Law Council
OF AUSTRALIA

Business Law Section

Corporate insolvency in Australia

Submission to the Parliamentary Joint Committee on Corporations and Financial Services

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Telephone +61 2 6246 3737 • *Fax* +61 2 6248 0639
Email Jessica.Morrow@lawcouncil.asn.au
GPO Box 1989, Canberra ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612
Law Council of Australia Limited ABN 85 005 260 622
www.lawcouncil.asn.au

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About the Business Law Section of the Law Council of Australia

The Law Council of Australia represents the legal profession at the national level, speaks on behalf of its Constituent Bodies on federal, national, and international issues, and promotes the administration of justice, access to justice, and general improvement of the law.

The Law Council advises governments, courts, and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession internationally and maintains close relationships with legal professional bodies throughout the world. The Law Council was established in 1933 and represents its Constituent Bodies: 16 Australian State and Territory law societies and bar associations, and Law Firms Australia. The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Law Society of the Australian Capital Territory
- New South Wales Bar Association
- Law Society of New South Wales
- Northern Territory Bar Association
- Law Society Northern Territory
- Bar Association of Queensland
- Queensland Law Society
- South Australian Bar Association
- Law Society of South Australia
- Tasmanian Bar
- Law Society of Tasmania
- The Victorian Bar Incorporated
- Law Institute of Victoria
- Western Australian Bar Association
- Law Society of Western Australia
- Law Firms Australia

Through this representation, the Law Council acts on behalf of more than 90,000 Australian lawyers.

The Business Law Section was established in August 1980 by the Law Council with jurisdiction in all matters pertaining to business law. The Business Law Section provides a forum through which lawyers and others interested in law affecting business can discuss current issues, debate and contribute to the process of law reform in Australia, as well as enhance their professional skills.

The Business Law Section is often called upon to make or assist in making submissions for the Law Council in areas of business law applicable on a national basis.

Currently the Business Law Section has approximately 900 members. It currently has 15 specialist committees and working groups:

- Competition & Consumer Law Committee
- Construction & Infrastructure Law Committee
- Corporations Law Committee
- Customs & International Transactions Committee
- Digital Commerce Committee
- Financial Services Committee
- Foreign Corrupt Practices Working Group
- Foreign Investment Committee
- Insolvency & Reconstruction Law Committee
- Intellectual Property Committee
- Media & Communications Committee
- Privacy Law Committee
- SME Business Law Committee
- Taxation Law Committee
- Technology in Mergers & Acquisitions Working Group

As different or newer areas of business law develop, the Business Law Section evolves to meet the needs or objectives of its members in emerging areas by establishing new working groups or committees, depending on how it may better achieve its objectives.

The Section has an Executive Committee of 11 members drawn from different states and territories and fields of practice. The Executive Committee meets quarterly to set objectives, policy, and priorities for the Section.

Current members of the Executive are:

- Mr Philip Argy, Chairman
- Professor Pamela Hanrahan, Deputy Chair
- Mr Adrian Varrasso, Treasurer
- Mr Greg Rodgers
- Mr John Keeves
- Ms Rachel Webber
- Ms Caroline Coops
- Dr Elizabeth Boros
- Ms Shannon Finch
- Mr Clint Harding
- Mr Peter Leech

The Section's administration team serves the Section nationally and is based in the Law Council's offices in Canberra.

Authorship and contributions

This Submission has been prepared by the Insolvency and Restructuring Committee of the Business Law Section with additional input from the SME Business Law Committee, Financial Services Committee, Taxation Committee, and the Corporations Committee.

Contributions to this Submission have been made by various members of those Committees, drawn from nearly every State and Territory of Australia, and include practitioners in private practice as solicitors or barristers, as well as corporate counsel and legal academics.

Notably, this Submission deals with matters of complexity on which reasonable minds can differ. The views expressed in this Submission may not necessarily reflect the views of all contributors or their respective workplaces and organisations, but the Submission is presented as the most widely held view among the contributors.

Further information

The Section would be pleased to discuss any aspect of this Submission. Any queries can be directed to the Chair of the Insolvency and Restructuring Committee, Chris Pearce, at chris.pearce@blackwall.legal or at +61 8 6169 2503.

The Section appreciates the opportunity to make this Submission and commends the Submission to the Parliamentary Joint Committee for its consideration.

With compliments



Philip Argy
Chairman
Business Law Section

Glossary

In this Submission, terms have the following meaning:

2015 PC Report	The Productivity Commission Inquiry Report into Business Set-up, Transfer and Closure, No 75 (2015)[1]
ABRS	Australian Business Registry Services, a department of the ATO
AFSA	The Australian Financial Security Authority
ALRC	The Australian Law Reform Commission
ARITA	The Australian Restructuring Insolvency & Turnaround Association
ASBFEO	The Australian Small Business and Family Enterprise Ombudsman
ASIC	The Australian Securities and Investments Commission
ATO	The Australian Taxation Office, though often used as a reference directly to the Commissioner, as the person entitled to be paid taxes and with relevant legislative powers
Bankruptcy Act	The *Bankruptcy Act 1966* (Cth)
BLS or **Section**	The Business Law Section of the Law Council of Australia
CCCD	Cross-class cram down, a mechanism to deal with uncooperative creditors who may be out of the money but are interfering with voting outcomes
CCIV Act	*Corporate Collective Investment Vehicle Framework and Other Measures Act 2022* (Cth)
Commissioner	The Commonwealth Commissioner of Taxation (unless otherwise specified)
Committee	The Insolvency and Restructuring Committee of the BLS
Corporations Act	The *Corporations Act 2001* (Cth)
Corporations Regulations	The *Corporations Regulations 2001* (Cth)
CVA	A company voluntary arrangement under the *Insolvency Act 1986* (UK)
DEWR	The Department of Employment and Workplace Relations

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

DIP Finance	So-called “debtor-in-possession finance” provided on a super-secured basis during a restructuring process
DOCA	A deed of company arrangement under Part 5.3A of the Corporations Act
DPN	A director penalty notice issued by the ATO under Div 269 of Schedule 1 of the *Taxation Administration Act 1953* (Cth)
FEG	The Department of Employment and Workplace Relations or the relevant part of that department which operates the Fair Entitlements Guarantee Scheme (references may also be to the Attorney-General’s Department in its former capacity as operator of that scheme)
GST	Goods and Services Tax
Harmer Inquiry	The General Insolvency Inquiry commissioned by the Commonwealth Attorney-General in 1983 operated by the ALRC
Harmer Report	The report of the Harmer Inquiry known as the Australian Law Reform Commission General Insolvency Inquiry Report No 45 (1988).[2]
IFM or **ASIC IFM**	ASIC’s industry funding model, under which a user-pays model has been instituted for cost-recovery (after the fact) from ASIC’s stakeholders for the services it provides across several service lines
ILRA	The *Insolvency Law Reform Act 2016* (Cth)
Inquiry	The Inquiry into Corporate Insolvency in Australia by the PJC, in respect of which this Submission is made
IPS	*Insolvency Practice Schedule (Corporations) 2016*, being Schedule 2 to the Corporations Act
IPS(B)	*Insolvency Practice Schedule (Bankruptcy) 2016*, being Schedule 2 to the Bankruptcy Act
IPR	The *Insolvency Practice Rules (Corporations) 2016* (Cth)
IPR(B)	The *Insolvency Practice Rules (Bankruptcy) 2016* (Cth)
LCA	The Law Council of Australia
MSME	Micro, small and medium-sized enterprises
PJC	The Parliamentary Joint Committee on Corporations and Financial Services

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

PPSA	The *Personal Property Securities Act 2009* (Cth)
PPSR	The Personal Property Securities Register, established under the PPSA.
Safe Harbour Review	The statutory review of the insolvent trading safe harbour under s588HA of the Corporations Act, including its final report published on 24 March 2022.[3]
Section or **BLS**	The Business Law Section of the Law Council of Australia
SBR	A small business restructuring effected under the SBR Regime
SBR Regime	The small business restructuring regime enacted in 2021 in Part 5.3B of the Corporations Act
SGC	Superannuation Guarantee Charge
SME	Small to medium-sized enterprise
Submission	This Submission by the BLS to the Inquiry
TOR or **Terms of Reference**	A term of reference, in particular a term of reference of the Inquiry as published by the PJC
VA	Voluntary administration (under Part 5.3A of the Corporations Act) or, as appropriate, "voluntary administrator", being the insolvency practitioner in charge of the administration.
Whittaker Review	Review of the Personal Property Securities Act 2009, conducted by Bruce Whittaker, the final report of which was delivered on 27 February 2015.[4]

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

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

Executive Summary

1. It has been over 39 years since the Australian Law Reform Commission was tasked to conduct the Harmer Inquiry. That review led to major reforms of the corporate insolvency regime in Australia which remain useful and effective today.

2. However, changes to the economy in the intervening decades warrant a fresh look at the regime. For that reason, this PJC Inquiry is welcomed.

3. This Submission first considers general and holistic questions about what Australia's insolvency regime should achieve. By definition, in the insolvency system there are insufficient funds to satisfy all stakeholders, and somebody must always miss out. That has inevitably led to aggrieved stakeholder groups through the years, often successfully lobbying for narrowly focused legislative reform to improve their position as against other stakeholders. The result is an awkward blend of laws not properly aligned from any policy perspective, located in different, difficult-to-navigate places.

4. For that reason, this Submission's primary, and key, recommendation is that the legislative scheme be redesigned. That is consistent with recent calls from the ALRC to do the same for other parts of the Corporations Act. Such a redesign does not need to break the system or require complete, substantive amendments to Australia's regime, but the opportunity should be taken to review parts of the law that require examination along the way.

5. On the following pages the Section has listed our 33 recommendations. Some of those recommendations can be implemented quickly with little cost or pain, to the material gain of stakeholders generally (such as limiting or cutting altogether the need for court applications to achieve certain extensions or other results).

6. Other recommendations require more thought, and a more detailed analysis of empirical data. It may be appropriate for some other body (such as the ALRC) to conduct a further review on some of those matters. If that takes some time, then so be it.

7. Ultimately, Australia's corporate insolvency regime works well. However, there are real opportunities to fine-tune the system and provide better results for all stakeholders.

Table of recommendations

Our recommendations are listed here for convenience in numerical order as they appear in the body of the Submission, accompanied by commentary supporting the conclusions.

Recommendation 1	In respect of any of the issues raised in the Inquiry on which the PJC is not able to come to a final conclusion (in the time available or because it is outside the scope of the Inquiry's Terms of Reference), the PJC should recommend a further review by the ALRC or another appropriate body into those matters.
Recommendation 2	Consideration should be given to relaxing independence requirements on voluntary administrators associated with pre-appointment work or providing more efficient mechanisms for managing those independence requirements (such as simplifying the appointment of special purpose investigators to report on pre-appointment matters).
Recommendation 3	Consideration should be given to replacing the requirement for court applications for section 439A convening period extensions with an administrative process or alternatively a default approval process.
Recommendation 4	Consideration should be given to replacing the requirement for court applications for orders limiting administrators' personal liability for moneys borrowed with an administrative process or alternatively a default approval process (particularly if the lender consents).
Recommendation 5	Consideration should be given to reducing the complexity and cost of the SBR Regime to encourage its use by micro-businesses.
Recommendation 6	Consideration should be given to relaxing either or both of the requirements that companies need to have paid all employee entitlements and have their taxation lodgements up to date in order to access the SBR Regime.
Recommendation 7	Consideration should be given to raising the debt cap for access to the SBR Regime, to allow the process to be used for larger SME entities.
Recommendation 8	Consideration should be given to whether the VA and SBR regimes can be better aligned or even combined into a single regime with a debtor-in-possession option.
Recommendation 9	Consideration should be given to reducing the complexity and cost of the simplified liquidation process to encourage its use by micro-businesses.

Recommendation 10	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 make orders about creditor-defeating dispositions.
Recommendation 11	The PJC should, or should recommend that the Attorney-General's Department, consider and move to implement the recommendations of the Whittaker Review into the PPSA.
Recommendation 12	The legislative scheme governing corporate insolvency (including relevant parts of the Corporations Act and the various schedules, regulations, rules, legislative instruments and guidance that apply) should be redesigned to eliminate unnecessary and obsolete provisions, establish a single source of relevant law, and provide a more easily navigable system for stakeholders.
Recommendation 13	Care should be taken in recommending or implementing any reforms to the unfair preference regime that might have the effect of incentivising directors to dispose of company assets prior to appointments in a manner contrary to creditors' interests as a whole.
Recommendation 14	Consideration should be given to the repeal of the Commissioner's statutory indemnity under section 588FGA of the Corporations Act.
Recommendation 15	The PJC should recommend to the Attorney-General's Department that action be taken to legislate for the proper management of trusts with insolvent trustees, on the basis recommended by the Harmer Report, with appropriate amendments (as expanded upon in this Submission).
Recommendation 16	In the event that broad reform on trusts with insolvent trustees may take some time, the PJC should push urgently to legislate for the prevention of ejection of corporate trustees as an automatic event upon appointment of an external administrator.
Recommendation 17	The PJC should recommend to the Treasury that action be taken to implement recommendations 1—13 of the Safe Harbour Review (including its additional specific guidance suggestions) with any appropriate amendments.
Recommendation 18	In this Inquiry, and in any broader review that may be recommended by the PJC and conducted by the ALRC or some other appropriate body, the consideration raised by the Safe Harbour Review in section 15 of its report should be taken into account.
Recommendation 19	Consideration should be given to any necessary amendments to the moratorium arrangements (automatic or otherwise) for creditors' schemes of arrangement under section 411 of the Corporations Act.

Recommendation 20	Consideration should be given to the abolition of circulating security receivership, with secured creditors given, in its stead, advantageous rights in an administration (such as choice of an administrator).
Recommendation 21	Consideration should be given to whether or not creditors' schemes of arrangement (or indeed the VA regime) should have available a "cross-class cram down" (**CCCD**) mechanism for classes of creditors who are effectively out of the money.
Recommendation 22	Consideration should be given to whether or not a more effective mechanism for access to super-secured finance is required as part of the Australian restructuring regime.
Recommendation 23	A review should be conducted of publicly available information, particularly provided by government organisations, on insolvency processes and additional funding made available to ensure materials are freely available, as plainly put as possible, and comprehensive.
Recommendation 24	Consideration should be given to whether or not additional or expanded regimes for debtor-in-possession restructuring should be made available as part of the Australian restructuring regime.
Recommendation 25	Consideration should be given to whether or not a better-regulated scheme for pre-pack administrations is required as part of the Australian restructuring regime.
Recommendation 26	Consideration should be given to whether any of the investigative and reporting burdens on insolvency practitioners are more burdensome than is necessary, taking into account the cost-benefit analysis of that work for all stakeholders.
Recommendation 27	Consideration should be given to whether any amendment can be made to the systems or processes in place regarding ASIC's industry funding model in order to provide better certainty to insolvency practitioners in a timely manner about the amount for which they will be liable under the model.
Recommendation 28	Consideration should be given to amending the Corporations Act, in particular sections 433 and 561, to provide clear priority to insolvency practitioners for payment of external administration costs and expenses.
Recommendation 29	Consideration should be given to reallocating responsibility for corporate insolvency (and personal insolvency), including related matters such as the PPSA, to a single dedicated regulator under a single department.
Recommendation 30	Consideration should be given to whether the armoury of various enforcement mechanisms available to the ATO to improve the Commonwealth's position as an insolvency creditor (at the expense of other creditors) remain appropriate.

Recommendation 31	Consideration should be given to binding legislative guidance governing the manner in which 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.
Recommendation 32	Consideration should be given to clarifying expectations on external administrators in respect of the use of circulating assets and their proceeds to fund trade-on activity, either in legislative form or binding guidance.
Recommendation 33	The PJC should, or should recommend that the Attorney-General, consider a broad review by the ALRC or another appropriate body into the potential harmonisation of corporate and personal insolvency laws as part of the redesign of the corporate insolvency legislative regime.

Overarching considerations

8. Before turning to the particular terms of reference of the Inquiry, it is appropriate to make some introductory comments about the insolvency regime in Australia.

The system works

9. In the Committee's view, the system works generally well and effectively. In answer to relatively frequent criticisms of the regime by certain stakeholders within it, it must be remembered that insolvency processes are designed to address circumstances where there is not enough money to go around.

10. Against that background, it is inevitable that some people will end up aggrieved. Stakeholders who do not often come into contact with insolvency are particularly likely:

    (a) to have difficulty navigating what is necessarily a complex regime; and

    (b) to be surprised about outcomes which are uncommon to ordinary business circumstances (such as not being paid where they would ordinarily be entitled to be paid, or indeed having to disgorge payments where they have committed no legal wrong).

A review is appropriate in any event

11. It has been over 39 years since the then Attorney-General tasked the ALRC with conducting a general review into insolvency which led to the Harmer Report.[5]

12. In a recent speech, the now chair of the ALRC, the Honourable Justice Sarah Derrington noted that that review was triggered by changes to the economic circumstances, and that the Section has seen a corresponding change in recent times:[6]

    2. As the Harmer Report recognised, "[i]nsolvency law is a matter of considerable importance to the Australian community", yet at that time, "[t]he law of corporate insolvency ha[d] never been reviewed". The ALRC also made the point that

    > *…there has been an extraordinary increase in the use of credit. Inflation has become a fact of economic life. Interest rates fluctuate. There has been high unemployment. These factors have led to a large increase in the number of insolvencies. This increase has further indicated shortcomings in the present insolvency procedures.*

    3. The same could be said about the expansion of the financial services market in Australia since 1988. The size and diversity of Australia's financial markets has increased from $4.3 trillion in 2001 to $19.5 trillion in 2021. Particular markets, such as those for derivatives and employee share schemes have exploded from $120 billion in 2001 to $727 billion in 2021.

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5 Harmer Report, Terms of Reference, 20 November 1983.

6 "The Changing Face of Law Reform in Australia: Commentary on the ALRC's Inquiry Into Insolvency, Its Contribution to the Current Legal Framework and the Need for a New Review Given the Passage of Over 30 Years", The Hon Justice S C Derrington, 11 November 2021, https://www.alrc.gov.au/wp-content/uploads/2021/11/211111-ALRC-ARITA-Keynote-DerringtonJ.pdf.

4. *In light of changes to business and personal finances, it is crucial that the insolvency system is regularly reviewed to keep pace with modern commercial imperatives. …*

13. Many but not all of the recommended reforms in the Harmer Report were introduced. A notable exception is the Harmer Inquiry's recommendations in respect of trusts with insolvent trustees, which continue to cause issues in today's regime. (We make recommendations in this respect under TOR3.)

14. Some law reform has followed in the intervening decades. Many of the most important reforms to the insolvency regime followed from a report by the Productivity Commission in 2015,[7] although that inquiry was not specifically focussed on insolvency matters.[8]

15. Much of the reform the Section has seen has been narrowly focussed and lacking in a holistic approach to the regime. We have progressively seen reforms which seek to protect certain classes of stakeholder, such as:

    (a) employees, by the enactment of the FEG system and various other reforms which are only accessible to entities who have paid all employee entitlements (such as safe harbour defences and the SBR Regime);

    (b) the ATO, by the various additional powers available to the Commissioner outside the formal order of priorities for creditor claims, including to pierce the corporate veil; and

    (c) trade creditors such as construction subcontractors, for example by State by State security for payment requirements.

16. The effect of those various reforms is that the regime has become somewhat unwieldy. The average stakeholder, particularly with no previous experience in the regime, can struggle to understand and navigate the system. More detail on the difficulties arising in this regard is included in the Section's analysis of TOR2 below.

What should our insolvency regime achieve?

17. In assessing the competency of the regime, it is necessary to ask what we want the regime to achieve. The Harmer Inquiry analysed what was termed the key "[p]rinciples of contemporary insolvency law", which Justice Derrington recently summarised as follows:

    1. *the fundamental purpose of an insolvency law is to provide a fair and orderly process for dealing with the financial affairs of insolvent individuals and companies;*

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

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7 2015 PC Report.

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

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

4. *as far as is possible and practical, insolvency laws should not conflict with the general law.*[9]

18. Hidden in those four key principles are a series of policy questions on complex matters to which there are no easy answers. A good example is the balance between, ensuring the regime encourages business continuation and employment where possible (on the one hand), and punishing poor corporate behaviour and maximising creditor returns (on the other).

19. Those ends will not always be at odds, but they often are. As it stands, for example, at least in principle, the voluntary administration regime (discussed further under TOR2 below) encourages continuation of business as a primary aim, even at the potential expense of creditor return,[10] although practitioners inevitably maintain creditor outcomes as a key focus, given they usually control the outcome through their voting rights.

This Inquiry

20. Given those matters, this Inquiry is a welcome development. The Terms of Reference are very broad and encourage comment on a very wide range of matters.

21. Some matters raised in this Submission can be dealt with quickly and effectively by legislative or administrative action and do not require a lengthy process. The PJC is to be commended on instituting this Inquiry and on its dedication to a short timetable so that potential reform can be considered in the near term.

22. Necessarily, some of the matters raised in this Submission may not be able to be dealt with in such an expedited manner. We have identified several areas where a broader consideration of the law may be required which might take some time.

23. Further, despite the breadth of the Terms of Reference, there are some matters outside the scope of the Inquiry. In particular, the potential to investigate further alignment between the corporate and personal insolvency regimes may need to be considered in a different forum.

24. For those reasons, some of the recommendations in this Submission are framed in the alternative or may be treated in the alternative—if the PJC is not able to recommend a position on some matters (in the time available or at all), it may be appropriate to recommend a further inquiry into those matters by the ALRC or another appropriate body similar to Corporations and Markets Advisory Committee (CAMAC) which was established in 1989 under the Australian Securities and Investments Commission Act 2001 (Cth) to provide advice and recommendations to the Minister about matters relating to corporations and financial services law, administration and practice, but which was abolished by Schedule 7 of the Statute

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9 The Changing Face of Law Reform in Australia, Derrington, above n6.

10 The objects set out in s435A of the Corporations Act emphasise “maximis[ing] the chances of the company, or as much as possible of its business, continuing in existence”, and only creditor return “if [that] is not possible”.

Update (Smaller Government) Act 2018 (Cth), which commenced on 21 February 2018.

Recommendation 1

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

The role of the Committee and the BLS

25. The approach taken in this Submission is to identify aspects of the regime which are working well, and those which may be open to improvement.

26. As is appropriate, the Section has made observations in this Submission on policy matters by virtue of its Committee members' experience with the regime. That is to be expected given their key role in assisting insolvency practitioners and other stakeholders in the administration of the insolvency and restructuring regime.

27. Nonetheless, except in very clear cases, the Section has attempted in this Submission to refrain from advocating for specific policy outcomes where different views might genuinely be held on those matters. Instead, where possible, it has identified the issues and made a recommendation in appropriate cases that the PJC make a determination on the matter or, if convenient, refer the matter for further consideration in a further inquiry.

TOR1—Recent and emerging trends

Scope

28. TOR1 covers recent and emerging trends in corporate insolvency practices:

    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*

29. The TOR invites particular comment on recent developments. Given the framing of the TOR, responses will necessarily involve a focus on anecdotal matters and so the examples and analysis provided in this Submission should be considered on that basis.

COVID-19 relief measures

30. The COVID-19 pandemic was described in 2020 by the then-Prime Minister as a dual crisis—a public health crisis spilling into an economic crisis.[11] Nonetheless, through the COVID-19 pandemic, Australia's economy performed reasonably well (in the two years from Q4 2019 to Q4 2021, Australia's real GDP increased by 3.4 per cent, ahead of the United States of America (**USA**), the United Kingdom (**UK)** and Canada, although behind some European countries and other OECD and non-OECD countries).[12]

31. The insolvency and other law reforms instituted primarily by the Treasury during 2020 need to be viewed through that prism: the economy was one of two primary foci of the reforms. The Committee and the BLS consulted closely with the Treasury and other arms of government during 2020 and 2021, making 19 formal written submissions on relevant law reform matters in those two years and consulting regularly with government representatives.

32. The Committee's observations arising directly from the pandemic reforms are as follows:

    (a) Government reacted quickly and efficiently, effecting changes to law in a timeframe members of this Committee had not previously seen.

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11 "Inside the crisis that changed Australian government", Sydney Morning Herald, 9 June 2020, https://www.smh.com.au/politics/federal/inside-the-crisis-that-changed-australian-government-20200608-p550hl.html.

12 "Minister overstates COVID comparison with 'world's best' economy boast", AAP, 12 April 2022, https://www.aap.com.au/factcheck/minister-overstates-covid-comparison-with-worlds-best-economy-boast/.

(b) Those timeframes necessarily created challenges, including incredibly short consultation periods. The necessary consequence was that some of the reforms included loose language and have unnecessarily complicated certain parts of the regime. A good example of that issue was uncertainty debated in great detail amongst insolvency practitioners about the proper interpretation of section 588GAAA of the Corporations Act and whether, in order to attract the temporary safe harbour relief from insolvent trading liability, a director was required to make an insolvency appointment prior to the end of 2020.[13]

(c) Whilst many of the reforms were temporary, some of the legislative reforms enacted in a short timeframe are permanent (such as the simplified liquidation process and SBR Regime discussed further under TOR2 below). Whilst no criticism is made of those who worked hard to achieve reform in those circumstances, there are opportunities to examine and tidy up deficiencies in the legislative drafting now.

33. The Committee's recommendations in respect of particular pandemic reforms are contained in its discussion under TOR2 regarding the specific relevant reform packages.

The effect of economic conditions

34. Some of the COVID-19 reforms and the accompanying economic conditions still affect the economy today. The JobKeeper programme, coupled with the temporary amendments to the statutory demand regime, arguably kept companies alive which otherwise would have failed, resulting in insolvency appointments during the pandemic period dropping by as much as 40 percent year-on-year.[14]

35. The widely feared "cliff" bringing with it a supposed wave of insolvency appointments has not (yet) eventuated. A consequence is that there are necessarily companies which would have failed but have not.[15] The BLS does not have access to necessary financial statistics to quantify that issue, but it may be that ATO or ABS data could confirm whether there are indeed a large number of so-called "zombie" companies as has been alleged.[16] Arguably, that state of affairs is problematic at a macro level, as it represents an inefficient allocation of resources—these insolvent entities are not paying their stakeholders, including their taxation obligations, and in accordance with the Harmer principles identified at paragraph 17 above, need to be dealt with effectively.

36. Certainly there seems to be some evidence that there is indeed a large number of companies in financial distress, given the 70 percent rise in unpaid Commonwealth

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13 See, e.g., "Don't Go Chasing Waterfalls - unfortunately, s588GAAA is (still) just not safe", Stephen Mullette, 17 December 2020, https://www.linkedin.com/pulse/dont-go-chasing-waterfalls-unfortunately-s588gaaa-still-mullette/.

14 ASIC Insolvency Statistics, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/.

15 Though note the observations of Russell Morgan in an early submission to this Inquiry about the large number of companies deregistered either compulsorily or voluntarily without any formal insolvency process: "Submission to the Inquiry into Corporate Insolvency in Australia", R Morgan, 15 November 2022, https://www.aph.gov.au/DocumentStore.ashx?id=a711e0df-0cb5-4f9a-8a3b-965a317422cd&subId=725631.

16 "Be afraid: the zombie economy can't last", Australian Financial Review, 23 December 2021, https://www.afr.com/wealth/personal-finance/be-afraid-the-zombie-economy-can-t-last-20211218-p59imx.

taxes during the pandemic, recently reported to be $45 billion.[17] It may be that increased recovery activity by the ATO during the 2022 calendar year[18] begins to address those issues. The ATO's position as an insolvency stakeholder and regulator more generally is discussed in more detail under TOR6 below, along with the Committee's relevant recommendations.

37. More anecdotally, members of the Committee report that particular economic conditions, which appear to be affecting current insolvency numbers and events, include primarily:

    (a) the increasing cost of labour;

    (b) supply chain issues, including both the consequent delay and price effects; and

    (c) the cost of, and difficulties obtaining, finance, particularly compared to more freely available capital in recent times.

38. A particularly hard-hit area in respect of all three of those economic conditions is the construction industry, and there is at least anecdotal evidence of a deepening crisis in that space, particularly in the fixed-price housing market, where construction companies have a limited ability to respond to delays and increased costs (including of their subcontractors) because of the (arguably necessary) inflexibility in standard residential construction contracts.

39. The Committee makes observations in this section in an attempt to provide information to the PJC to assist with its findings under the Terms of Reference. The Committee does not make any particular recommendation under this TOR.

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17 "Distressed taxpayers owe the government $45b", Australian Financial Review, 31 October 2022, https://www.afr.com/politics/federal/distressed-taxpayers-owe-the-government-45-billion-20221031-p5bube.

18 "ATO prioritising support and assistance for debt collection efforts", Media Release – ATO, 13 May 2022, https://www.ato.gov.au/Media-centre/Media-releases/ATO-prioritising-support-and-assistance-for-debt-collection-efforts/.

TOR2—Operation of the existing law

Scope

40. TOR2 invites comment on the existing regulatory environment:

> *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 in the context of corporate insolvency.*

41. The TOR explicitly mentions one relatively well-established reform (that is, the PPSA) and three relatively recent reforms, but does not limit itself to those reforms alone. Necessarily, comments will cover the broader regime and other reforms such as those established under the ILRA. We have included consideration of the voluntary administration regime and some observations more generally about the existing state of the legislation.

The voluntary administration regime

42. Introduced in 1993[19] following the Harmer Report, voluntary administration has a significant track record of success. Whilst not specifically mentioned in this TOR, it bears mentioning as it forms a material part of the Australian insolvency space.

43. Despite calls over the years for consideration of alternative regimes such as the USA's Chapter 11 corporate bankruptcy[20] restructuring system, the Committee feels that the voluntary administration regime is generally a better system in the Australian marketplace. It serves both large and SME business well (although the cost of the process is occasionally a prohibitive factor for micro-businesses), and save for a small number of potential improvements, the system works well.

44. As already mentioned,[21] the voluntary administration regime emphasises the continuation of business as a key aim. Members of the Committee report that the moratoria allowing businesses to continue to trade through a voluntary administration provide an efficient and effective mechanism to achieve business restructure provided funding is available to finance the so-called "trade-on" activities. In that regard, the Committee notes:

> (a) the voluntary administration regime generally involves personal liability on the part of administrators for debts incurred during continued trading activity;

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19 *Corporate Law Reform Act 1992* (Cth).

20 Note that the American corporate insolvency regime uses the term "bankruptcy" to include corporate insolvency, whereas in Australia "bankruptcy" is used exclusively in reference personal insolvency.

21 See paragraph 19 above.

(b) consequently, the process can be more expensive than ordinary trading (as administrators require surplus funds on trust or other protective measures to ensure they are not personally exposed); and

(c) debtor-in-possession models (discussed further in TOR4 below) are often proposed as an alternative solution in order to allow the continuation of trade by the existing management team, but notably it is important that continued trading in that environment must be supervised in some way in order that a moratorium on creditor enforcement can be justified. Further, supervision can also be costly (it is suggested that the US Chapter 11 regime is a particularly costly alternative).

45. There is no doubt that VA trading activity can be expensive. That expense increases due to strict conflict and independence requirements on appointees meaning insolvency practitioners involved in the lead-up to appointment are often unable to take on an appointment. It is at least arguable that those rules overemphasise the risks associated with poor corporate behaviour by insolvency practitioners, to the detriment of creditors, whose returns are diminished by the increased costs associated with having an additional practitioner involved.

46. Another alternative to the costs of continued trading through a VA is the introduction of a pre-pack administration regime, also discussed further in TOR4 below. Such a regime formally allows the disposition of business assets prior to the appointment of administrators, provided necessary procedures are followed.

47. The consequence of the somewhat expensive nature of the “trade-on” administration regime is that whilst the regime has been generally successful at providing an effective mechanism for continuation of viable businesses despite point-in-time insolvency, the returns to ordinary unsecured creditors can suffer.

48. There are a few perhaps unnecessarily expensive aspects of a VA that could be addressed in short order. In particular, expensive court applications are required for often relatively simple transactions utilising creditor funds for limited advantage. They include:

(a) necessarily seeking court approval for even short extensions of the convening period for the second meeting of creditors under section 439A of the Corporations Act; and

(b) necessarily seeking court approval to limit administrators’ personal liability under section 443A of the Corporations Act for finance provided during the administration, even where the lender agrees that personal liability should not attach.

49. Whilst the protections have justifiable ends, particularly in SME administrations, the $10-$20,000 or more spent on court applications of this nature can significantly detract from the viability of continuing to trade the business, and even if viable, dissipate creditor returns unnecessarily. That cost outweighs any benefit of the court protection, in circumstances where it is quite rare for these applications to be refused.

50. Alternative approaches may be for an administrative approval process rather than requiring a court application, or a default position that no court application is required unless a creditor requests it within a certain period of notice being provided.

51. Legitimate criticism has been made of certain administrative process reforms (such as the regime by which ASIC may declare a creditor-defeating disposition, discussed later under this TOR2), but that does not mean an administrative process cannot work *per se* if designed and administered appropriately.

Recommendation 2

Consideration should be given to relaxing independence requirements on voluntary administrators associated with pre-appointment work or providing more efficient mechanisms for managing those independence requirements (such as simplifying the appointment of special purpose investigators to report on pre-appointment matters).

Recommendation 3

Consideration should be given to replacing the requirement for court applications for section 439A convening period extensions with an administrative process or alternatively a default approval process.

Recommendation 4

Consideration should be given to replacing the requirement for court applications for orders limiting administrators' personal liability for moneys borrowed with an administrative process or alternatively a default approval process (particularly if the lender consents).

Small business restructuring

52. The SBR regime was introduced as a cost-efficient way to manage the expected wave of insolvencies following the COVID-19 pandemic. That wave has not (yet) arrived and indeed during the first year or so of operation, the SBR regime was barely used. Initial explanations for that lack of use included difficulties associated with satisfying the relevant thresholds.

53. However, usage of the regime has materially improved in recent months:[22]

	2021				2022		
Calendar Quarter	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**
Restructurings	5	7	8	13	9	40	83
Restructuring Plans	1	5	7	12	5	13	45

[22] ASIC Insolvency Statistics, above n14.

54. The Committee suggests that as practitioners get used to the legislative provisions and procedures and develop tools to be able to use the regime more effectively, usage has increased.

55. Nonetheless, the number of restructuring appointments pales into insignificance compared with the total number of appointments. The total average number of insolvency appointments per quarter across those seven quarters was 1,743. Even the increased numbers in the September quarter of 2022 make up a mere 5 percent of the 2,528 total number of appointments.

56. Anecdotal reports to Committee members suggest that the cost of a standard SBR is in the order of $15–25,000, rather than in the $5,000 originally contemplated. Ultimately, despite attempts to simplify the SBR process, it is not significantly cheaper to implement than a VA process, perhaps aside from the cost of an external administrator continuing to trade the business which is avoided under the SBR Regime. The insistence of the ATO on relatively rigorous analysis by an SBR practitioner contributes to difficulties in containing costs. That cost may be a factor in preventing more extensive use of the scheme by micro-businesses with limited available cash. Consideration should be given to whether the process could be even further simplified to reduce its cost. That would require less onerous obligations on the insolvency practitioner appointed to perform the role.

57. There is room to argue that the barriers to accessing the SBR regime should be loosened. There is not a clear policy basis for excluding entities which have not paid employee entitlements (as distinct from any other stakeholders), particularly given:

    (a) those employee entitlements are generally protected in the replication of the section 556 order of priorities as part of any restructuring arrangement;[23] and

    (b) in any event, at least some employees are likely to retain their jobs if a restructuring can be achieved, benefitting the employees who retain employment and the Commonwealth which does not have to make the FEG scheme available.

58. In the same vein, strict compliance with taxation lodgement requirements might not need to be a formal requirement to access the SBR Regime. Bringing lodgements up to date can be materially cost-prohibitive for SBR practitioners, to the creditors' disadvantage (including the Commissioner).

59. Similarly, it is arguable that the debt cap should be raised to make the SBR Regime available to all SME businesses, as distinct from just those with minimal debts (in practice, mostly micro-businesses). Against that, it might be argued that:

    (a) debtor-in-possession regimes present risk for creditors, particularly given the automatic moratorium on creditor enforcement and other activities where directors' continued trading activity might be effectively unchecked;

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[23] Section 556 of the Corporations Act sets out the order of priority for classes of unsecured creditors claiming against available assets in a liquidation.

(b) that risk needs to be balanced against the benefits of the regime, including cost savings avoided by not having a VA involved in trading the business on; and

(c) balancing these factors favours the SBR Regime most strongly for smaller businesses with smaller debts, where a VA would be cost-prohibitive or at least extra-destructive of creditor return relatively.

60. In any event, consideration should be given to whether either the SBR Regime or some modified version of it could be made available to all SME businesses.

61. Indeed, there is a suggestion from some of the Committee's members that there is enough material alignment between the SBR and VA regimes that they could be effectively combined into one set of legislative provisions, reducing complexity in the Corporations Act (see further discussion on that topic later in this TOR2) and simplifying navigability for consumers.

Recommendation 5

Consideration should be given to reducing the complexity and cost of the SBR Regime to encourage its use by micro-businesses.

Recommendation 6

Consideration should be given to relaxing either or both of the requirements that companies need to have paid all employee entitlements and have their taxation lodgements up to date in order to access the SBR Regime.

Recommendation 7

Consideration should be given to raising the debt cap for access to the SBR Regime, to allow the process to be used for larger SME entities.

Recommendation 8

Consideration should be given to whether the VA and SBR regimes can be better aligned or even combined into a single regime with a debtor-in-possession option.

Simplified liquidation

62. Simplified liquidations were another development intended to cater for the expected (but so far absent) large wave of insolvencies following the COVID-19 pandemic. Unfortunately, the process has been rarely used:

	2021				2022		
Calendar Quarter	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**
Simplified liquidations	12	11	10	7	5	7	8

63. Unlike the SBR Regime, usage of the simplified liquidation process has not yet picked up. Whilst it may simply be a matter of time, the Committee suggests that consideration could be given to further reducing complexity and costs associated with the process. If that cannot be achieved, it is difficult to justify retention of a process which is rarely used.

Recommendation 9

Consideration should be given to reducing the complexity and cost of the simplified liquidation process to encourage its use by micro-businesses.

Unlawful phoenixing reforms

Creditor-defeating dispositions

64. Proposed legislation to combat so-called "unlawful phoenixing" was first announced in 2017.[24] Those reforms were not ultimately implemented until early 2020.[25]

65. "Phoenixing", conceptually, is the continuation of an existing business, usually in a new entity, leaving the old entity liquidated or otherwise abandoned with some creditors left unpaid. Clearly enough, done properly that process is consistent with the aims of the voluntary administration regime—the continuation of business even if at times at the expense of creditor returns.[26]

66. However, phoenixing is often achieved nefariously, and without adequate (or sometimes any) payment for business or business assets. That activity is usually known as unlawful (or illegal) phoenixing. The 2020 reforms introduced a concept of creditor-defeating disposition, a new voidable transaction, where a company disposes of assets effectively below their true value. A PricewaterhouseCoopers report commissioned by the ATO's Phoenix Taskforce estimated the annual direct impact on the Australian economy of illegal phoenix activity as between $2.85 billion and $5.13 billion.[27]

67. Additionally, liquidators can now obtain a determination from ASIC that the relevant disposition was creditor-defeating at first instance (avoiding any court involvement), with the onus then on the recipient to prove in court that it was not. The intention of

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24 "A comprehensive package of reforms to address illegal phoenixing", Media Release – Minister for Revenue & Financial Services, 12 September 2017, https://ministers.treasury.gov.au/ministers/kelly-odwyer-2016/media-releases/comprehensive-package-reforms-address-illegal-phoenixing.

25 The *Treasury Laws Amendment (Combating Illegal Phoenixing) Act* 2020 received royal assent on 17 February 2020.

26 See discussion at paragraphs 19 and 44 above.

27 "The economic impacts of potential illegal phoenix activity report", PricewaterhouseCoopers, July 2018, https://www.ato.gov.au/uploadedFiles/Content/ITX/downloads/The_economic_impacts_of_potential_illegal_Phoenix_activity.pdf

that regime is to make it easier for unfunded liquidators to unwind illegal phoenix activity where there are no assets left in the company and no funding to pursue court proceedings. A corollary is that the provisions should discourage illegal phoenixing in the first place.

68. We note in passing that some concern has been expressed about the constitutionality of ASIC's power under this new provision.[28] Ideally any review of the operation of the provision should give thought to the same issue.

69. Some members of the Committee have been critical of the regime on the basis it has been somewhat ineffective. In particular:

    (a) in almost three years since the introduction of the regime, the Committee is aware of only a single successful court decision on a creditor-defeating disposition;[29] and

    (b) the Committee is not aware of a single determination by ASIC of the existence of a creditor-defeating disposition. [30]

70. Some counterarguments may be made in respect of those views:

    (a) First, it is likely to take some time following enactment of new legislation for results to be observed. Voidable transaction proceedings have a three-year limitation period from the so-called relation-back day (usually the start or about the start of the liquidation).[31]

    (b) Second, the effectiveness of rules prohibiting or punishing conduct cannot be measured solely by measuring recorded contraventions of those rules. If restructuring advisors in the lead up to insolvency are aware of the provisions, they will likely advise directors to ensure they do not contravene the rules, particularly given the provisions extend to duties on officers and prohibitions on other persons (such as advisors) in relation to procuring creditor-defeating dispositions.[32]

    (c) Third, even in the absence of final reported decisions or determinations about creditor-defeating dispositions, their existence may provide leverage to insolvency practitioners to negotiate return of or payment for property.[33]

71. Nonetheless, there are at least anecdotal reports to Section members that SME directors appear to consider ASIC to be somewhat ineffective in respect of pursuit of

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28 See, e.g., the Committee's views on the initial consultation for the introduction of the provision: "Treasury Law Amendment (Combating Illegal Phoenixing) Bill 2019 – Submission", Law Council of Australia BLS, 13 March 2019, https://www.lawcouncil.asn.au/publicassets/777586a9-f849-e911-93fc-005056be13b5/3599%20-%20Treasury%20Law%20Amendment%20Combating%20Illegal%20Phoenixing%20Bill%202019.pdf.

29 *Franklin v Tecnologie Fluenti Pty Ltd (Re Intellicomms Pty Ltd (in liq))* [2022] VSC 228 and subsequent decisions involving the same company.

30 under 588FGAA of the Corporations Act.

31 Corporations Act, s588FF(3).

32 See, e.g., Corporations Act, ss588GAB and 588GAC.

33 See, e.g., *3 Property Group 13 Pty Ltd (In Liq) v 3 Property Group 17 Pty Ltd* [2021] FCA 1158, where liquidators obtained orders to maintain caveats over the title while proceedings (and presumably negotiations) progressed in relation to a final outcome.

poor corporate behaviour by SME directors. If that is the case, more needs to be done to address this issue. Further, the Section has already noted observations about large numbers of companies being deregistered (either voluntarily or compulsorily) without any formal insolvency process.[34] More examination of those cases may be required to determine whether there is a pattern of behaviour to achieve unlawful phoenixing with no recourse. With the benefit of some empirical data, proper consideration should be given to whether the creditor-defeating disposition regime is working effectively.

Recommendation 10

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 make orders about creditor-defeating dispositions.

72. A material additional challenge arises in respect of many micro-businesses, in that they may hold few or perhaps no assets of any value. Often, the value in the business is limited to relationships and some brand goodwill which is often worth nothing or very little without the individual associated with the brand (and is therefore not saleable).

73. Unfortunately, there is really nothing to be done in respect of the phoenixing of businesses of that nature. No formal insolvency appointment and sale of the business is likely to realise any value whatsoever out of the business, and whilst creditors may be aggrieved, there are few options to assist them. Options may be available to examine and pursue directors for trading activity or use of company funds or assets prior to the appointment, but if there is no disposition below value of business assets, the so-called "phoenix" activity is unlikely to be actionable, with or without strong anti-phoenixing laws.

Director identification numbers

74. Another reform introduced in the legislative anti-phoenixing package was the introduction of director identification numbers. It appears generally accepted that this reform is welcome and it is useful to be able to track directors who might otherwise use slightly different names and addresses in respect of different entities to avoid matching of their roles.

75. That system is only now in the process of introduction and has been subject to some criticism from the community. The roll-out has faced challenges and, a week before the 30 November 2022 deadline for registration, fewer than 1.5 million of Australia's estimated 2.5 million directors had registered.[35]

76. It is somewhat unclear why the ABRS (Australian Business Registry Services), which administers the scheme, is a department of the ATO rather than ASIC (which regulates company directorship). At least at first impression, the addition of an additional regulator into the company officer registration space is likely to create

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34 Morgan, above n15.

35 "ATO's director ID system deadline looms, with more than 1 million people facing $13,000 fines", ABC, 23 November 2022, https://www.abc.net.au/news/2022-11-23/director-id-ato-update-one-week-left/101682400.

inefficiency. Evidently, the rollout of that system is a challenging task, and it may be that the administrators of the regime simply need more time to establish the system. The Committee has made recommendations in respect of the potential for a more streamlined single-regulator system in its comments regarding TOR6 below.

The PPSA

77. The PPSA was introduced in 2009 (though the legislation commenced in 2012), in an effort to provide for a national scheme governing security interests in personal property and providing rules as to their priorities and enforcement.

78. The regime was the subject of the very thorough Whittaker Review in 2015. The BLS made six separate submissions to the Whittaker Review (in answer to its two calls for submissions and four separate consultation papers).[36] It is unnecessary to re-examine the detail of all of those matters here. The recommendations of the Whittaker Review received strong support from the BLS, other professional bodies and business groups. Unfortunately, only a few of the recommendations of the Whittaker Review have been implemented.

79. Whilst it may be useful to revisit the recommendations of the 2015 review in the context of the PJC's review of insolvency laws, a wholesale re-examination of the PPSA may not be warranted other than to the extent necessary to identify any issues with the regime considered on a holistic basis.

80. There are a relatively small number of changes that could be made to both the PPSA, and the functionality of the PPSR, which would likely result in significant practical improvements. The Whittaker Review identified these things (among its 394 recommendations) but in the main they are yet to be properly considered or implemented by Government.

81. The PPSA is clearly a complex legislative package and is difficult at times for some stakeholders to understand. However, the materials published by AFSA on the PPSR website[37] are, in the main, clear and helpful, and the registration and search systems are easy to use and efficient. On balance, it is strongly arguable that the

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36 Statutory Review of the Personal Property Securities Act 2009 (Cth) – Submission 1, Law Council of Australia BLS, 6 June 2014 https://www.lawcouncil.asn.au/publicassets/2861483d-e1d6-e611-80d2-005056be66b1/140606-Submission-2838-Statutory-Review-Personal-Property-Securities-Act-2009.pdf; Statutory Review of the Personal Property Securities Act 2009 (Cth) – Submission 2, Law Council of Australia BLS, 28 July 2014 https://www.lawcouncil.asn.au/publicassets/03a0844f-e1d6-e611-80d2-005056be66b1/140728-Submission-2868-Statutory-Review-Personal-Property-Securities-Act-2009.pdf; Statutory Review of the Personal Property Securities Act 2009 (Cth) - Response to consultation Paper No. 1, Law Council of Australia BLS, 10 November 2014, https://www.lawcouncil.asn.au/publicassets/34565143-e1d6-e611-80d2-005056be66b1/141110-Submission-2903-Statutory-Review-Personal-Property-Securities-Act-2009.pdf; Statutory Review of the Personal Property Securities Act 2009 (Cth) - Response to Consultation Paper No. 2, Law Council of Australia BLS, 14 November 2014, https://www.lawcouncil.asn.au/publicassets/3e565143-e1d6-e611-80d2-005056be66b1/141114-Submission-2904-Statutory-Review-Personal-Property-Securities-Act-2009.pdf; Statutory Review of the Personal Property Securities Act 2009 (Cth) – response to consultation paper No. 3, Law Council of Australia BLS, 28 November 2014, https://www.lawcouncil.asn.au/publicassets/364a5a49-e1d6-e611-80d2-005056be66b1/141128-Submission-2913-Statutory-Review-Personal-Property-Securities-Act-2009-Response-Consultation-Paper-NO3.PDF; Statutory Review of the Personal Property Securities Act 2009 (Cth) - Response to Consultation Paper No.4, Law Council of Australia BLS, 19 December 2014, https://www.lawcouncil.asn.au/publicassets/544a5a49-e1d6-e611-80d2-005056be66b1/141219-Submission-2919-Statutory-Review-Personal-Property-Securities-Act-2009.pdf.

37 https://www.ppsr.gov.au/.

system is better than its amalgam of predecessor arrangements which included some obligations to register charges with ASIC, various state-based vehicle and other registries and other arrangements left simply to the common law.

Recommendation 11

The PJC should, or should recommend that the Attorney-General's Department, consider and move to implement the recommendations of the Whittaker Review into the PPSA.

Structural issues with the legislative scheme

82. The corporate insolvency regime has its base in Chapter 5 of the Corporations Act. At least initially, that Chapter (and the associated provisions of its predecessor in the Corporations Law, enacted under the *Companies Act 1989* (Cth) until constitutional issues led to the present legislation) and the accompanying regulations contained all of the relevant material stakeholders needed to assess insolvency issues.

83. In the subsequent decades, reforms and administrative action have led to an almost incomprehensible amalgam of provisions which are difficult to locate and interpret. Some, but not all, of the relevant provisions are now contained not in Chapter 5 of the Corporations Act but in a schedule to the Act known as the IPS, or the *Insolvency Practice Schedule (Corporations)*. That enactment is to be distinguished from the IPS(B) or *Insolvency Practice Schedule (Bankruptcy)*, which contains similar, and similarly numbered, provisions (but which are not the same). Both schedules are to be distinguished from the IPR or *Insolvency Practice Rules (Corporations)* and the IPR(B) or *Insolvency Practice Rules (Bankruptcy)*, which again contain similarly numbered, but different provisions removed in the main from the Corporations Regulations.

84. The legislative scheme in respect of matters pertaining to single issues or events are disparately placed, so that convening a first meeting of creditors requires one to consider section 436A of the Corporations Act, regulation 5.3A.03A of the Corporations Regulations, Division 75 of the IPS and Divisions 70 and 75 of the IPR. Other relevant legislation, such as the PPSA, applies to the corporate insolvency regime, but provisions on similar matters are contained inexplicably in different places—so that, for example, vesting of a security interest in a grantor for late registration is dealt with in section 588FL of the Corporations Act, whereas vesting of a security interest in a grantor for failure to register at all is dealt with in section 26 of the PPSA.

85. Legislative instruments (such as those used during the COVID-19 pandemic to make special rules as to meetings) make additional changes, which are often oblique and difficult to find. A recent example relates to the enactment of the Corporate Collective Investment Vehicles (**CCIV**) regime by the CCIV Act. That legislation introduced a new type of company with sub-funds, to be used in funds management. An existing ASIC legislative instrument, *ASIC Corporations (Externally-Administered Bodies) Instrument 2015/251*, exempted registered managed investment schemes from certain financial reporting obligations in the event of insolvency. A new legislative instrument, ASIC Corporations (Amendment) Instrument 2022/0940, came into force earlier this month and amends the earlier instrument to provide that retail CCIVs are exempted in certain (but not all)

circumstances from those financial reporting requirements in the event a sub-fund has a liquidator appointed to it.

86. Complicated legislation in respect of complicated matters is a necessary evil. The Committee makes no particular criticism here of the complexity of the substance of legislation covering these difficult subject matters. However, relevant provisions are messily arranged in different places and are difficult to find and navigate, even for experienced professionals.

87. In an interim report recently published by the ALRC as part of its review into financial services legislation, it was noted that the Corporations Act alone (leaving aside the other relevant sources) was now 3,700 pages long. Since late 2020, when the ALRC's inquiry began, 597 pages have been added.[38] In an interview following release of the report, the ALRC's Principal Legal Officer indicated its new prototype legislation covering certain parts of the Act could reduce the length of the legislation by 66 percent.[39]

88. The ALRC Chair, Justice Derrington, said this of the ALRC's research on the matter in late 2021:

> *17. As part of its Inquiry, the ALRC has undertaken extensive analysis, alongside wide-ranging consultations, which have revealed the following general problems with the law:*
>
> - *problem one—incomplete understanding of legislative complexity;*
> - *problem two—complex use of definitions;*
> - *problem three—difficulties navigating definitions;*
> - *problem four—overly prescriptive legislation;*
> - *problem five—obscured policy goals and norms of conduct; and*
> - *problem six—difficulties administering complex legislation.*
>
> *In sum, the ALRC has found that stakeholders generally feel that the law is too complex and in need of simplification.*

Recommendation 12

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

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38 "Interim Report B, Financial Services Legislation", ALRC Report 139, September 2022 https://www.alrc.gov.au/wp-content/uploads/2022/09/ALRC-FSL-Interim-Report-B-139.pdf.

39 "Corps Act should be slashed by 66 percent, says ALRC", Lawyers Weekly, 9 November 2022, https://www.lawyersweekly.com.au/biglaw/36027-corps-act-should-be-slashed-by-66-says-alrc.

TOR3—Other reform

Scope

89. TOR3 goes beyond the existing state of the law and invites comment on potential reforms that have been raised in the community.

> *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.*

90. The TOR once again names three specific potential areas for reform along with a reference to international developments, however, the TOR is not restrictive and the Committee has taken the opportunity to make reference to some other potential areas where reform might be considered.

The unfair preference regime

91. 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.

92. There are effectively two starting points for existing economic models of unfair preference regimes:

(a) The first option is that proposed by and large by the Harmer Report, which provides simply for a level playing field. An automatic (or close to automatic) determination that all payments close to appointment were preferences means that every unsecured creditor is effectively fairly treated. Whilst a person who has been paid and must disgorge the payment might feel particularly aggrieved, they are in no worse position than a person who was never paid in the first place.

(b) The second option, as has been adopted by some other jurisdictions such as the UK[40] and Hong Kong,[41] involves an additional intention or "desire" element associated with the transaction. That model does not seek to level the playing field absolutely, but instead to prevent a company's management from intentionally disposing of assets in the lead-up to appointment of an insolvency practitioner. Notably, the knowledge or intention of the recipient is not the relevant distinction under this model, but that of the company.

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40 *Insolvency Act 1986* (UK) s239.

41 *Companies Ordinance* (Cap 32) (HKSAR) s266B; *Bankruptcy Ordinance* (Cap 6) (HKSAR) s50.

93. The Australian legislative history in this regard is that all Australian state legislatures initially adopted what was then referred to as "fraudulent preference" provisions from the UK predecessor legislation. The New South Wales Parliament departed from the English approach in adopting (in 1841) a model of preference recovery where the debtor's intention had no bearing. Ultimately, despite all other states retaining the English system, when harmonised Commonwealth companies legislation was introduced, the NSW system was adopted.[42]

94. Material debate has ensued in recent times in Australia about the unfair preference regime. One primary reason for that is that, following law reform programmes focussed on several specific classes of specialised creditors (see paragraph 15 above) the plight of ordinary unsecured trade creditors, in particular subcontractors in construction and resource projects, has recently come to the fore.

95. Not only are those lowly ranked creditors rarely the recipients of material distributions out of insolvency processes, but payments they had received are often clawed back subsequently by liquidators.

96. Acknowledging the difficult position of those creditors, nonetheless, the preference regime is an important part of the legislative scheme. Without it, directors would be improperly incentivised to dispose of company assets prior to appointment to desired recipients at the expense of others. Even minor amendments to the legislation such as minimum caps on recovery are likely to present potential loopholes of which bad actors might take advantage. Indeed, standover tactics will be rewarded in the event that the preference recovery regime is disapplied. Consequently, the Committee recommends material caution in considering any reforms to the unfair preference regime recommended in other stakeholder submissions.

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

Recommendation 13

Care should be taken in recommending or implementing any reforms to the unfair preference regime that might have the effect of incentivising directors to dispose of company assets prior to appointments in a manner contrary to creditors' interests as a whole.

98. There is one particular issue with the unfair preference regime that appears to lack logical policy consistency and should be amended. The statutory indemnity in favour of the Commissioner by directors in relation to any amount that is required to be disgorged to the liquidator under a preference claim leads to odd and inconsistent outcomes. Whereas the director may not be personally liable for

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42 This legislative history is discussed by the Full Court of the Federal Court in *Ferrier and Another v Civil Aviation Authority* (1994) 127 ALR 472 at 484 - 488.

certain tax liabilities in the first place (notably, the Section has discussed DPNs and other personal liability issues for directors below), the director in any event becomes liable to the Commissioner for tax for which they would not otherwise have been liable purely because it was paid in the first place.

99. There are different views on the ideal strength of the Commissioner's priority in the liquidation order of priorities of creditor claims and other various leverage opportunities available to the Commissioner. However, whatever one's view on those matters, this clunky provision leads to perverse incentives on a director not to pay tax in the lead up to appointment of an insolvency practitioner, and certainly not to have honest conversations with the ATO about the financial circumstances of the company, lest personal liability arise as a result of a preference claim.

Recommendation 14

Consideration should be given to the repeal of the Commissioner's statutory indemnity under s588FGA of the Corporations Act.

Insolvent trusts

100. As already noted, the treatment of trusts under corporate insolvency law has long been identified as an area for improvement with historical calls for reform. Most significantly, the Harmer Report made several sensible recommendations for corporate trading trusts reform which remain unimplemented.

101. More recently in 2021, the Treasury consulted in relation to clarifying the treatment of trusts under insolvency law, but no reforms ensued. The BLS made a submission to the Treasury as part of that consultation process, the bulk of which it continues to adopt.[43] It is unnecessary to reproduce the bulk of that submission, but notably, the Committee recommends the adoption of the recommendations made in the Harmer Report, with some additional matters to take into account intervening events. The Committee's views on insolvent trust reform are as follows:

(a) (***Insolvency framework should provide for external administration of trusts with an insolvent trustee***) The Committee is supportive of extending the existing regime to all external administration processes to which corporate trustees can become subject. Such amendment should include clarity in respect of issues which commonly occur in this context, for example:

(i) the powers of external administrators appointed to insolvent corporate trustees to administer and sell trust assets;

(ii) the circumstances in which an insolvent company may be removed as trustee;

(iii) the right of the external administrator to be paid remuneration and expenses from trust assets;

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43 "Clarifying the Treatment of Trusts under Insolvency Law", Law Council of Australia BLS, 10 December 2021, https://www.lawcouncil.asn.au/publicassets/499912e6-328a-ec11-9449-005056be13b5/4138%20-%20Clarifying%20the%20treatment%20of%20trusts%20under%20insolvency%20law.pdf.

(iv) the ability of secured creditors with security over the whole or substantially the whole of trust assets to enforce that security interest;

(v) the treatment of exclusion or exoneration clauses in trust deeds in the event of the insolvency of the corporate trustee; and

(vi) the applicability of the voidable transaction regime to transactions conducted by a corporate trustee.

(b) The implementation of such a regime would provide clarity and certainty for key stakeholders including insolvency practitioners, trust creditors, trust beneficiaries, employees and trade creditors. Further, it would reduce the need (and associated costs) of court applications thereby preserving the trust funds available for distribution.

(c) Any revised framework should not operate to treat the external administration of trusts as distinct economic entities (at least not before first engaging in broader consultation with stakeholders).

(d) (An insolvent company's affairs and property should include those held as trustee) The Committee recommends that, consistent with the Harmer Report:

(i) a reference to the business or affairs of a company for the purpose of the operation of the insolvency provisions should expressly include a reference to its business or affairs as trustee; and

(ii) a reference to the property or assets of a company that is being wound up in insolvency should include the property and assets held by the company as trustee to the extent that the company is entitled to a charge or other beneficial interest in respect of that property/asset.

(e) Further, the Committee suggests that such references extend to all external administrations (including those not based in insolvency). It should be clear that an external administrator can control all aspects of a company's business activity (including as trustee) and the assets generated by this activity. This clarity would, among other things, avoid the costs associated with external administrators seeking court relief in relation to their ability to deal with and sell assets of the trust.

(f) (***No exclusion or limitation on the right of indemnity***) The Committee recommends that any term or condition of a trust deed that might have the effect of excluding or limiting a company from exercising the equitable right of indemnity against trust property for debts and liabilities properly incurred by the company in the conduct of a trust be void against the liquidator/voluntary administrator/managing controller appointed to the trustee or its assets (the concept of 'limiting' and the extension to a 'voluntary administrator or managing controller' constitutes an extension to the Harmer Report recommendation). There are currently inconsistent positions adopted by State legislation. The Committee's recommendations would provide for national uniformity and clarity and would ensure a fairness among creditors as the level of recoveries are dependent on the applicability of the indemnity.

(g) (***Limits on enforceability of ejection clauses***) Trustee ejection clause generally involve the automatic removal or disqualification of a trustee upon the occurrence of an insolvency event. The Committee recommends that:

(i) an ejection clause in a trust deed should have no effect in respect of an insolvent corporate trustee of a financially non-viable trust—in these circumstances, a trustee should only be replaced by Court order;

(ii) an ejection clause in a trust deed in respect of an insolvent corporate trustee of a financially viable trust be restricted unless a new trustee is appointed—the rationale for this is that the beneficiaries may want the trust to continue (with a new trustee), not in the hands of an external administrator; and

(iii) there be legislative provision that any attempt by an appointor to change the trustee after an external administration commences (or an application for external administration is brought) is void in the absence of approval from the Court or the external administrator.

(h) Whilst the current ipso facto provisions (introduced by the *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017* (Cth) and related statutory rules) go some way in implementing the first recommendation, there are gaps which require attention (for example, trust deeds which pre-date 1 July 2018 or corporate trustees which go straight into liquidation).

(i) Further, the Committee agrees with the Harmer Report recommendation that clauses in a trust deed that purport to exclude a corporate trustee's right of indemnity should be void against a liquidator (to the extent of a right of exoneration). This should also extend to limitation of liability clauses and other forms of insolvent external administrations.

(j) (***Searchable register of trusts***) The Committee recommends a public searchable register be created that makes available relevant details of the trust such as ABN (or other identifying number), current trustee, beneficiaries etc. This would provide clarity to key stakeholders such as creditors and other external administrators as to existing trust structures.

(k) (***Identification of trustees***) The Committee recommends that when acting as trustees, the trustee should be required to set out the name and ABN of the trust in all public documents and negotiable instruments. This will assist key stakeholders to understand, for example, whether a debt is incurred in by the corporate in its capacity as trustee of in its individual capacity.

(l) (***Notification to beneficiaries of sale***) The Committee recommends that beneficiaries of the trust be notified before the corporate trustee sells any of the trust assets. This would give beneficiaries an opportunity to pay the trustee or former trustee fair market value for the asset so that they or their value is retained in the trust or to apply for court orders prior to the sale.[44]

(m) (***Right of possession of trust assets***) The Committee recommends that the Corporations Act provide that, if a company holds trust assets when a new trustee is appointed, the former trustee be entitled to retain possession of the trust property to enforce its right of indemnity, until such right has been satisfied or secured. This would clarify the ability to enforce the right of

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44 It is acknowledged that a policy question arises whether that obligation should be limited to circumstances where the trustee is insolvent, given a sale which breaks exactly even (or perhaps returns minimal amounts to beneficiaries) gives rise to materially similar considerations for the beneficiaries.

indemnity as against the new trustee. This will assist in achieving a just outcome for creditors and make it more difficult to phoenix businesses and assets.

(n) (***Distribution of proceeds of right of indemnity***) The Committee recommends that a set of default rules apply to the distribution of proceeds on enforcement of the right of indemnity, with an ability similar to what is currently provided for in section 447A to vary their application as a particular case may require. Such default rules should generally follow existing trust principles and what is already done by external administrators of corporate trustees and former trustees, which is to use trust assets only to pay trust liabilities. There are two exceptions to this recommendation:

(i) where the company is a trustee of one trading trust and, other than inadvertently, did not trade or act in its own capacity, the Committee recommends that trust and non-trust creditors should be treated equally—this would act to achieve fairness among creditors (some of whom may not be aware in which capacity the company was acting) and be consistent with the general approach adopted in insolvency which seeks to treat creditors equally; and

(ii) where the company's own assets are insufficient to pay the costs and expenses attributable to the administration of the company's own non-trust affairs, they are to be to be paid from trust assets in the statutory order of priority.

(o) The Committee would be happy to discuss this recommendation and appropriate nuances in more detail.

(p) (***Protection of beneficiaries/unitholders***) The Committee make two further recommendations:

(i) the rule in *Hardoon v Belilios*[45] should not apply to trusts. A uniform national approach is required adopting the provisions of section 100A of the *Trustee Act 1925* (NSW) for the reasons previously articulated by the NSW Law Reform Commission;[46] and

(ii) the Corporations Act should be amended to clarify that oppression provisions apply to trading trusts—as explained by the Victorian Law Reform Commission.[47]

(q) (***Statutory indoor management rule***) For the same reasons that the statutory indoor management rule applies to companies (see sections 128 and 129 of the Corporations Act), the Committee recommends that a similar set of statutory assumptions apply to third parties dealing with a corporate trustee. Creditors should be entitled to assume that a trustee with whom a creditor is dealing is properly performing its duties as trustee. In this way, creditors

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45 [1901] AC 119.

46 "Laws relating to beneficiaries of trusts", NSW Law Reform Commission, Report 144, May 2018, https://www.lawreform.justice.nsw.gov.au/Documents/Publications/Reports/Report%20144.pdf.

47 "Trading Trusts – Oppression Remedies", Victorian Law Reform Commission, January 2015, https://www.lawreform.vic.gov.au/wp-content/uploads/2021/07/VLRC_Trading_Trusts_Report_Web.pdf.

would not be unjustly prejudiced by the trustee's right of indemnity—upon which the creditor's right to be paid from trust assets hinges—being compromised or reduced by a breach of trust by the trustee.

102. It is difficult to overstate the urgency of insolvent trust reform with these reforms anticipated by the Harmer Inquiry some 34 years ago. As much was lamented by three High Court justices in the opening paragraph of their famous *Carter Holt* judgment concerning insolvent trustees in 2019.[48] Regrettably, *Carter Holt* was not able to resolve even the simple question whether administrators or liquidators over insolvent (former) trustees ejected by contractual provisions maintain a power of sale as part of their lien over trust assets. Consequently, simple court proceedings to appoint external administrators as receivers and managers of trusts, and more complicated applications to deal with difficult priorities questions which are not properly dealt with in the legislation are expensive, time consuming and lead to worse outcomes for the practitioners, the stakeholders and everybody involved.

103. At the very least, urgent and simple reform (at little or no cost to Government) could provide for an *ipso facto* prohibition on the sacking of corporate trustees upon appointment - saving material court time, cost, and additional regulatory red tape (by virtue of court supervision of a court appointed receivership) for the administration of insolvent trading trusts.

Recommendation 15

The PJC should recommend to the Attorney-General's Department that action be taken to legislate for the proper management of trusts with insolvent trustees, on the basis recommended by the Harmer Report, with appropriate amendments (as expanded upon in this Submission).

Recommendation 16

In the event that broad reform on trusts with insolvent trustees may take some time, the PJC should push urgently to legislate for the prevention of ejection of corporate trustees as an automatic event upon appointment of an external administrator.

Insolvent trading and relief from it

104. The insolvent trading regime in Australia is stricter than that in some other jurisdictions. In the UK and Singapore, for example, a less severe "wrongful trading" prohibition involves a lower bar for the threshold question whether continuing to trade is permissible.

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48 *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth* [2019] HCA 20, per Kiefel CJ, Keane and Edelman JJ at [1]: "In 1988, the Australian Law Reform Commission observed that although the trading trust had been used extensively for more than a decade, "the companies legislation makes little or no provision for corporate trustees which become insolvent". That observation remains true today. The issue that arises on this appeal, which was foreseen nearly four decades ago, essentially concerns whether creditors who would be priority creditors of an insolvent company are priority creditors when that company trades as the trustee of a trading trust." (references omitted).

105. The recent Safe Harbour Review report observed that separately from considering the operation and effectiveness of the safe harbour regime, a more holistic consideration of the insolvent trading prohibition (indeed Australia's insolvency laws generally) was required.[49] Notably, it was suggested that a "wrongful trading" provision might rid directors of the need to consider the vexed question of "actual insolvency" (which is frequently the subject of boardroom concern and legal advice), instead allowing focus on more easily ascertained criteria. Relevantly, the UK's wrongful trading threshold was supported by the BLS in its submission on the framing of the safe harbour laws in consultation before their enactment.[50]

106. The Safe Harbour Review also identified the potential for the expansion of the business judgment rule in subsection180(2) of the Corporations Act to cover the insolvent trading prohibition.[51] These issues were part of the basis for the call in that review for a "holistic in-depth review of Australia's insolvency laws."[52]

107. Ultimately, despite the initial reservation by the former government in response to that call, this PJC Inquiry is an opening to conduct that broader review. Necessarily, the broad set of matters raised in the Safe Harbour Review (and not just those related strictly to the insolvent trading safe harbour) should be considered as part of the review.

108. Leaving aside those broader questions about the structure of the insolvent trading prohibition, the Committee largely supports the recommendations of the Safe Harbour Review in respect of insolvent trading safe harbours.

109. The Committee's view is that the current safe harbour regime (particularly the safe harbour provided by section 588GA) is generally an effective process that gives companies and their directors the necessary breathing space to assess their options properly, formulate an achievable recovery plan and then execute it.

110. Some Committee members have expressed concern at how access to the safe harbour regime is effectively blocked for the majority of MSMEs because they cannot satisfy the qualification criteria of having paid all employee entitlements or having their tax affairs up to date—thresholds which might be seen to prefer FEG and the ATO respectively. Arguably these requirements are unfairly discriminatory and unnecessarily prefer the interests of FEG and the ATO ahead of the broader stakeholder group, preventing a wider application of safe harbour.

111. Against that assessment, the Section notes the Safe Harbour Review considered whether the thresholds to access were too onerous and found that on balance they were not.[53] In any event, access to safe harbour (and indeed the importance of insolvent trading safe harbour) for MSMEs is generally limited because directors' capital structures tend to be so heavily intertwined with those of the company (that is, they have contributed their available capital to the business, and they have

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49 Safe Harbour Review, [15.3].

50 "Submission in response to the Treasury 'National Innovation and Science Agenda – Improving bankruptcy and insolvency laws", Law Council of Australia BLS, 26 May 2016, https://www.lawcouncil.asn.au/publicassets/0f8d4d1c-1eb5-e611-80d2-005056be66b1/3153_-_National_Innovation_and_Science_Agenda_Improving_bankruptcy_and_insolvency_laws.pdf.

51 Safe Harbour Review, [15.2].

52 Safe Harbour Review, Recommendation 14.

53 Safe Harbour Review, [11.1].

personally guaranteed finance facilities, property leases and sometimes trade credit facilities) that the prospect of an insolvent trading claim is not a key consideration for those directors when considering the appropriate mechanism for company restructure.

Recommendation 17

The PJC should recommend to the Treasury that action be taken to implement recommendations 1—13 of the Safe Harbour Review (including its additional specific guidance suggestions) with any appropriate amendments.

Recommendation 18

In this Inquiry, and in any broader review that may be recommended by the PJC and conducted by the ALRC or some other appropriate body, the consideration raised by the Safe Harbour Review in section 15 of its report should be taken into account.

Schemes of arrangement

112. In late 2021, the Treasury conducted consultation on improving schemes of arrangement to better support businesses.[54] Whilst 22 published submissions were made, no particular conclusions or recommendations appear to have followed from the exercise.

113. The BLS submission[55] to that consultation identified that:

    (a) the procedure for creditors' schemes of arrangement under Part 5.1 of the Corporations Act has been largely useful and flexible for larger enterprises (noting the VA regime has been more effectively used since its introduction for SME entities);

    (b) the lack of an automatic moratorium was not self-evidently an issue, though expansion or clarification of the discretionary court-ordered moratorium under subsection 411(16) of the Corporations Act should be considered;

    (c) a holistic investigation was justified into schemes, the VA regime and other international alternatives such as the UK's company voluntary arrangement (CVA), or its Part A1 moratorium regime;

    (d) the current voting threshold (75 percent by value and majority by number) was probably justified, noting that the UK's CVA regime and newly introduced restructuring plans required 75 percent by value in each relevant class, but no

54 https://treasury.gov.au/consultation/c2021-190907.

55 "Improving Schemes of Arrangement to Better Support Businesses – Submission to Treasury", Law Council of Australia BLS, 17 September 2021, https://www.lawcouncil.asn.au/publicassets/80255a32-331f-ec11-9441-005056be13b5/4095%20-%20Improving%20schemes%20of%20arrangement%20to%20better%20support%20businesses.pdf.

headcount at all, and that perhaps the headcount requirement should be subject to the discretion of the court in the event of manipulation;

(e) it may or may not be necessary to introduce a "DIP" or debtor-in-possession finance scheme such as that available under in the UK, USA or Singapore (as to which, see further below); and

(f) consideration should be given to a "cross-class cram down" (**CCCD**) regime to allow a class of creditors to be bound notwithstanding a lack of favourable vote from that class, on the basis they are no worse off, similar perhaps to Australia's section 444GA test in respect of shareholding, but for a class of creditors instead (again, as to which, see further below regarding the international experience).

Recommendation 19

Consideration should be given to any necessary amendments to the moratorium arrangements (automatic or otherwise) for creditors' schemes of arrangement under section 411 of the Corporations Act.

Other recent international developments

Security enforcement

114. In Australia, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry[56] uncovered materially poor behaviour in banking institutions, though most of the Commission's findings were not focussed on insolvency processes (the Report noted they were outside of scope in the letters patent for the Commission).[57] In any event, Committee members have noted that financial institutions' conduct, particularly enforcement activity by them, was modified materially over the course of the last decade following substantial criticism of receiverships - particularly in the agricultural space.

115. Given most banks have refrained for some time from appointing receivers to insolvent businesses, it might be argued that a prohibition is not necessary. However, the necessity of a largely unused system should be questioned as part of a holistic review. Indeed, Australia is somewhat out of step internationally in retaining the concept of floating charge receivership (or perhaps circulating security receivership, to use the PPSA language).[58] International investors and financiers are sometimes surprised by Australia's regime allowing direct enforcement by secured creditors over the business assets. The UK abolished its equivalent "administrative receivership" in 2003, subject to limited exceptions, and instead granted secured

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56 "Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry", Final Report, 4 February 2019, https://www.royalcommission.gov.au/banking/final-report.

57 Ibid, Volume 3, p39.

58 For reference, the language "floating charge" and "circulating security" generally refers to security granted in favour of a creditor over "circulating assets" now defined in s340 of the PPSA. Whilst the definition is complex, as a rule of thumb, assets which are not fixed and which are used and disposed of in business operations are generally circulating (such as cash, receivables and stock, subject to certain exceptions).

creditors a right to appoint (or replace) a company's administrator with their own choice of personnel.[59]

Recommendation 20

Consideration should be given to the abolition of circulating security receivership, with secured creditors given, in its stead, advantageous rights in an administration (such as choice of an administrator).

Cross-class cram down provisions

116. In the United Kingdom, both CVAs and Part 26A restructuring plans contemplate a CCCD regime. Under the relevant legislation,[60] at least 75 percent in value of the creditors or class of creditors or members or class of members (as the case may be), present and voting either in person or by proxy must vote in favour of it. However, by virtue of a CCCD provision, the court has jurisdiction to sanction a restructuring plan which fails to obtain this 75 percent threshold if:

    (a) the court is satisfied that, if the plan were to be sanctioned, none of the members of the dissenting class would be any worse off than they would be in the event of the "relevant alternative" (**Condition A**); and

    (b) at least one class of creditor who would receive a payment or have a genuine economic interest in the company in the event of the "relevant alternative" voted in favour of the plan by the requisite statutory majority (i.e. 75 percent) (**Condition B**),

117. where the "relevant alternative" is effectively the alternative to the successful transaction or restructure.

118. A similar Australian provision was introduced to the VA regime in 2007,[61] but only in respect of shareholders' interests.

Recommendation 21

Consideration should be given to whether or not creditors' schemes of arrangement (or indeed the VA regime) should have available a "cross-class cram down" (**CCCD**) mechanism for classes of creditors who are effectively out of the money.

Super-secured finance

119. Singapore recently adopted a wholesale new insolvency regime.[62] Part of that regime includes a concept of so-called DIP Finance, or debtor-in-possession finance, where a company trading through a restructure process may borrow money

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59 *Insolvency Act 1986* (UK) s72A.

60 *Companies Act 2006* (UK), s901F(1).

61 Corporations Act, s444GA; *Corporations Amendment (Insolvency) Act 2007* (Cth).

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

on a super-secured basis, above existing secured creditors. The provisions effectively replicate sections 361 and 364 of the *US Bankruptcy Code*.

120. The UK has also legislated a system of "moratorium debts" under a Part A1 moratorium, which can take priority over all other debts.

121. It is conceptually possible for administrators in a VA to borrow funds in Australia on effectively a super-secured basis. That is because an administrator is usually personally liable for the debt under section 443A of the Corporations Act and have a high-ranking indemnity under sections 443D and 556 of the Act for repayment of those funds. However, in order to be used effectively, an administrator ordinarily requires orders limiting their own personal liability for the relevant debt (as compared with the company's liability). Consequently, the availability of funding is more expensive, less immediate and less flexible. Some commentators have identified the potential for a more structured super-senior finance, to allow more effective rescue structures.[63]

Recommendation 22

Consideration should be given to whether or not a more effective mechanism for access to super-secured finance is required as part of the Australian restructuring regime.

63 "Rescue Financing in Australian Restructuring", Clayton Utz, 2021, https://www.claytonutz.com/from-red-to-black-2021/rescue-financing-in-australian-restructuring-the-existing-market-and-the-opportunities-ahead

TOR4—Access to turnaround facilities

Scope

122. TOR4 asks for comment about potential approaches to ensure businesses do not unnecessarily collapse in distressed circumstances:

> *4. supporting business access to corporate turnaround capabilities to manage financial distress*

123. That language is particularly broad and necessarily overlaps with some of the matters already discussed, such as the effectiveness of, and potential reforms to, the insolvent trading and safe harbour regimes.

124. In any event, the Committee has raised for consideration some other measures in relation to this TOR.

Availability of Information

125. We have already discussed above the need for a better designed and more easily navigable legislative landscape.[64] It is pertinent to note that the drafting of the legislation is only part of the story.

126. Given the necessary complexity of insolvency laws, it is all the more important that effort be made to ensure companies, directors and other stakeholders have proper access to good quality information about their circumstances, their options and the risks and consequences of the various potential outcomes.

127. Notably, the ALRC in its recent interim report issued as part of its inquiry into financial services regulation made the following recommendation:[65]

> ***Recommendation 19:*** *The Australian Securities and Investments Commission should publish additional freely available electronic materials designed to help users navigate the legislation it administers. Such materials should include annotated versions of the Corporations Act 2001 (Cth), National Consumer Credit Protection Act 2009 (Cth), and Australian Securities and Investments Commission Act 2001 (Cth).*

Recommendation 23

A review should be conducted of publicly available information, particularly provided by government organisations, on insolvency processes and additional funding made available to ensure materials are freely available, as plainly put as possible, and comprehensive.

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64 See paragraphs 82 to 88 above.

65 "Interim Report B, Financial Services Legislation", above n38.

Debtor-in-possession regimes

128. In the discussion above regarding the effectiveness of the SBR and VA regimes,[66] a potential for a broader regime for debtor-in-possession restructuring was raised.

129. Debtor-in-possession restructuring has been talked about in Australia for quite some time. During the Turnbull administration, there appeared to be material governmental movement for the adoption of the US Chapter 11 bankruptcy restructuring regime in Australia. However, there is limited support for a US-style regime, administered by the court, which is generally considered to be overly expensive and cumbersome.

130. A tension always arises in respect of debtor-in-possession restructuring because publicly-known restructuring tends to require some form of moratorium on stakeholder action in order to provide breathing space to complete a transaction, but there are risks associated with providing for such moratoria unchecked, while the directors continue to run the business. Comfort can be provided, for example, when a creditor is told they should continue to trade with the company but the voluntary administrator is personally liable for payment of the purchase price.

131. The SBR Regime walks that line by simply balancing the risks to creditors against the cost of VA trading. For larger SME businesses that cannot currently access the SBR Regime, that balancing act may not play out in the same way. However, it is notable that improvements to the schemes of arrangement regime could allow that structure to take effectively a debtor-in-possession role for larger businesses. An effective and affordable debtor-in-possession model for mid-sized businesses requires a solution to the moratorium trading issue.

Recommendation 24

Consideration should be given to whether or not additional or expanded regimes for debtor-in-possession restructuring should be made available as part of the Australian restructuring regime.

Pre-pack restructuring

132. One available option to address concerns about debtor-in-possession regimes involving continued trade through moratorium periods may be a better-regulated pre-pack administration regime. In discussions above regarding the VA regime,[67] emphasis was made on the cost of the process, particularly where trading on is required. Indeed, more than just cost is at stake. Sometimes the very fact of a restructuring process is enough to spook the marketplace and the VA moratorium (intended to provide the company with some breathing space to plan a restructure) is not sufficiently effective to retain the business's value.

133. An alternative to a VA trade-on is a pre-pack administration, where an insolvent company sells its business and assets to a buyer before appointing administrators. In Australia, there are occasional attempts at pre-pack processes or processes effectively similar to a pre-pack arrangement, prior to placing the old entity into deed

66 See paragraphs 44 and 59 above.

67 See paragraph 46 above.

administration (with a deed of company arrangement (DOCA) or into liquidation. However, questions persist over legal issues surrounding pre-pack processes, and in Australia the process remains relatively unregulated. Risks include the concern that a later-appointed administrator or liquidator will need to investigate the veracity of the sale (and may seek to unwind it as, amongst other things, a creditor-defeating disposition). Further, in order to comply with independence requirements, there is no capacity for the ultimately appointed administrators to be involved in the sale process before appointment which leads to duplication of effort and increased costs.

134. In the UK, pre-pack administration processes have been sanctioned and regulated to ensure those concerns can be properly dealt with. Elements of the UK structure would not be acceptable under Australian law as it currently stands, such as the administrator's active involvement in the sale process prior to formal appointment.

Recommendation 25

Consideration should be given to whether or not a better-regulated scheme for pre-pack administrations is required as part of the Australian restructuring regime.

TOR5—Insolvency practitioners

Scope

135. This TOR is directed at considerations around the role of corporate insolvency practitioners:

> *5. the role, remuneration, financial viability, and conduct of corporate insolvency practitioners (including receivers, liquidators, administrators, and small business restructuring practitioners)*

136. The words in parentheses in TOR5 provide a non-exhaustive list of those insolvency practitioners intended to be covered by the description. However, it is noteworthy that the language "insolvency practitioners" is not well defined (certainly not in a legislative sense) despite its common usage.

137. The lack of definition around that term belies a broader issue—the many and various roles of different types of advisors in the insolvency and restructuring space—and the terminology associated with them is particularly complex. The Committee has included in Annexure 1 to this Submission a diagram which attempts to assist in characterising the terminology used to describe those many and various roles.

Conduct

138. Members of the BLS's Committee deal with insolvency practitioners on a day-to-day basis. On the whole, they are hard-working, smart professionals with strong moral principles. Most (but not all) insolvency practitioners are well-regulated by their own voluntary ethics code (such as if they are members of ARITA).

139. Among 644 registered liquidators,[68] it is of course possible that there will be instances of poor performance. However, on the whole, insolvency practitioners tend to attract more than their fair share of criticism given the hard work that they do, and particularly given they often go unpaid for that work.

140. More likely, complaints about insolvency practitioners are a symptom of general grievance with the system, particularly by stakeholders unfamiliar with insolvency processes, which is to be expected. Care should be taken not to focus too strongly on additional regulation of insolvency practitioners in a manner that could simply increase the cost of doing business to the detriment of creditor returns.

Roles

141. The Committee considers 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. Consideration should be given to whether wholesale reform can be made to truncate the requirements on practitioners, particularly in micro-business insolvency processes, so as to preserve available

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68 ASIC Insolvency Statistics, Series 4: Registered Liquidator Lists, https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-4a-registered-liquidator-lists/.

funds for creditor returns. Obviously, a limited amount of work (such as identification of creditors and admission/rejection of proofs) is imperative, but many creditors would prefer a slightly higher return than more information on why the company collapsed.

Recommendation 26

Consideration should be given to whether any of the investigative and reporting burdens on insolvency practitioners are more burdensome than is necessary, taking into account the cost-benefit analysis of that work for all stakeholders.

Financial viability

142. As already mentioned, the Committee considers that on the whole, insolvency practitioners are hard-working and do a good job at difficult tasks. The market demands that they be remunerated effectively for that work.

143. Insolvency processes are usually complex, require large amounts of work in short periods of time (often out of ordinary business hours), and practitioners are exposed to personal liability both in respect of certain parts of their role under the Corporations Act and also increasingly under state environmental and occupational health and safety laws.[69]

144. Practitioners are increasingly subject to additional costs (which at times, such as in respect of the ASIC industry funding model, are entirely unpredictable and difficult to manage) measured against numbers of appointment even where those entities are unfunded leaving the practitioner out of pocket. The Committee is aware the Treasury recently conducted consultation in respect of the ASIC IFM, and the BLS made a submission earlier this month in response, advocating at least in part for further cross-subsidisation in order to reduce high volatility and unpredictability in amounts charged to stakeholders.[70]

Recommendation 27

Consideration should be given to whether any amendment can be made to the systems or processes in place regarding ASIC's industry funding model in order to provide better certainty to insolvency practitioners in a timely manner about the amount for which they will be liable under the model.

145. One particular issue that can leave insolvency practitioners out of pocket is the still unresolved question of fee priority in respect of property the subject of circulating

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69 See, e.g., *The Australian Sawmilling Company Pty Ltd (in liq) v Environment Protection Authority* [2021] VSCA 294, where the Court of Appeal dismissed an appeal against the decision setting aside the liquidators' disclaimer of property, leaving them potentially personally liable as occupiers for the company's significant environmental clean up obligations. The High Court dismissed an application for special leave to appeal on the basis the legislation had been amended, but notably, the amended legislation is potentially even more onerous or liquidators.

70 "ASIC Industry Funding Model Review – Submission", Law Council of Australia BLS, 4 November 2022, https://www.lawcouncil.asn.au/resources/submissions/australian-securities-and-investments-commission-industry-funding-model-review.

security. Certain attitudes to section 561 of the Corporations Act are to the effect that despite the clear priority in section 556 in favour of costs of the administration (including remuneration) before employees, that section 561 has the effect of relegating practitioners to sit behind both employees and the security holders. In the UK, this issue came to a head following a decision of the House of Lords to the effect that liquidator fees did not have the requisite priority.[71] That led to amendments to the UK equivalent of section 561 reversing the position, ensuring proper liquidator remuneration.[72]

Recommendation 28

Consideration should be given to amending the Corporations Act, in particular sections 433 and 561, to provide clear priority to insolvency practitioners for payment of external administration costs and expenses.

71 *Leyland DAF v Talbot* [2004] UKHL 9.

72 *Insolvency Act 1986* (UK) s176ZA.

TOR6—Role of government

Scope

146. TOR6 lists some government agencies who have particular interests in the insolvency regime and asks for comment on the government's role.

> *6. the role of government agencies in the corporate insolvency system, including:*
>
> *a. the role and effectiveness of ASIC as the corporate insolvency regulator;*
>
> *b. the ATO's role and enforcement approaches to corporate insolvency, and relevant changes to its approach over the course of the COVID-19 pandemic; [and]*
>
> *c. the role, funding and operation of relevant bodies, including the Assetless Administration Fund and the Small Business Ombudsman.*

147. Once again, there is a non-exhaustive list of government departments or agencies, which omits at least one organisation who have regular engagement with insolvency practitioners: FEG (now administered by DEWR) is not specifically mentioned, but its impact as a creditor is material. We have taken the opportunity to address the role of FEG alongside other arms of government for the purposes of this analysis.

The role and effectiveness of ASIC

148. The Committee notes at the outset that the PJC has separately commenced a broad inquiry into ASIC's capacity and capability to respond to reports of alleged misconduct.[73]

149. This Submission has already noted a number of areas of discontent amongst the profession about regulation of the insolvency profession. Those issues include concerns about the ASIC IFM,[74] the lack of apparent action to date in respect of creditor-defeating dispositions,[75] confusion over the regulatory structure in the allocation of the ABRS to the ATO rather than ASIC,[76] and the contribution to legislative confusion caused by ASIC legislative instruments.[77]

150. Most of those objections are not specifically directed at competency issues, rather structural concerns about the regime. That said, it is clear enough that there is a general dissatisfaction with ASIC's role as a regulator amongst the profession. A recent PhD thesis analysed insolvency practitioners' attitudes to their regulation.[78] One interviewee described dealings with ASIC as follows:

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73 https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/ASICallegedmisconduct.

74 See paragraph 144 above.

75 See paragraphs 68 to 71 above.

76 See paragraph 76 above.

77 See paragraph 85 above.

78 "Practitioners' Perspectives: Experiences Adhering to Legal and Ethical Regulatory Standards", PhD Thesis, Dr Elizabeth Streten, 28 Nov 2019, https://eprints.qut.edu.au/134254/1/Elizabeth_Streten_Thesis.pdf.

"it's almost like entrapment … there's so many lodgements and if somebody misses one they get shot …"

151. Further to those concerns, 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, 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 it is unclear why many of them need to be in different departments. The administration of the FEG 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.

152. This Submission has already noted a need for the corporate insolvency legislation to be redesigned in a single, easily navigable source. Later in the Submission, considerations about harmonising the corporate and personal insolvency regimes are also discussed. Whether or not the personal and corporate insolvency regimes are to be harmonised, it is sensible to consider ensuring 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.

Recommendation 29

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

The role of the ATO

153. The ATO is one of the largest and most important strategic creditors in the economy. It is imperative in that regard that its status as an insolvency creditor is given proper thought.

154. The approach of the ATO during the pandemic and the strategies for the future are described in its most recent annual report:[79]

Impacts on collectable debt

As the economy recovers, one of our key priorities is to address the collectable debt [80] that has accrued over the past 3 years. This has increased from $26.5 billion at 30 June 2019 to $44.8 billion at 30 June 2022—up $18.3 billion or 69 percent.

The increased debt is a result of disrupted economic activity due to lockdowns and cash flow impacts on small businesses and households. During the early stages of COVID-19 we deliberately shifted our focus away from firmer debt

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79 Commissioner of Taxation's Annual Report 2021-2022, p18, https://www.ato.gov.au/uploadedFiles/Content/CR/Downloads/Annual_Reports/n0995_ATO_annual_report_2021-22_Digital.pdf.

80 Collectable Debt refers to undisputed and not insolvent debt.

> *collection action to assist businesses and the community experiencing challenges because of the pandemic. While most payments are made on time, debts that remain unpaid and accumulate over time require firmer and stronger action.*
>
> *Due to these increased and enduring debts, we expanded our enhanced engagement program through a series of awareness campaigns, advising clients of the potential firmer and stronger actions they could be subject to if they do not engage—including director penalty notices, garnishee, disclosure of business tax debts or legal remedies including insolvency.*

155. Going forward, the annual report explains:[81]

> *We have identified 7 key focus areas essential to our vision of being a leading tax, superannuation and registry administration, and contributing to the economic and social wellbeing of Australians.*
>
> *The focus areas comprise:*
>
> *implementing targeted strategies to address collectable debt …*

156. The importance of this focus area is highlighted by it being the first.

157. It is also significant that the fourth focus area is "improving small business tax performance". The small business tax gap is the largest compared to any other sector.[82]

158. The annual report (at appendix 6) demonstrates small business is largely responsible for collectable debt. The appendix states that $29.3 billion of collectable debt (more than 65 percent) is in the small business sector. The largest type of tax debt is activity statement debt (e.g. BAS instalments) amounting to $29.7 billion (just over 66 percent of collectable debt).

159. To put these numbers into perspective, Australia's deficit in the Government's recent Budget is $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 percent of the deficit.

160. Further detail as to the ATO approach was given by Second Commissioner Jeremy Hirschhorn in his keynote address to the Tax Institute Tax Summit on 20 October 2022. In his speech the Second Commissioner stated:

> *Over 22% of our debt book is on a payment arrangement. On one hand, this shows how we are working with taxpayers to develop tailored solutions, but, on the other hand, it paints a stark picture of how many taxpayers are struggling to meet their obligations (and perhaps not just with the ATO).*
>
> *Many stakeholders have also made clear to us the system-wide role that the ATO has in helping struggling businesses understand that they should move to finalisation of the business rather than struggle on as "zombie businesses".*

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81 Commissioner of Taxation's Annual Report 2021-2022, above n79, p7.

82 "Tax gaps estimate the difference between what the ATO collects and the amount that would have been collected if every taxpayer was fully compliant with the law." See Ibid pages 64, 68.

> *Obviously this is very challenging to many who have poured their efforts and resources into that business, and is another area where we really seek the assistance of tax and other professional advisors.*
>
> *In this regard, our analysis shows a strong pattern of clients who are missing multiple obligations are also at high risk of trading while insolvent. We estimate somewhere between $6 billion—$9 billion of our collectable debt book includes debt that will ultimately be found insolvent and not collectable. The focus of our debt recovery approach this year is targeting high value debts, with a priority on those who have multiple outstanding obligations.*

161. Members of the Committee (and the Section more broadly, including members of the SME Business Law Committee and the Taxation Committee) have differing views in respect of both:

    (a) the appropriate policy position in respect of the Commissioner's standing as a creditor (including various rights to improve the position); and

    (b) the effectiveness of the ATO in its role.

162. Consequently, this Submission puts various views without seeking to advance any particular policy position.

163. Members are aligned on the importance of the collectable debt position as a matter of national significance. Members appreciate the "supportive posture" [83] taken by the ATO during the pandemic but recognise that this posture has necessarily had the consequence that collectable debt has grown as a result.

164. It is in the national interest for the growth of collectable debt to be contained and reversed. The focus given by the Commissioner to this problem is to be welcomed in that regard.

165. Some members, particularly those on the Taxation Committee, consider that laws should be complied with across the board and it is inequitable for some taxpayers to comply with their tax obligations whilst others, especially in the small business sector, have not—this inequity undermines public confidence in taxation laws. Members of the Insolvency and Restructuring Committee face circumstances on a day-to-day basis where lack of funds prevent compliance with laws, and so the insolvency regime must apply to their exclusion.

166. Members are in general agreement that a hardline 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.

167. Steps might be taken outside the insolvency space proper to increase the level of on time lodgement and payment to arrest the growth of uncollected debt. That might be achieved through:

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[83] As it has been described in the Commissioner's keynote address to the Tax Institute Tax Summit by Second Commissioner Jeremy Hirschhorn, 20 October 2022, https://www.ato.gov.au/Media-centre/Speeches/Commissioner/Commissioner-s-address-to-the-Tax-Institute-s-Tax-Summit-2022/

(a) increasing public education to articulate risk factors to match ATO action with those which are high risk or lower risk;

(b) increasing ATO collection and enforcement activity in relation to high risk debt;

(c) making payment plans more attractive for lower risk debt e.g. more liberal polices for remission of interest and penalties as an incentive and allowing for longer repayment periods (currently the ATO usually refuses plans for repayment over more than 12 months);

(d) increasing tax debt advisory support and education services for small business taxpayers;

(e) establishing more support for key industry sectors that may be struggling with tax debts; and

(f) considering the feasibility of tax system changes to bring forward date of payment of tax withholding instalments to when payment occurs (e.g. to employees) and GST (e.g. point of sale) rather than waiting for Business Activity Statements to be lodged.

168. Turning to the insolvency space more specifically, historically, the Commissioner had a section 221P[84] statutory recovery priority (allowing the Commissioner to take precedence over the priority granted to other creditors under company legislation. As part of the reforms instituted following the Harmer Inquiry, that statutory priority was removed, and the Commissioner was instead given a limited ability to pursue directors personally for certain outstanding taxes under the DPN regime.

169. That power has been expanded in recent years (and so has its use), with the ATO announcing earlier this year that it was issuing 30–40 DPNs per day.[85] The DPN regime now covers additional taxes in SGC and GST and a so-called "lockdown" regime has been introduced such that even if external administrators are appointed, a director may not escape personal liability.

170. In addition to the DPN regime, the Commissioner:

(a) has garnishee powers against the company and against directors personally (for example, where a lockdown DPN is in place);

(b) can set-off debts payable against amounts owing to it without regard to section 553C of the Corporations Act, unlike ordinary creditors;

(c) has a statutory indemnity from the director for preferential payments recovered by a liquidator as voidable transactions; and

(d) has available the security bond deposit regime which can be difficult to dispute, particularly if the relevant expected debt does not eventuate.

171. The DPN regime can be overly harsh on directors for at least several reasons:

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84 Section 221P of the former *Income Tax Assessment Act 1936* (Cth).

85 See above, n18.

(a) A director of a company placed in liquidation loses their right to challenge the actual liabilities for PAYG, SGC or GST, but remains subject to those liabilities under any lockdown DPNs—effectively making those exactions incontestable. It seems inequitable that a director can't challenge the liability underlying their supposed DPN debts.

(b) The ATO accounting for DPN payments is quite difficult for both liquidators and affected directors to monitor. The director cannot access the relevant company accounts any longer and the liquidator cannot directly see that the relevant director has made payments until they may be cross-posted to the company liability accounts from each director's respective personal/DPN sub-account.

(c) Following some case law with negative connotations (noting that the ATO only pursues the worst cases in court as a rule—so the case law is not covering the full range of situations), the ATO takes a very strict position on DPN defences being claimed by directors—even that of the 'illness or other good reason' defence which most would generally think should apply more liberally to cover serious psychological or physical health matters preventing a director being able to effectively participate in the management of the relevant company. Committee members have received a number of referrals of such cases from insolvency practitioners attempting to assist affected directors and Committee members consider that the ATO responses have, unfortunately, been largely unsympathetic and often overly stringent.[86]

172. Committee members generally agree that there is some balance by which the ATO should take (and should be entitled to take) appropriate action to manage the concerning levels of debt through some mixture of support and enforcement strategies, using its extensive debt collection powers. They suggest the ATO should adopt an approach which properly differentiates between client taxpayers who need or deserve more lenient treatment, and those that should have a firmer touch due to their actual, rather than merely suspected, past conduct.

173. In terms of the ATO's strict engagement with the profession, it can be difficult to predict what action the ATO will take on a given matter. Often there is no way of knowing how the ATO will vote at a creditors' meeting until the meeting itself, leading to potentially wasted time preparing DOCA proposals or adjourning meetings. Indeed, the Commissioner's decision to vote on a motion at a creditor's meeting in respect of a bankrupt has been held not to be reviewable under the *Administrative Decisions (Judicial Review) Act 1977* (Cth) as it is not strictly a "decision under an enactment,[87] and it is likely the same position subsists in respect of corporate insolvency. Arguably, such a decision should be reviewable.[88]

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86 Notably, further to comments above at paragraph 68 above concerning ASIC powers, some concern has been expressed anecdotally that the right of the Commissioner to determine whether defences apply under s269-35(4A) of Schedule 1 to the *Taxation Administration Act 1953* (Cth).

87 *Hutchins v Deputy Commissioner of Taxation* (1996) 136 ALR 153.

88 As to which, see further the BLS's recent submission to the Inspector-General of Taxation and Taxation Ombudsman, "Investigations into Commissioner of Taxation's General Power of Administration (GPA) and Remedial Power (CRP)", Law Council of Australia BLS, 7 March 2022, https://www.lawcouncil.asn.au/publicassets/20a857b8-6b9f-ec11-944b-005056be13b5/4187%20-%20IGTO%20Investigations%20into%20Commissioner%20of%20Taxations%20GPA%20and%20CRP.pdf.

174. Whatever the ultimate view about the appropriate level of leverage the Commissioner should have to improve return outcomes from insolvent taxpayers, there should be clear guidance, consistently applied on how those powers will be exercised. One example of where the ATO's approach is generally well-founded in commerciality and consistently applied is the scheme for asserting unfair preferences. In that instance there is indeed clear guidance (for example, about the ATO's obligations under the *Legal Services Directions 2017* (Cth) and settlement procedures).[89] Ideally, all aspects of the ATO's dealings with practitioners (and insolvency stakeholders generally) would be as predictable and well-explained as that.

Recommendation 30

Consideration should be given to whether the armoury of various enforcement mechanisms available to the ATO to improve the Commonwealth's position as an insolvency creditor (at the expense of other creditors) remain appropriate.

Recommendation 31

Consideration should be given to binding legislative guidance governing the manner in which 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.

The role of FEG

175. As a counterpoint to other government regulators, it is relatively well-accepted that FEG (as administered by DEWR) is staffed by a small but experienced and well-resourced group of staff who understand insolvency matters well and are engaged actively in many, if not most, external administrations involving material employee liability.

176. There has been material dissatisfaction for some time in some corners of the profession with FEG's attitude to trading activity by external administrators. In particular, FEG exerts material pressure on practitioners regarding the use of company funds to trade on a business which would otherwise be available to pay employee entitlements if the business were shut down. There are material issues with that approach to the legislative regime. Whilst the Commonwealth's direct interests in the insolvency are protected if the FEG regime does not need to be called upon to pay employee creditors, the closure of businesses can hurt other stakeholders and the economy generally. As has been noted several times already in this Submission, it is also contrary to the objects of the VA regime in section 435A of the Corporations Act. Whatever the ultimate policy position, there needs to be a clearer position on the expectations of external administrators.

89 https://www.ato.gov.au/Tax-professionals/Your-practice/Insolvency-practitioners/Unfair-preference-payments/.

Recommendation 32

Consideration should be given to clarifying expectations on external administrators in respect of the use of circulating assets and their proceeds to fund trade-on activity, either in legislative form or binding guidance.

Opportunities for assetless administration fund

177. The establishment of a formal assetless companies fund was one of the unimplemented reforms recommended by the Harmer Report. Whilst it is notable that ASIC now maintains an assetless administration fund, it is not an all-encompassing programme of the type anticipated by the Harmer Report recommendation.

178. Notably, 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.[90]

[90] See, e.g., "Australians living under state control are testifying at the Disability Royal Commission. But gag laws mean you won't see their faces", ABC, 20 November 2022, https://www.abc.net.au/news/2022-11-20/australia-guardianship-trustee-disability-royal-commission/101670046.

TOR7—Other matters

Scope

179. The final term of reference effectively invites comments on any other aspect of the corporate insolvency regime.

    7. any related corporate insolvency matters

180. Notably, the language explicitly limits the scope (consistently with the language of the whole Inquiry) to corporate insolvency and not personal insolvency (bankruptcy). Notwithstanding that restriction, the Section has made some comments below about opportunities to consider aligning the corporate insolvency regime with the personal insolvency regime.

Simplification and harmonisation of insolvency laws

MSME-specific issues

181. The Corporations Act applies a 'one size fits all' approach to insolvency and restructuring, excluding the recent and somewhat minor exception of the SBR Regime. Further, the Corporations Act does not specifically recognise MSME businesses, which make up the great majority of businesses (and employers) in Australia. Importantly:

    (a) many are unincorporated and conducted as 'sole practitioners' or in partnership, which is governed by numerous legislation that is unharmonised;

    (b) for incorporated MSMEs, directors are frequently majority shareholders, personal guarantors (often secured against the family home) and major creditors of the business; and

    (c) the majority of MSME directors have had limited business education and consequently have difficulty understanding the different types of business structures, securities, guarantees and, in the event of insolvency, what the effects are on the business, them personally, and other stakeholders.

182. The complexity of the Corporations Act, and the failure of the legislation to address the factors discussed above, results in:

    (a) unnecessary cost and regulatory red tape being applied to MSMEs, causing director confusion, increased cost to business and significant cost to the government to administer compliance;

    (b) the need for unincorporated business owners to understand the legal and business implications of not just the Corporations Act but also the Bankruptcy Act and how they interact; and

    (c) business owners in a sole trader or partnership structure, having to understand various un-harmonised state and federal legislation.

183. Possible solutions for the above problems include:

(a) integrating corporate and personal insolvency legislation for MSMEs, which would require significant business and community consultation to achieve a workable and acceptable legislative framework;

(b) significantly simplifying the Corporations Act insolvency and restructuring provisions insofar as they apply to MSMEs; and

(c) requiring all MSME business owners to undertake a basic educational course addressing their duties and responsibilities.

Broader opportunity for harmonisation

184. This Submission (in TOR2 and TOR6 above) has already dealt with the need to redesign the current legislative scheme for corporate insolvency, and a suggestion that there might be a single regulator under a single department responsible for the bulk of relevant insolvency matters.

185. In line with those two propositions, it would be sensible to conduct a wholesale review of the corporate insolvency scheme against the personal insolvency scheme and align the two together (along with related matters such as the PPSA).

Recommendation 33

The PJC should, or should recommend that the Attorney-General, consider a broad review by the ALRC or another appropriate body into the potential harmonisation of corporate and personal insolvency laws as part of the redesign of the corporate insolvency legislative regime.

Annexure 1—Descriptions of insolvency and restructuring advisors

