State referrals), the constitutional issues in the distinction would be dealt with in that process'.[59]

14.35 Other inquiry participants shared similar views. For example, ARITA advocated for a single insolvency law which addresses companies, partnerships, trusts and individuals.[60] Deloitte opined that '[i]t would be short sighted…to provide a solution only for trading trusts with corporate trustees'.[61]

Ejection of trustee in insolvency

14.36 A frequent issue that was nominated as requiring reform arises where a trustee has a claim against trust assets to satisfy its right of indemnity or to satisfy liabilities incurred in the administration of the trust.[62] The committee was told that at present, trust deeds frequently contain clauses which eject trustees from this position upon entering liquidation.[63] Mr Richard Fisher, a consultant with Ashurst Australia and a Commissioner for the Harmer Review, explained that the effect of this is to deny trustees in liquidation the 'continuing authority and

56 Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 55.

57 Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 55.

58 Dr Nuncio D'Angelo, *Submission 19.1*, p. 4.

59 Dr Nuncio D'Angelo, *Submission 19.1*, p. 4.

60 ARITA, *Submission 36*, p. 13.

61 Deloitte, *Submission 32*, p. 6.

62 See, for example, Professor Jason Harris, Private capacity, *Committee Hansard*, 13 December 2022, p. 46; Mr Fisher, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 18; Drs Garry Hamilton and David Morrison, *Submission 5*, p. 5; Australian Credit Forum (ACF), answers to questions on notice, 28 February 2023 (received 21 March 2023), p. 8; BlueRock, *Submission 8*, p. 4; SCoLA, *Submission 37*, p. 4.

63 Mr Fisher, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 18. See also, Professor Harris, *Committee Hansard*, 13 December 2022, p. 47; Mr Christopher Pearce, Chair, Insolvency and Restructuring Committee, BLS LCA, *Committee Hansard*, 14 December 2022, p. 27.

ability to manage the trust assets, sell them and so forth', the proceeds from which could be used to satisfy claims of creditors.[64]

14.37 In these circumstances, liquidators must apply to the court to be appointed as receiver of trust assets in order to be able to deal with them.[65] The rationale for this arrangement, Mr Fisher explained, is that 'because the administration involves the affairs of a trust, that administration should be subject to court supervision'.[66]

14.38 Inquiry participants told the committee that this arrangement causes unnecessary costs for liquidators and therefore detrimentally impacts returns to creditors.[67] Professor Jason Harris described this issue as 'the most pressing issue [in this] space' and 'an unnecessary cost on the system'. He explained:

> What we know is a number of insolvency practitioners might be appointed over a company—let's say there's $30,000 worth of assets in the trust fund. All of that is going to be covered by their right of indemnity, so they are entitled to that amount, and yet they still have to go off to court and spend $15,000 or $20,000 to confirm that.[68]

14.39 Professor Harris explained that notionally, the rule exists to protect trust beneficiaries. However, in his view:

> …in all of these cases we're talking about circumstances where the trustee company's right of indemnity is available and that, in most cases, will exhaust the funds regardless. The beneficiaries are not going to get anything out of this on either outcome.[69]

14.40 Legislative amendments were suggested to enable liquidators to deal with trust assets.[70] Professor Harris expressed that this issue could be rectified by an amendment to the Corporations Act, as had been recommended by the Harmer Review, to express that, in circumstances where the right of indemnity is open,

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64 Mr Fisher, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 18.

65 Mr Fisher, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 18.

66 Mr Fisher, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 18.

67 Mr Fisher, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 20; Mr Pearce, BLS LCA, *Committee Hansard*, 14 December 2022, p. 27; Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 57; Australian Credit Forum (ACF), answers to questions on notice, 28 February 2023 (received 21 March 2023), p. 8; BlueRock, *Submission 8*, p. 4; KordaMentha, *Submission 14*, p. 5.

68 Professor Harris, *Committee Hansard*, 13 December 2022, p. 46.

69 Professor Harris, *Committee Hansard*, 13 December 2022, p. 47.

70 See, for example, DyeCo Solvency & Turnaround, *Submission 13*, p. 8.

property of the company specifically includes property that is held on trust.[71] Mr Fisher also suggested this amendment,[72] which he described as follows:

> All we're suggesting is that, where those liabilities have been incurred in the course of running the trust, the liquidator have direct access to the trust assets to satisfy the claims of the company corporate trustee in liquidation, in the way that the liquidator would have access to the company's assets which it owned in its own right to satisfy the claims of its creditors. The law says that the trust assets are charged with an obligation to satisfy the liabilities of the trustee incurred in its capacity as trustee.[73]

14.41 Submitters also noted that this issue could also be addressed by extending the *ipso facto* clause regime to prohibit such clauses.[74] The BLS LCA stated that while such an approach may go some way to addressing this issue, gaps would remain, including 'trust deeds which pre-date 1 July 2018 or corporate trustees which go straight into liquidation'.[75]

14.42 Mr Fisher told the committee that so far as he is aware:

> …no objection is ever raised to the circumstance that the liquidator of a corporate trustee applies to a court for the liquidator's appointment as received. So there is no objection, so far as the courts are concerned in their oversight of this regime, to the liquidator of the corporate trustee acting as received of the trust assets.[76]

14.43 The effect of this amendment, therefore is 'to remove that additional step…of the liquidator as the corporate trustee having to go to court and spend the money associated with having the liquidator…appointed as receiver'.[77] Mr Fisher advised that this proposal does not seek to change the benefits of using a corporate trust, but rather improve the administration of trusts in insolvency to make it more simple and less expensive.[78]

14.44 It was suggested to the committee that such reform could be described as 'low hanging fruit'[79] and could be undertaken swiftly.[80] The BLS LCA told the

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71 Professor Harris, *Committee Hansard*, 13 December 2022, p. 47.

72 Mr Fisher, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 18.

73 Mr Fisher, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 18.

74 BlueRock, *Submission 8*, p. 4; Australian Institute of Credit Management (AICM), *Submission 9*, p. 5; CPA Australia, *Submission 11*, [p. 3].

75 BLS LCA, *Submission 30*, p. 37.

76 Mr Fisher, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 19.

77 Mr Fisher, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 19.

78 Mr Fisher, Ashurst Australia, *Committee Hansard*, 14 December 2022, p. 19.

79 Associate Professor Mark Wellard, Private capacity, *Committee Hansard*, 1 March 2023, p. 15.

80 Drs Hamilton and Morrison, *Submission 5*, p. 5; BlueRock, *Submission 8*, p. 4.

committee that on this issue, there appears to be broad consensus, and that this area could be one addressed in the short-term future without need for consideration by the comprehensive review.[81]

14.45 Associate Professor Hargovan, with whom Associate Professor Wellard agreed, expressing the view that a carve-out of the nature suggested could exist for a 'plain vanilla trust', otherwise known as a single trading trust where the company has acted as trustee for one trust only.[82]

Register of trusts

14.46 The committee was told that a major issue in dealing with trusts is the lack of transparency involved.[83] It heard that while sophisticated investors may be able to ascertain that the entity they are dealing with is a trust, many do not, and therefore do not realise that the assets of those entity do not, in a beneficial sense, belong to that company.[84]

14.47 One solution proffered is the establishment of a publicly available register of trusts.[85] Associate Professor Hargovan suggested that such a register would 'be enormously helpful' for those who engage with trusts. It would increase 'awareness of the entities they are dealing with and what the possible implications are... There would be a benefit in creating transparency'.[86]

14.48 The repository for such a register was also discussed. Dr D'Angelo, for instance, expressed the view that the register should sit within ASIC.[87] For ASIC's part, Mr Warren Day, Chief Operating Officer of ASIC, stated that it was for government, Treasury and the parliament to consider whether trusts should be registered and searchable in the same way as companies.[88] He explained:

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81 Mr Pearce, BLS LCA, *Committee Hansard*, 14 December 2022, pp. 27, 32.

82 Associate Professor Anil Hargovan, Executive Member, SCoLA, *Committee Hansard*, 1 March 2023, p. 15; Associate Professor Wellard, *Committee Hansard*, 1 March 2023, p. 15.

83 See, for example, Professor Harris, *Committee Hansard*, 13 December 2022, p. 48; Mr Stephen Golledge SC, *Submission 6*, p. 4; ACF, answers to questions on notice, 28 February 2023 (received 21 March 2023), p. 7; AICM, *Submission 9*, p. 5; KordaMentha, *Submission 14*, p. 5; Southern Steel Group, *Submission 27*, [p. 3].

84 See, for example, Professor Harris, *Committee Hansard*, 13 December 2022, p. 48.

85 See, for example, Professor Harris, *Committee Hansard*, 13 December 2022, p. 48; Mr Michael Murray, Private capacity, *Committee Hansard*, 1 March 2023, pp. 24, 28; Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 56; ACF, answers to questions on notice, 28 February 2023 (received 21 March 2023), p. 7; CPA Australia, *Submission 11*, [p. 3]; BLS LCA, *Submission 30*, p. 37.

86 Associate Professor Anil Hargovan, SCoLA, *Committee Hansard*, 1 March 2023, p. 14.

87 Dr D'Angelo, *Committee Hansard*, 28 February 2023, p. 56.

88 Mr Warren Day, Chief Operating Officer, Australian Securities and Investments Commission (ASIC), *Committee Hansard*, 1 March 2023, p. 38.

> There are some functional things, though, that go with that. Obviously, there would need to be a separate register set up for them, and that would have to be through, I would expect, Australian Business Registry Services, which, as members of this committee would know, is connected into this modernisation of business registers.[89]

14.49 Mr Day pointed to the ongoing review of the Modernising Business Registers program, which is being led by Mr Damon Rees and is due to report to government by 30 June 2023.[90] Mr Day suggested that the establishment of such a register would have to follow the modernisation of the current registers of companies and business names. He expressed the view that he could not 'see how you would find time to then push in another register of those things'.[91]

Committee view

14.50 Between the Treasury consultation process and evidence provided to this inquiry, a significant body of evidence has developed which supports timely and substantial legislative reform to protect stakeholders who undertake or engage in business with trusts. It is clear that the status quo, wherein corporate trust insolvency is a matter largely determined by common law precedence rather than legislation, drives up rates of litigation and thus expense.

14.51 The committee acknowledges that the issues related to trust law are complex and require rigorous examination. However, the Harmer Report recognised that legislative reform was necessary to clarify the treatment of trusts in insolvency law more than 30 years ago, and proposed solutions to address this. The inattention that has persisted since has resulted in continuing uncertainty, inefficiency and expense for stakeholders in this space. Ensuring that stakeholders who engage in business with trusts receive the same protections as those who engage with *Corporations Act* companies is a matter both of fairness and economic advantage.

14.52 The committee acknowledges and supports calls for reform to address the absence of a dedicated statutory regime for dealing with insolvency in the trust environment. The committee is of the view that the following considerations should be taken into account in this process:

(a) In order for broader reform to be enacted, the Commonwealth may need to seek a referral of powers from the State governments. The government should seek the views of the State governments on this matter and establish a path forward.

(b) The committee has heard that the current body of law in respect of trusts has developed in a piecemeal way, leading to inconsistencies and

89 Mr Day, ASIC, *Committee Hansard*, 1 March 2023, p. 38.

90 Mr Dickson, Treasury, *Committee Hansard*, 22 March 2023, p. 51.

91 Mr Day, ASIC, *Committee Hansard*, 1 March 2023, p. 38.

inefficiencies. The government should seek to achieve cohesive legislative reform to end this cycle.

(c) The committee supports the views of inquiry participants who favour the implementation of the Harmer Report recommendations and is of the view that the government should analyse and update the recommendations where necessary to ensure that they reflect contemporary circumstances.

(d) The committee finds favour with the proposition that reforms in this space should not fundamentally undermine the core tenets of the trust structure. It encourages the government to consider proposals for legislative reform, such as those put to this inquiry and the *Clarifying the treatment of trusts in insolvency* Treasury consultation, while maintaining the inherent benefits of this structure.

14.53 The committee notes the near universal support for the implementation of an amendment to the Corporations Act to allow liquidators appointed to an insolvent corporate trustee to deal with trust assets. The committee supports such an amendment for single trading trusts but is of the view that further consultation may be necessary (noting the consultation already undertaken by Treasury), before extending this to trustees of multiple trusts.

14.54 The committee supports the establishment of a register to increase the transparency of trading trusts. The committee notes the ongoing work of the Modernising Business Registers program, but is of the view that the government should consider options for establishing such a register at a reasonable time.

Recommendation 28

14.55 The committee recommends that the government amends the *Corporations Act 2001* to expressly clarify the treatment of trusts with corporate trustees during insolvency.

Senator Deborah O'Neill
Chair

Appendix 1
Submissions and additional information

1 Drs Richard Winter and Sagi Peari
2 Mr Russell Morgan
3 Economic Abuse Reference Group
4 MinterEllison
5 Drs Garry Hamilton and David Morrison
6 Mr Steven Golledge SC
7 Australian Financial Security Authority
- 7.1 Supplementary to submission 7

8 BlueRock
9 Australian Institute of Credit Managment
10 Vantage Performance
11 CPA Australia
12 Mr Ben Sewell
13 DyeCo Solvency & Turnaround
14 KordaMentha
15 Narrow Road Capital Pty Ltd
16 Ms Paulina Fishman
17 Mr Michael Murray and Dr Rosalind Mason
18 Prof Jason Harris and Mr Michael Murray
19 Dr Nuncio D'Angelo
- 19.1 Supplementary to submission 19

20 Association of Independent Insolvency Practitioners Ltd
21 Housing Industry Association
22 Australian Credit Forum
23 Australian Banking Association
24 Mr. Daniel Calderisi and Jacob Moore
25 Prof Christopher Symes
26 Ashurst
27 Southern Steel Group
28 Small Business Development Corporation
30 Business Law Section, Law Council of Australia
31 Australian Small Business and Family Enterprise Ombudsman
32 Deloitte
33 Attorney-General's Department
34 Department of the Treasury
35 Australian Taxation Office

36 Australian Restructuring Insolvency & Turnaround Association
- 36.1 Supplementary to submission 36
- 36.2 Supplementary to submission 36

37 Society of Corporate Law Academics
38 Turnaround Management Association Australia
39 Chartered Accountants Australia and New Zealand
40 Shopping Centre Council of Australia
- 40.1 Supplementary to submission 40

41 Ms Catherine Robinson
42 Mr David Blanchett
43 Commercial Bar Association of Victoria
44 Australian Institute of Company Directors
45 King & Wood Mallesons
46 Dr Sulette Lombard
47 Kroll
48 Master Builders Australia
49 The Electrical Trades Union
50 SV Partners
51 Associate Professor Mark Wellard
52 Department of Employment and Workplace Relations
54 Mr Neil Hannan
55 KPMG Australia
56 Subbies United and The Subcontractors Alliance
57 NSW Small Business Commission
58 Financial Counselling Australia and the Small Business Debt Helpline
59 Scanlan Carroll
60 Mr Allan Eskdale
61 Condon Advisory Group
62 Institute of Public Accountants
63 Australian Retailers Association
64 Barrett Walker Accountants
65 Mr Royden James
66 Incolink
67 McGrathNicol
68 CFMMEU (Construction and General Division)
69 Australian Manufacturing Workers' Union
70 Mr Nicholas Crouch
71 Ms. Suzann Owens
72 The Hon. Reginald Barrett AO
73 Mr Michael Brennan
74 Professor Lynne Taylor
75 Australian Council of Trade Unions
76 Dr Allison Silink

77 Professor Jenny Buchan

78 Badenoch Integrated Logging Pty Ltd
Response by Craig Crosbie and Daniel Bryant, Liquidators of the Gunns Group

Tabled Documents

1 ARITA - Simplified Liquidation Flowchart, July 2022. Tabled at a public hearing on 14 December 2022.

2 ARITA - Small Business Restructuring Process Flowchart, July 2022. Tabled at a public hearing on 14 December 2022.

3 Law Council of Australia - Aide Memoire - Comparison of submissions. Tabled at a public hearing on 14 December 2022.

4 Turnaround Management Association - Australia Safe Harbour Guidelines. Tabled at a public hearing on 14 December 2022.

5 Small Business Debt Helpline - Opening Statement. Tabled at a public hearing on 28 February 2023.

6 Small Business Debt Helpline - Statistics from the Helpline for the period ended 31 December 2022. Tabled at a public hearing on 28 February 2023.

7 Narrow Road Capital - Opening Statement. Tabled at a public hearing on 28 February 2023.

8 Chartered Accountants ANZ, Institute of Public Accounts, and CPA Australia - Opening statement. Tabled at a public hearing on 28 February 2023.

9 Dr Nuncio d'Angelo - Opening Statement. Tabled at a public hearing on 28 February 2023.

10 Australian Banking Association - Opening Statement. Tabled at a public hearing on 28 February 2023.

11 ATO - Opening Statement. Tabled at a public hearing on 1 March 2023

12 ASIC - Opening Statement. Tabled at a public hearing on 1 March 2023

13 DEWR - Opening Statement. Tabled at a public hearing on 1 March 2023

Additional Information

1 Additional information provided by the Australian Financial Security Authority, 'Registered trustee remuneration in the personal insolvency system: best practice report 2020', provided on 14 December 2022.

2 Additional information provided by the Australian Financial Security Authority, 'Untrustworthy advisors: A hidden scourge in Australia's personal insolvency system', provided on 14 December 2022.

3 Additional information provided by the Australian Restructuring Insolvency and Turnaround Association, Keynote Address by The Hon Justice S C Derrington, Chair of the ALRC, ARITA Expert Series: Insolvency - Session 1, 11 November 2021, received 14 December 2022.

4 Correspondence from Ms Jillian Kitto, Assistant Commissioner Lodge and Pay Enforcement from the Australian Taxation Office, clarifying evidence given at a public hearing in Canberra on 13 December 2022, received 20 January 2023.

5 A Hargovan, 'Australian Insolvency Law Reform for Small Business—Janus-Faced?', Insolvency Law Bulletin (2020), vol. 21, pp. 5—10. Provided by Professor Anil Hargovan on 27 February 2023.

6 J Buchan, 'Chapter 15. Franchisees as externalities of insolvent franchisors: a windfall gain for employees?', Handbook on corporate restructuring, edited by Paul J. Omar and Jennifer L. L. Gant, Elgar (2021), pp. 261–277. Provided by Emeritus Professor Jenny Buchan on 28 February 2023.

7 J Gant and J Buchan, 'Moral Hazard, Path Dependency and Failing Franchisors: Mitigating Franchisee Risk Through Participation', Federal Law Review (2019), vol. 47(2), pp. 261–287. Provided by Emeritus Professor Jenny Buchan on 28 February 2023.

8 Correspondence from Mr Nick Pilavidis, Chief Executive Officer from the Australian Institute of Credit Management, rectifying evidence given at a public hearing in Sydney on 28 February 2023, received 3 March 2023.

9 Additional information provided by the Attorney-General's Department, 'Ministerial Roundtable on Personal Insolvency: summary', provided on 23 March 2023.

10 Correspondence from Ms Helen Davis, General Manager from the Small Business Debt Helpline, rectifying evidence given at a public hearing in Sydney on 28 February 2023, received 22 March 2023.

11 Hansard Proof transcript for a briefing given on 23 March 2023 by Professors Mark Wellard and Anil Hargovan from SCoLA, and Mrs Robyn Erskine from INSOL Interational regarding Badenoch v Bryant High Court decision.

12 PowerPoint slides provided by Professors Mark Wellard and Anil Hargovan from SCoLA, presenting Badenoch v Bryant High Court decision at briefing on 23 March 2023.

13 Correspondence from Ms Ashleigh Dalmau, Chief Operating Officer from Incolink, rectifying evidence given at a public hearing in Sydney on 21 February 2023, received 5 April 2023.

Answer to Question on Notice

1 ASBFEO-001. Senators O'Neill and Pratt - Small Business Insolvency: asked in writing, 13 December 2022 (received 17 January 2023).

2 AGD-001. Senators O'Neill and Scarr - Implementation of recommendation and drafting of legislation regarding the Whittaker review: asked at a public hearing, 13 December 2022 (received 20 January 2023).

3 AGD-002. Senator Scarr - Recommendations for change or reform in relation to the Whittaker review: asked at a public hearing, 13 December 2022 (received 23 January 2023).

4 Professor Jason Harris and Mr Michael Murray-001. Senator Scarr - Simplified liquidations: asked at a public hearing, 13 December 2022 (received 27 January 2023)

5 Mr Bruce Whittaker-001. Senator O'Neill - Recommendations: asked in writing, 13 December 2022 (received 3 February 2023)

6 AGD-003. Senator O'Neill - What data does AGD collate with respect to personal bankruptcy?: asked in writing 22 December 2022 (received 7 February 2023)

7 AGD-004. Senator O'Neill - Corporate Insolvency Regime: asked in writing 22 December 2022 (received 7 February 2023)

8 AGD-005. Senator O'Neill - Responsibilities of the corporate insolvency regime and the personal bankruptcy regime: asked in writing 22 December 2022 (received 7 February 2023)

9 AGD-006. Senator O'Neill - Support to the personal and corporate insolvency regimes: asked in writing 22 December 2022 (received 7 February 2023)

10 AGD-007. Senator O'Neill - Whether AGD, Treasury or some other Commonwealth entity collate data about both corporate and personal insolvencies: asked in writing 22 December 2022 (received 7 February 2023)

11 ASBFEO-002: Senator O'Neill - Small Business Insolvency: asked in writing 22 December 2022 (received 9 February 2023)

12 ATO-001. Senator O'Neill - ASBFEO interactions: asked at a public hearing, 13 December 2022 (received 6 February 2023)

13 ATO-002. Senator O'Neill - Complexity of corporate insolvency laws: asked in writing 22 December 2022 (received 6 February 2023)

14 ATO-003. Senator O'Neill - Director Penalty Notice numbers: asked at a public hearing 13 December 2022 (received 6 February 2023)

15 ATO-004. The Hon. Mr Pitt MP - Director Penalty Notices and insolvent companies: asked at a public hearing 13 December 2022 (received 6 February 2023)

16 ATO-005. Senator O'Neill - General questions: asked in writing 22 December 2022 (received 6 February 2023)

17 ATO-006. Senator Scarr - Internal training on insolvency law: asked at a public hearing, 13 December 2022 (received 6 February 2023)

18 ATO-007. Senator O'Neill - Number of insolvency specialists in ATO: asked at a public hearing, 13 December 2022 (received 6 February 2023)

19 ATO-008. Senator O'Neill - Personal and corporate insolvency overlap: asked in writing 22 December 2022 (received 6 February 2023)

20 ATO-009. Senator O'Neill - Pre and post insolvency phases: asked at a public hearing, 13 December 2022 (received 6 February 2023)

21 ATO-010. Senator O'Neill - Specialised client support team: asked at a public hearing, 13 December 2022 (received 6 February 2023)

22 ATO-011. Senator Scarr - Tax clearance and simplified liquidation: asked at a public hearing, 13 December 2022 (received 6 February 2023)

23 ATO-012. The Hon. Mr Pitt MP - Total tax: asked at a public hearing, 13 December 2022 (received 6 February 2023)

24 ATO-013. Senator Scarr - Businesses with unpaid super entering payment plans following DPN awareness letter issuing: asked at a public hearing, 13 December 2022 (received 6 February 2023)

25 ATO-014. Senator O'Neill - Value of information reported by Registered Liquidators to ASIC (illegal phoenixing): asked in writing 22 December 2022 (received 6 February 2023)

26 Treasury-001. Dr Mulino MP - World business rankings, insolvency: asked at a public hearing, 13 December 2022 (received 10 February 2023)

27 Treasury-002. Senator Scarr - Small business restructuring and simplified liquidation process: asked at a public hearing, 13 December 2022 (received 10 February 2023)

28 Treasury-003. Senator O'Neill - Corporate and personal insolvency data: asked in writing 22 December 2022 (received 10 February 2023)

29 Treasury-004. Senator O'Neill - Voluntary administrations: asked in writing 22 December 2022 (received 10 February 2023)

30 Treasury-005. Senator O'Neill - Harmonisation of insolvency regimes: asked in writing 22 December 2022 (received 10 February 2023)

31 Treasury-006. Senator O'Neill - Portfolio split of insolvency regimes: asked in writing 22 December 2022 (received 10 February 2023)

32 Treasury-007. Senator O'Neill - ATO and liquidations: asked in writing 22 December 2022 (received 10 February 2023)

33 Treasury-008. Senator O'Neill - Effectiveness of changes to corporate insolvency framework: asked in writing 22 December 2022 (received 10 February 2023)

34 Treasury-009. Senator O'Neill - Corporate insolvency data: asked in writing 22 December 2022 (received 10 February 2023)

35 APRA-001. Senator O'Neill - Triggers for General Insurer judicial management: asked at a public hearing, 14 December 2022 (received 10 February 2023)

36 APRA-002. Senator O'Neill - APRA Powers - Prevention of GI judicial management: asked in writing 23 December 2022 (received 10 February 2023)

37 APRA-003. Senator O'Neill - HIH Insurance: asked in writing 23 December 2022 (received 10 February 2023)

38 APRA-004. Insurance Insolvency Risks: asked in writing 23 December 2022 (received 10 February 2023)

39 TMA-001. Senator O'Neill - General questions: asked in writing 23 December 2022 (received 10 February 2023)

40 ASIC-001. Senator O'Neill - Response to ASIC mentions and claims made by hearing participants: asked at a public hearing, 14 December 2022 (received 8 February 2023)

41 ASIC-002. Senator O'Neill - Automatic responses from Ai: asked at a public hearing, 14 December 2022 (received 8 February 2023)

42 ASIC-003. Senator Scarr - Recommendation 27 from ARITA's submission to publish ASIC algorithm: asked at a public hearing, 14 December 2022 (received 8 February 2023)

43 ASIC-004. Senator Scarr - Recommendation 28 from ARITA's submission to demonstrate that its decision to terminate the National Insolvency Trading Program was consistent with regulatory good practice: asked at a public hearing, 14 December 2022 (received 8 February 2023)

44 ASIC-005. Senator O'Neill - Correction to ASIC Table 29: asked at a public hearing, 14 December 2022 (received 8 February 2023)

45 ASIC-006. Senator O'Neill - Policy rationale for government's role in personal and corporate insolvency: asked in writing 23 December 2022 (received 8 February 2023)

46 ASIC-007. Senator O'Neill - Corporate insolvency data: asked in writing 23 December 2022 (received 8 February 2023)

47 ASIC-008. Senator O'Neill - Insolvency practitioners as 'frontline investigators': asked in writing 23 December 2022 (received 8 February 2023)

48 ASIC-009. Senator O'Neill - ASIC reviews of AAF: asked in writing 23 December 2022 (received 8 February 2023)

49 ASIC-010. Senator O'Neill - Whether other jurisdictions offer AAF-style grants: asked in writing 23 December 2022 (received 8 February 2023)

50 ASIC-011. Senator O'Neill - Resourcing: asked in writing 23 December 2022 (received 8 February 2023)

51 ASIC-012. Senator O'Neill - Anecdotal evidence: asked in writing 23 December 2022 (received 8 February 2023)

52 ASIC-013. Senator O'Neill - Root and branch review: asked in writing 23 December 2022 (received 8 February 2023)

53 ASIC-014. Senator O'Neill - Purpose of Australia's insolvency laws: asked in writing 23 December 2022 (received 8 February 2023)

54 ASIC-015. Senator O'Neill - Major reforms: asked in writing 23 December 2022 (received 8 February 2023)

55 ASIC-016. Senator O'Neill - International best practice: asked in writing 23 December 2022 (received 8 February 2023)

56 ASIC-017. Senator O'Neill - Data and research: asked in writing 23 December 2022 (received 8 February 2023)

57 ASIC-018. Senator O'Neill - Harmonisation of corporate, personal, trust, and partnership insolvency law asked in writing 23 December 2022 (received 8 February 2023)

58 ASIC-019. Senator O'Neill - Recent reviews: asked in writing 23 December 2022 (received 8 February 2023)

59 ASIC-020. Senator O'Neill - Small business restructuring and simplified liquidation reform: asked in writing 23 December 2022 (received 8 February 2023)

60 ASIC-021. Senator O'Neill - Recommendations in submissions and timing of reforms: asked in writing 23 December 2022 (received 8 February 2023)

61 Professor Jason Harris and Mr Michael Murray-002. Senator O'Neill - Various: asked 22 December 2022 (received 10 February 2023)

62 LCA-001. Senator O'Neill - General questions: asked 23 December 2022 (received 14 February 2023)

63 SCoLA-001. Senator O'Neill - Various: asked 23 December 2022 (received 17 February 2023)

64 AIIP-001. Senator O'Neill - Various: asked 23 December 2022 (received 23 February 2023)

65 Ashurst-001. Senator O'Neill - Various: asked 23 December 2022 (received 15 February 2023)

66 PC-001. Senator O'Neill - Various: asked 22 December 2022 (received 21 February 2023)

67 LCA-002. Senator O'Neill - Legislative Guide on Insolvency Law: asked 23 December 2022 (received 15 February 2023)

68 ACTU-001. Senator Scarr - Fair Entitlements Guarantee: asked at a public hearing, 1 March 2023 (received 8 March 2023)

69 ACTU-002. Senator Scarr - Thin capitalisation: asked at a public hearing, 1 March 2023 (received 8 March 2023)

70 ACTU-003. Mr Georganas MP - Payment trusts: asked at a public hearing, 1 March 2023 (received 8 March 2023)

71 AMWU-001. Senator Scarr - Standing of unions in schemes of arrangement proceedings: asked at a public hearing, 21 February 2023 (received 10 March 2023)

72 KPMG-001. Senator O'Neill - Various: asked at a public hearing, 21 February 2023 (received 14 March 2023)

73 CFMMEU-001. The Hon. Mr Pitt MP - Costs of cascading trusts: asked at a public hearing, 21 February 2023 (received 15 March 2023)

74 CFMMEU-002. Senator O'Neill - Regulation of Pre-Insolvency Practitioners: asked at a public hearing, 21 February 2023 (received 15 March 2023)

75 HIA-001. Senator O'Neill and Ms Mascarenhas MP - ATO activities and software available to businesses: asked at a public hearing, 21 February 2023 (received 14 March 2023)

76 Dr Sulette Lombard-001. Senator O'Neill - Proposed public funder model: asked at a public hearing, 21 February 2023 (received 14 March 2023)

77 Dr Sulette Lombard-002. Senator O'Neill - Debate on business model of insolvency practitioners: asked at a public hearing, 21 February 2023 (received 14 March 2023)

78 NSWSBC-001. Senator O'Neill - Languages used by NSW SBC to provide information to concerned parties: asked at a public hearing, 28 February 2023 (received 15 March 2023)

79 MBA-001. Dr Mulino MP - Economic trends, construction: asked at a public hearing, 21 February 2023 (received 14 March 2023)

80 MBA-002. Senator O'Neill - Sector retention: asked at a public hearing, 21 February 2023 (received 14 March 2023)

81 MBA-003. The Hon. Mr Pitt MP - Current terms of payment in construction industry: asked at a public hearing, 21 February 2023 (received 14 March 2023)

82 MBA-004. Senator O'Neill - Tabling of documents, answered in MBA-001: asked at a public hearing, 21 February 2023 (received 14 March 2023)

83 MBA-005. Senator O'Neill - Intersection of infrastructure businesses with insolvency sector: asked at a public hearing, 21 February 2023 (received 14 March 2023)

84 Professor Mark Wellard-001. Senator Scarr - Failure and automatic disqualification: asked at a public hearing, 1 March 2023 (received 20 March 2023)

85 AGD-008. Senator O'Neill - Consolidating insolvency policy into one policy department: asked at a public hearing, 1 March 2023 (received 21 March 2023)

86 ATO-015. Senator O'Neill - DPNs and domestic violence or elder abuse: asked at a public hearing, 1 March 2023 (received 23 March 2023)

87 ATO-016. Mr Georganas MP - Payment plan amendments: asked at a public hearing, 1 March 2023 (received 23 March 2023)

88 ATO-017. Senator O'Neill - Registered liquidator and pre-insolvency advisor practices: asked at a public hearing, 1 March 2023 (received 23 March 2023)

89 ATO-018. Senator O'Neill - Timing for issuing DPN: asked at a public hearing, 1 March 2023 (received 23 March 2023)

90 DEWR-001. Senator Scarr - Ovato Group Case: asked at a public hearing, 1 March 2023 (received 23 March 2023)

91 DEWR-002. Senator Scarr - Communication Between Department and Union in relation to Ovato Case: asked at a public hearing, 1 March 2023 (received 23 March 2023)

92 DEWR-003. Senator Scarr - What FEG does not Pay as a Proportion: asked at a public hearing, 1 March 2023 (received 23 March 2023)

93 DEWR-004. Senator Scarr - Project Cost of Super Entitlements to the Taxpayer: asked at a public hearing, 1 March 2023 (received 23 March 2023)

94 DEWR-005. Mr Georganas MP - Other Jurisdictions Conducting Reviews: asked at a public hearing, 1 March 2023 (received 23 March 2023)

95 DEWR-006. Senator Scarr - Whittaker Review: asked at a public hearing, 1 March 2023 (received 23 March 2023)

96 Professor Jason Harris and Mr Michael Murray-003. Senator O'Neill - Professional Groups: asked at a public hearing, 1 March 2023 (received 22 March 2023)

97 AICM-001. Senator O'Neill - Various: asked at a public hearing, 28 February 2023 (received 22 March 2023)

98 SBDH-001. Senator O'Neill - Various: asked at a public hearing, 28 February 2023 (received 22 March 2023)

99 ACF-001. Senator O'Neill - Various: asked at a public hearing, 21 February 2023 (received 21 March 2023)

100 Professor Rosalind Mason and Mr Michael Murray-001. Senator Scarr - Harmer Review: asked at a public hearing, 1 March 2023 (received 16 March 2023)

101 CPA, IPA, CA ANZ-001. Senator O'Neill - ATO reporting: asked at a public hearing, 28 February 2023 (received 21 March 2023)

102 CPA, IPA, CA ANZ-002. Senator O'Neill - Deregistration: asked at a public hearing, 28 February 2023 (received 21 March 2023)

103 CPA, IPA, CA ANZ-003. Senator O'Neill - Preference payments: asked at a public hearing, 28 February 2023 (received 21 March 2023)

104 CPA, IPA, CA ANZ-004. Senator O'Neill - Regulation of pre-insolvency advice: asked at a public hearing, 28 February 2023 (received 21 March 2023)

105 Treasury-010. Senator O'Neill - Bryant v Badenoch impacts: asked at a public hearing, 1 March 2023 (received 22 March 2023)

106 Treasury-011. Senator O'Neill - Insolvency policy consolidation: asked at a public hearing, 1 March 2023 (received 22 March 2023)

107 Treasury-012. Senator O'Neill - Safe harbour instances: asked at a public hearing, 1 March 2023 (received 22 March 2023)

108 Treasury-013. Senator O'Neill - Personal and corporate insolvency differences: asked at a public hearing, 1 March 2023 (received 22 March 2023)

109 Treasury-014. Senator O'Neill - Insolvency information across jurisdictions: asked at a public hearing, 1 March 2023 (received 22 March 2023)

110 Treasury-015. Senator Scarr - Ovato matter oversight: asked at a public hearing, 1 March 2023 (received 22 March 2023)

111 ABA-001. Senator O'Neill - Various: asked at a public hearing, 28 February 2023 (received 21 March 2023)

Media Releases

1 Inquiry into corporate insolvency in Australia - Media release, 28 September 2022

Appendix 2
Public hearings

Tuesday, 13 December 2022
Main Committee Room
Australian Parliament House
Canberra

Attorney-General's Department
- Ms Alice Linacre, First Assistant Secretary—Courts, Tribunals and Commercial
- Ms Jenna Priestly, Assistant Secretary—Commercial and Copyright Law Branch

Department of the Treasury
- Mr Tom Dickson, Assistant Secretary, Corporations Branch
- Ms Zoe Irwin, Director (A/g), Financial Reporting and Insolvency Unit

Productivity Commission
- Mr Michael Brennan, Chair (via video conference)
- Ms Rosalyn Bell, Head of Office (A/g)

Australian Small Business and Family Enterprise Ombudsman
- The Hon Bruce Billson, Australian Small Business and Family Enterprise Ombudsman
- Miss Alexandra Hordern, Director, Policy and Advocacy
- Mr Cameron Dyson-Smith, Assistant Director, Policy and Advocacy
- Ms Ekaterina (Katie) Grazhdannikova, Analyst, Policy and Advocacy

Mr Michael Murray, Private capacity

Professor Jason Harris, Private capacity

Australian Taxation Office
- Ms Jillian Kitto, Assistant Commissioner, Lodge and Pay Enforcement
- Mr George Montanez, Assistant Commissioner, Integrated Compliance, Phoenix and Evasion Program
- Mr Gary Busby, Senior Insolvency Advisor, Lodge and Pay Enforcement

Australian Financial Security Authority

- Mr Gavin McCosker, Deputy Chief Executive
- Ms Elyse Herrald-Woods, National Manager, Government Business
- Mr Paul Shaw, National Manager, Enforcement and Practitioner Supervision

Mr Bruce Whittaker, Private capacity

Wednesday, 14 December 2022

Wilarra Room
The Grace Hotel
Sydney

Australian Restructuring Insolvency & Turnaround Association

- Mr Michael Brereton, President
- Mr John Winter, Chief Executive Officer
- Dr Warren Mundy, Special Advisor
- Ms Narelle Ferrier, Technical and Standards Director

Ashurst

- Mr James Marshall, Partner
- Mr Richard Fisher, Consultant

Business Law Section, Law Council of Australia

- Mr Chris Pearce, Chair of the Insolvency & Restructuring Committee
- Mr Bruce Collins, Chair of the SME Committee
- Mr Tony Ryan, Deputy Chair of the Insolvency and Restructuring Committee
- Mr David Walter, Member of the Insolvency & Restructuring Committee

Society of Corporate Law Academics

- Associate Professor Vivienne Brand, President
- Dr Michael Duffy, Secretary

Association of Independent Insolvency Practitioners Ltd

- Mr Stephen Hathaway, President
- Mr David Levi, Committee Member

Turnaround Management Association Australia

- Ms Jennifer Ball, Chair of National Board
- Mr Paul Apathy, Director

Australian Prudential Regulatory Authority

- Mr Paul Tattersall, Acting Executive Director, Banking Division
- Mr Peter Diamond, General Manager, Credit and Market Risk
- Ms Sandy Bone, Manager, Retail Credit Risk

Australian Securities and Investments Commission

- Mr Warren Day, Chief Operating Officer
- Mr Greg Yanco, Executive Director, Markets Group
- Ms Thea Eszenyi, Senior Executive Leader, Registered Liquidators & Financial Reporting and Audit

Tuesday, 21 February 2023

Corinthian Room
Sydney Masonic Centre
66 Goulburn St
Sydney

A/Prof Sulette Lombard, Private capacity

Incolink

- Ms Ashleigh Connolly, Chief Operating Officer

Subcontractors Alliance

- Mr Les Williams, Co-Owner of Sunshine Coast Based WK Civil and Subcontractor.

Subbies United

- Mr John Goddard, Managing Director

Australian Manufacturing Workers' Union

- Ms Lorraine Cassin, Assistant National Secretary
- Ms Margaret Hogan, National Industrial Officer
- Mr David Bradbury, Member and former employee of Ovato

CFMMEU (Construction and General Division)

- Mr David Noonan, National Secretary
- Mr Stuart Maxwell, Senior National Industrial Officer

The Electrical Trades Union

- Mr Trevor Gauld, National Policy Officer

Mr Michael Brennan, Private capacity

KPMG Australia

- Mr David Heathcote, National Managing Partner, Deals Tax Legal
- Mr Peter Gothard, ASPAC Restructuring Services Leader

Master Builders Australia

- Mr Shaun Schmitke, Deputy Chief Executive Officer
- Mr Shane Garrett, Chief Economist

Housing Industry Association

- Mrs Jocelyn Martin, Deputy Managing Director—Policy and Industry
- Ms Melissa Adler, Executive Director—Industrial Relations and Legal Services

Southern Steel Group

- Mr Grant Morris, National Credit Manager

Tuesday, 28 February 2023

Corinthian Room
Sydney Masonic Centre
66 Goulburn St
Sydney

Australian Banking Association

- Mr Steve Blinkhorn, Director of Legal Affairs
- Mr Ross McNaughton, Group Head of Credit Restructuring, Assurance and Model Risk

Australian Institute of Credit Management

- Mr Nick Pilavidis, Chairperson

Australian Credit Forum

- Ms Anna Taylor, Legislation Chairperson

Narrow Road Capital Pty Ltd

- Mr Jonathan Rochford, Managing Director

Financial Counselling Australia and the Small Business Debt Helpline

- Ms Helen Davis, General Manager, Small Business Debt Helpline
- Mr Ryan McIlveen, Legal & Quality Officer, Small Business Debt Helpline

CPA Australia

- Ms Kristen Beadle, Insolvency Policy
- Mr Gavan Ord, Senior Manager Business Policy

Institute of Public Accountants

- Ms Vicki Stylianou, Group Executive, Advocacy and Policy
- Mr Adrian Hunter, Brooke Bird Turnaround—Advisory and Insolvency Specialists

Chartered Accountants Australia and New Zealand

- Ms Jill Lawrence, Senior Policy Advocate
- Mr Andrew Barnden, Member, Registered liquidator and trustee in bankruptcy

Dr Nuncio D'Angelo, Private capacity

Mr Ben Sewell, Private capacity

NSW Small Business Commission

- Mr Christopher Lamont, Commissioner

Wednesday, 1 March 2023

Committee Room 2S3
Australian Parliament House
Canberra

Australian Council of Trade Unions

- Mr Scott Connolly, Assistant Secretary
- Mr Andrew Linden, Workers' Capital Researcher

Ms Catherine Robinson, Private capacity

Professor Anil Hargovan, Private capacity

Professor Jenny Buchan, Private capacity

Associate Professor Mark Wellard, Private capacity

Professor Lynne Taylor, Private capacity

Dr Rosalind Mason, Private capacity

Mr Michael Murray, Private capacity

Australian Securities and Investments Commission
- Mr Greg Yanco, Executive Director, Markets Group
- Ms Thea Eszenyi, Senior Executive Leader, Registered Liquidators & Financial Reporting and Audit
- Mr Warren Day, Chief Operating Officer

Australian Taxation Office
- Ms Jillian Kitto, Assistant Commissioner, Lodge and Pay Enforcement
- Mr George Montanez, Assistant Commissioner, Integrated Compliance, Phoenix and Evasion Program
- Mr Gary Busby, Senior Insolvency Advisor, Lodge and Pay Enforcement

Department of Employment and Workplace Relations
- Ms Alex Mathews, First Assistant Secretary, Employee Entitlement Safeguards and Policy Division
- Mr Henry Carr, Branch Manager, Senior Executive Lawyer
- Ms Sue Saunders, Assistant Secretary, Fair Entitlements Guarantee Branch

Department of the Treasury
- Mr Tom Dickson, A/g First Assistant Secretary, Market Conduct Division
- Ms Zoe Irwin, A/g Director Financial Reporting and Insolvency Unit

Attorney-General's Department
- Ms Alice Linacre, First Assistant Secretary, Courts Tribunal and Commercial Division
- Ms Jenna Priestly, Assistant Secretary, Commercial and Copyright Law Branch