30 November 2022

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: corporations.joint@aph.gov.au

Dear Committee Secretary

Corporate Insolvency in Australia Inquiry

The Australian Restructuring Insolvency & Turnaround Association is pleased to provide this submission to the Committee in relation to its inquiry into Australia's corporate insolvency law.

ARITA is Australia's largest representative body of insolvency practitioners, covering some 80% of registered liquidators and bankruptcy trustees as well as insolvency lawyers and other experts in the field of business rescue.

Whilst our submission fully addresses the Committee's terms of reference, we have taken this opportunity to advocate for a more fundamental root and branch review of Australia's insolvency system. Building on the recent work of the Australian Law Reform Commission in relation to the financial services provisions of the *Corporations Act 2001* (Cth) we believe the time has come for a fundamental simplification of the design and drafting of the law.

But more is required. Australia needs a single unified insolvency law that encourages a turnaround and restructuring culture that is focused first on saving viable but distressed businesses; enhances creditor outcomes by reducing unnecessary processes and other regulatory burdens; and deals effectively with malfeasance on the part of both business operators and insolvency professionals. Such a law would be administered by a new, for-purpose agency whose task would be encouraging a turnaround culture, increasing the understanding of business operators about their opportunities and obligations when their businesses are in trouble, and enforcing the law in a rigorous way.

We look forward to participating in the Committee's hearing next month, but if you require any information before or after that time, please contact Dr Warren Mundy at wmundy@arita.com.au or on 0409 911 554.

Yours sincerely

John Winter
Chief Executive Officer

About ARITA

The Australian Restructuring Insolvency and Turnaround Association (ARITA) represents professionals who specialise in the fields of restructuring, insolvency and turnaround.

First formed in1931, we now have more than 2,200 members and subscribers including accountants, lawyers and other professionals with an interest in insolvency and restructuring.

Around 80% of registered liquidators and registered trustees choose to be ARITA members.

ARITA's ambition is to lead and support appropriate and efficient means to expertly manage financial recovery.

We achieve this by providing innovative training and education, upholding world class ethical and professional standards, partnering with government and promoting the ideals of the profession to the public at large. In 2022, ARITA delivered 83 CPE events with over 4,775 attendees.

ARITA promotes best practice and provides a forum for debate on key issues facing the profession.

We also engage in thought leadership and public policy advocacy underpinned by our members' knowledge and experience. We represented the profession at 15 inquiries, hearings and public policy consultations during 2022.

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Recommendations

Recommendation 1: The Committee should recommend that the government embark on comprehensive reform of Australia's insolvency system that delivers:

- A clear statement of objectives for Australia's insolvency laws that are consistent with the growth of the Australian economy.
- Best practice legislative drafting along the lines of that recently proposed by the ALRC in relation to the financial services provisions of the *Corporations Act*, that makes the law accessible and understandable to the majority of those it regulates, namely the owners and operators of small and medium sized businesses.
- Consistent with general and growing international practice, a single insolvency law addressing companies, partnerships, trusts and individuals.
- A single, standalone government agency committed to the best practice regulation of businesses and individuals experiencing financial difficulty and insolvency, and the insolvency profession.

Recommendation 2: The Committee should recommend that Australia's insolvency law should have as its objectives:

(a) to provide a genuine opportunity for restructure of economically viable businesses, without providing incentives for inappropriate behaviour by debtors and creditors
(b) where restructuring is not possible, to expeditiously and efficiently realise the value of the assets of the insolvent business at lowest reasonable cost
(c) to ensure directors and other relevant persons have acted in accordance with their duties and where reasonable to do so identify any fraud or other malfeasance associated with the business
(d) where individuals become insolvent and have committed no offences, to discharge them from bankruptcy as soon as practicable
(e) to ensure that where there is a public interest in the affairs of the distressed business extending beyond the enforcement of the law and the interests of the creditors (for example, the maintenance of critical supply chains or aviation services), that this is made clear to all stakeholders, and is properly had regard to by the relevant insolvency practitioner; and
(f) to support the development and best practice regulation of the insolvency profession.

Recommendation 3: That the Committee recommends that regulators be required to collate and make freely available all collected data on insolvency for academic study

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Recommendation 4: The Committee should recommend that the Attorney General provide the Australian Law Reform Commission with a terms of reference to develop a simplified, unified personal and corporate insolvency law to be administered by a new for purpose agency.

Recommendation 5: The Committee should recommend that the Treasurer direct the Productivity Commission to undertake a focused study of the insolvency system to identify and recommend the reduction and/or elimination of unnecessary regulatory burdens to inform any future reform of the insolvency law.

Recommendation 6: The Committee should recommend that the recommendations of the Independent Review of Safe Harbour arrangements be implemented immediately irrespective of the progress of wider system reforms.

Recommendation 7: The Committee should recommend that the laws relating to Small Business Restructuring be amended to reduce complexity and cost and improve timeliness as outlined in Appendix A of this submission.

Recommendation 8: The Committee should recommend that the laws relating to Simplified Liquidation be amended to reduce complexity and cost and improve timeliness as set out in Appendix B in this submission.

Recommendation 9: The Committee should recommend that the law be amended to create a definition of, and offences relating to, illegal phoenixing that should be applicable to all parties involved, including advisors.

Recommendation 10: The Committee should recommend that any process to develop a new insolvency law should consider whether pre-insolvency advisors should be registered.

Recommendation 11: The Committee should seek a comprehensive explanation from ASIC as to why its level of enforcement activity in relation to illegal phoenixing seems to be so low.

Recommendation 12: That the Committee should recommend that the insolvency law allow an external administrator to give notice to claimants on the PPS Register to verify their claims within a set period, failing which their claims will be treated as unsecured or not at all.

Recommendation 13: That the Committee should recommend the law be amended to designate all related party preference payments to be unfair preferences in the first instance. Provision should be made to allow the related party to demonstrate to the liquidator that the payment was not an unfair preference.

Recommendation 14: That the Committee should recommend the law be amended to ensure all unfair preference demands be accompanied by a version of an “unfair preferences rights” guide that is approved by the regulator.

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Recommendation 15: That the Committee should recommend the law be amended so thar unfair preference claims for “uncommercial” amounts be prevented – a minimum claim being set at $4,000 in line with the recently adjusted statutory minimum for statutory demands.

Recommendation 16: That the Committee should recommend that the Government commission a review of the interaction of the insolvency law with state and territory laws and in particular the operation of section 5 of the *Corporations Act.*

Recommendation 17: The Committee should recommend that the relevant laws be changed to allow registered liquidator appointed to a trustee to access assets held in the relevant trusts without recourse to the courts.

Recommendation 18: The Committee should recommend that the establishment of a national register of trusts and until it is established, the ATO and other government agencies holding information that identify the relationship between trusts and their trustees should be authorised to disclose that information to an external administrator appointed to a corporate trustee.

Recommendation 19: The Committee should recommend that the relevant laws be changed so that the relevant insolvency regimes are applied to insolvent trust funds as standalone economic entities.

Recommendation 20: The Committee should recommend that the law relating to members’ voluntary liquidations be amended to remove the requirement to obtain clearance from the ATO prior to a distribution being made.

Recommendation 21: The Committee should recommend that the law be amended to remove any provisions that give creditor’s rights in the members’ voluntary liquidation process.

Recommendation 22: The Committee should recommend, in order to ensure competitive neutrality, members’ voluntary administrations be excluded from any industry levies applied to registered practitioners.

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Recommendation 23: The Committee should recommend, as did the Productivity Commission in its 2015 Report, that in instances where a liquidator is unable to recover funds to cover their own fee, and where the regulator is satisfied that the activities are not excessive, the liquidator should be able to apply for the balance of the fees to be paid by the regulator.

Further, the Assetless Administration Fund should be renamed the Public Interest Administration Fund (PIAF) and its objectives and funding modified to reflect this new function.

To the extent that this requires additional funding, it should be raised by increasing the annual review fee for company renewals.

Funding should also be available from PIAF in instances where the regulator initiates further investigations beyond those required by the relevant liquidation process.

Recommendation 24: The Committee should recommend that the law be amended to add the same academic requirements as registered liquidators to the restructuring practitioner registration criteria alongside a minimum experience requirement of a lower level than registered liquidators.

Recommendation 25: The Committee should recommend that more focus be placed on diversity and inclusion initiatives by regulators and the profession.

Recommendation 26: The Committee should recommend that there be a single dedicated regulator established to regulate both corporate and personal insolvency in Australia and this regulator should be modelled on the Australian Financial Security Authority.

Recommendation 27: The Committee should recommend that ASIC publish the algorithm that it applies to reports lodged by registered liquidators and demonstrate how it aligns to its published enforcement priorities and the reporting obligations of registered liquidators.

Recommendation 28: The Committee should ask ASIC to demonstrate that its decision to terminate the National Insolvency Trading Program was consistent with regulatory good practice.

Recommendation 29: The Committee should recommend that greater investment should be made in educating company directors in proactively managing financial distress and in advising creditors of their rights and obligations in an insolvency.

Recommendation 30: The Committee should recommend that the ATO should not be given any greater priority of payment over other unsecured creditors, especially noting their increased knowledge of the solvency of a business.

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Recommendation 31: The Committee should recommend that in addition to being a model litigant as required under the *Legal Services Directions 2017*, the ATO must be required to act as a model creditor at all times, and that its compliance with both requirements be reviewed annually by the Inspector General of Taxation.

Recommendation 32: The Committee should recommend that the ATO must substantially increase its internal knowledge/training of insolvency law given other creditors look to them for guidance.

Recommendation 33: The Committee should recommend that the law be amended to ensure that the approved remuneration and reasonable expenses of a liquidation should be paid out of any circulating assets prior to the distribution to employees or creditors with a security over such circulating assets.

Recommendation 34: That the Committee should recommend that the FEG Recovery Program consult with the profession, employee and employer organisations to develop guidance which when implemented gives effect to the objectives of voluntary administrations currently set out in s435A of the *Corporations Act.*

Recommendation 35: The Committee should recommend that where the FEG Recovery Program requires information from a voluntary administrator or liquidator that goes beyond accepted best practice, such as is set out in ARITA's standardised remuneration report which reflects the Insolvency Practice Rules (Corporations) 2016, that the FEG Recovery Program should reimburse the administrator or liquidator for their reasonable costs.

Recommendation 36: FEG Recoveries Branch must be required to act as a model litigant in all circumstances.

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Glossary

AFSA	Australian Financial Security Authority
ALRC	Australian Law Reform Commission
Anti Phoenixing Act	*Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020* (Cth)
ARITA	Australian Restructuring Insolvency and Turnaround Association
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
Bankruptcy Act	*Bankruptcy Act 1966* (Cth)
Corporations Act	*Corporations Act 2001* (Cth)
FEG	Fair Entitlements Guarantee
Harmer Review	ALRC Report 45 1988, General Insolvency report, Canberra, Commissioner-in-charge, Mr RW Harmer BA LLB (Syd)
ILRA	*Insolvency Law Reform Act 2016*
MVL	Members' voluntary liquidation (a solvent liquidation)
NITP	National Insolvency Trading Program
NOCLAR	Non-compliance with Laws and Regulations
MSMEs	Micro-Small-Medium Enterprises
OECD	Organisation for Economic Cooperation and Development
PC	Productivity Commission
PPS Act	*Personal Property Securities Act 2009* (Cth)
PPS Register	Personal Property Securities Register
Registered Liquidator	A natural person who is registered as a liquidator under the Corporations Act and acts in a fiduciary capacity. Only a registered liquidator can act as a liquidator (except in some MVLs), voluntary administrator, deed administrator, a restructuring practitioner for a company or of a restructuring plan, receiver/receiver and manager, or scheme administrator. Depending on the appointment, a registered liquidator can have total management control of the affairs, money and other property of a company. A liquidator has the responsibility to determine and pay out creditors' claims.
Registered Trustee	A natural person who is registered as a trustee under the Bankruptcy Act who takes control of all the debtor's property and can recover property disposed of before bankruptcy. A trustee has the responsibility to determine and pay out creditors' claims. Only a registered trustee can take an appointment to a bankruptcy (as well as government's Office Trustee in Bankruptcy), personal insolvency agreement or as a controlling trustee.
Safe Harbour Review	Review of the Insolvent Trading Safe Harbour report, November 2021
SBR	Small Business Restructuring
UNCITRAL	United Nations Commission on International Trade Law

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1 Why Australia needs a good insolvency framework

Recommendation 1: The Committee should recommend that **the government embark on comprehensive reform of Australia's insolvency system that delivers:**

- A clear statement of objectives for Australia's insolvency laws that are consistent with the growth of the Australian economy.
- Best practice legislative drafting along the lines of that recently proposed by the ALRC in relation to the financial services provisions of the *Corporations Act*, that makes the law accessible and understandable to the majority of those it regulates, namely the owners and operators of small and medium sized businesses.
- Consistent with general and growing international practice, a single insolvency law addressing companies, partnerships, trusts and individuals.
- A single, standalone government agency committed to the best practice regulation of businesses and individuals experiencing financial difficulty and insolvency, and the insolvency profession.

Recommendation 2: The Committee should recommend that Australia's insolvency law should have as its objectives:

(a) to provide a genuine opportunity for restructure of economically viable businesses, without providing incentives for inappropriate behaviour by debtors and creditors
(b) where restructuring is not possible, to expeditiously and efficiently realise the value of the assets of the insolvent business at lowest reasonable cost
(c) to ensure directors and other relevant persons have acted in accordance with their duties and where reasonable to do so identify any fraud or other malfeasance associated with the business
(d) where individuals become insolvent and have committed no offences, to discharge them from bankruptcy as soon as practicable
(e) to ensure that where there is a public interest in the affairs of the distressed business extending beyond the enforcement of the law and the interests of the creditors (for example, the maintenance of critical supply chains or aviation services), that this is made clear to all stakeholders, and is properly had regard to by the relevant insolvency practitioner; and
(f) to support the development and best practice regulation of the insolvency profession.

ARITA, the Australian Restructuring Insolvency and Turnaround Association, welcomes the opportunity to participate in this inquiry.

ARITA is Australia's largest association of insolvency practitioners covering around 80% of registered liquidators and bankruptcy trustees. We are regarded as a world-leading professional body in this industry and one of the largest providers of education for insolvency practitioners in the world. We are the only body that is legislated to provide a representative on all liquidator and trustee registration and disciplinary committees administered by ASIC and AFSA, and our Code of Professional Practice (and our enforcement of its standards) provides the ethical and practical foundations of the operation of the profession.

As the Australian economy emerges from the rigours of COVID-19 we are seeing insolvencies begin to return to their pre-covid levels. Deteriorating domestic and international economic conditions will place businesses[1], small and large, under pressure which will exacerbate this trend, especially if there is a recession in the global and/or domestic economies.

Australia's insolvency regime is not broken, but it is far from international best practice. Whilst addressing the Committee's term of reference will flush out reforms that will provide improvements, they will be piecemeal. What is required is wholesale reform that will deliver:

- A clear statement of objectives for Australia's insolvency laws that are consistent with the growth of the Australian economy.
- Best practice legislative drafting along the lines of that recently proposed by the ALRC in relation to the financial services provisions of the *Corporations Act*, that makes the law accessible and understandable to the majority of those it regulates, namely the owners and operators of small and medium sized businesses.
- Consistent with general and growing international practice, a single insolvency law addressing companies, partnerships, trusts and individuals.
- A single, standalone government agency committed to the best practice regulation of businesses and individuals experiencing financial difficulty and insolvency, and the insolvency profession.

Throughout this submission we will urge the Committee to make this overarching recommendation. We understand that the development of such a framework will take significant effort on behalf of policymakers and stakeholders alike, but law reform is the ordinary business of government – ordinary business in this case that has been neglected for decades.

[1] In this submission, we use the words "business" and "firm" interchangeably to mean an economic entity, or a group of associated economic entities, undertaking the production of goods and/or services. "Company" is used to refer to an entity incorporated under the *Corporations Act*.

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ARITA is more aware than most of the mantra of the founding Chair of the Productivity Commission, Professor Gary Banks AO, that, when it comes to reform, the expected benefits must outweigh the expected costs. We understand this to be an injunction against reform for reform's sake. But it is not a requirement for detailed empirical analyses to demonstrate the reform has merit. Indeed, the PC itself did not find such analyses necessary when it recommended safe harbour, Director IDs, prohibition of *ipso facto* clauses and other reforms in its 2015 *Business Set-up, Transfer and Closure Inquiry Report*[2]. Similarly, nor did the Hawke-Keating Governments as they pursued their National Competition Policy reform agenda in the 1990s – the empirical analysis in that case was performed by the PC many years later in 2005.[3]

Whilst it is not possible to estimate with any precision the benefits of wholesale reform of Australia's insolvency law prior *ex ante*, the sources of those benefits are apparent, in no particular order:

- more businesses surviving periods of financial difficulty
- more efficient allocation of labour and capital
- less dislocation of employment
- reduced compliance and transaction costs
- greater creditor recovery
- more effective identification of unlawful activity and therefore a reduction in the social cost of such activity
- reduced administrative costs to government
- reduced risk of interruption of nationally significant goods and services markets and less distress for individual members of the community; and
- possibly others.

The costs of this reform are readily estimable, largely contained within the Commonwealth Government and are relatively small – we are certain that, like ourselves, other significant stakeholders will freely and willingly contribute their resources to this work. In our view, it is hard to see how the benefits of an economy-wide microeconomic reform, implemented properly, would not outweigh what are relatively minor costs to the Commonwealth.

Since the PC provided its *Business Set-up, Transfer and Closure Inquiry Report*, the OECD has undertaken a significant body of empirical work through its *Exit Policies and Productivity Growth* project to understand how differences in insolvency regimes impact the relative productivity performance of national economies.[4] As discussed later in this submission, the broad finding of that work is that reforms proposed by the PC in 2015, which we seek to

[2] Productivity Commission 2015, *Business Set-up, Transfer and Closure*, Final Report 75, Canberra.
[3] Productivity Commission 2005, *Review of National Competition Policy Reforms*, Report no. 33, Canberra.
[4] A number of the papers arising from this work stream are cited in the immediately following footnotes.

build on here, have positive impacts on national productivity giving policymakers further comfort as to their merit and that of the wider insolvency reform agenda.

1.1 The economics of insolvency

Insolvency is one way in which businesses exit the economy – merger, takeover and voluntary closure are the main alternatives. Despite the negative impact that insolvency can have on a range of stakeholders – employees, creditors, customers, shareholders and the broader economy – it nevertheless plays an important role in increasing average levels of productivity in the economy by facilitating structural change within and between businesses and sectors, allowing entrepreneurs and others to learn and experiment, and transferring skills and information between businesses.

The OECD observes that "a well-functioning exit margin, which sorts successful market activities from unsuccessful ones, is vital for aggregate productivity growth".[5] Various empirical studies have identified links between the cost of business closures – a key measure of the effectiveness of an insolvency regime – to productivity spillovers[6], labour misallocation[7], capital misallocation[8] and skills mismatches.[9]

Within the insolvency framework, restructuring via mechanisms such as safe harbour, small business restructuring and voluntary administration represent particular opportunities to avoid transaction costs and intellectual property destruction that necessarily accompany business liquidation, in addition to the obvious benefits of maintaining employment and continuity of service to customers. It is likely that following restructuring, creditors will receive greater returns than under a liquidation as they will share in the firm value that is preserved.

But in circumstances where the business cannot be saved, it is critical that the insolvency framework enables efficient (in terms of both time and cost) redeployment of employees and capital. In the case of the collapse of Ansett, for example, prompt action by the administrators and airport operators (who effectively were secured creditors in relation to Ansett's domestic terminals) enabled the return of the majority of Ansett's terminals to the economy which allowed the continued operation of regional services under the Regional Express brand and facilitated the expansion of (then) Virgin Blue into a meaningful competitor to Qantas.

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[5] Muge Adalet McGowan and Dan Andrews (2016) *Insolvency Regimes and Productivity Growth: A Framework for Analysis,* OECD Economics Department Working Paper No. 1309, p7.
[6] Westmore, B. (2013), "R&D, Patenting and Productivity: The Role of Public Policy", OECD Economics Department Working Paper, No. 1046; Saia, A., D. Andrews and S. Albrizio (2015), "Productivity Spillovers from the Global Frontier and Public Policy: Industry Level Evidence", OECD Economics Department Working Paper, No. 1238.
[7] Andrews, D. and F. Cingano (2014), "Public Policy and Resource Allocation: Evidence from Firms in OECD Countries", Economic Policy, No. 29(78), pp. 253-296.
[8] Andrews, D., C. Criscuolo and C. Menon (2014), "Do Resources Flow to Patenting Firms?: Cross-Country Evidence from Firm Level Data", OECD Economics Department Working Papers, No. 1127.
[9] Adalet McGowan, M. and D. Andrews (2015), "Skill Mismatch and Public Policy in OECD countries", OECD Economics Department Working Paper, No. 1210.

Another important economic feature of our insolvency regime is that where a business is insolvent, its affairs are placed in the hands of an administrator or liquidator who acts on behalf of the unsecured creditors as a group. By having a single professional (though liquidators may have one or more co-appointees to assist in their duties) determine, realise and distribute an insolvent business' assets, creditors can significantly reduce monitoring costs, transaction costs in agreeing on the distribution of the realised assets (including the potential for court-based disputes) and duplication of enforcement costs compared to other multi-stakeholder regimes such as Chapter 11.

Perhaps of equal importance from an economic efficiency perspective, as Duns noted, this collective approach is more likely to lead to the continuation of the business in some form:

> *This would occur where the sale of the debtor's assets on a going-concern basis would result in a greater return to creditors than a sale of the same assets on a piecemeal basis. A sale on an going-concern basis is unlikely to occur in the absence of an agreement among creditors.*[10]

It goes without saying that there are stakeholders in a business beyond the creditors who will exhibit a strong preference for the continuation of the business:

- employees will have a strong interest in the business continuing – indeed their future income may be more important to them than their position as a creditor, especially if their unpaid prior entitlements are secured in part or whole by a government scheme such as FEG,
- suppliers (who may or may not be creditors) that have made sunk investments that are specific to the business in difficulty may struggle to find alternative customers, especially if the relevant markets are more regionally focused,
- customers may be prepared to pay more for goods and services, or accept more onerous trade and credit conditions, if the availability of substitute suppliers are difficult to find or unavailable, and
- providers of debt and equity capital may prefer the business to trade on in the belief this will lead to higher returns in the longer run.

Large insolvencies often create issues for the wider economy beyond the business' direct stakeholders. The collapse of Ansett and the administration of Virgin caused significant concerns for all tiers of government about the provision of aviation services to regional communities and unacceptable levels of concentration in national aviation markets, as well as the impact of large regionally concentrated job losses. The insolvencies of Arrium mining and ABC Learning also raised significant regional and economy-wide impacts.

Australian insolvency law does not provide a transparent way for these wider issues to be addressed in a systematic and understandable way by administrators and liquidators. It seems the consequence of this is that governments end up pursuing what on face value are legitimate public policy issues, in a manner largely unseen either by employees (or their

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[10] Duns, J. (2002) *Insolvency: Law and Policy*, Oxford University Press, Melbourne, p9.

representatives), other creditors or the wider community through direct, usually confidential, dealings with alternative providers of capital and administrators and liquidators. We believe that this is an issue worthy of consideration either by the Committee or the wider review that we propose the Committee recommends.

Finally, whilst we will argue elsewhere that the current approach to enforcement is problematic both in terms of the structure of the law and ASIC's administration of it, enforcement is nevertheless an important economic component of any insolvency framework. Obviously, the economy is well served by the removal of corrupt, reckless and/or incompetent directors – this is to the benefit of shareholders, creditors and other stakeholders. The personal and corporate sanctions contained in the corporate insolvency law provide a credible threat of detection of corporate wrongdoing that enhances creditor and investor confidence in people they often don't know and therefore their willingness to advance finance in all its forms.

1.2 Insolvency system objectives

For those familiar with the evolution of statutory drafting in Australia, it comes as no surprise that there is no "objects clause" in the *Corporations Act* that sets out the objectives of the corporate insolvency system other than that relating to voluntary administration set out in s435A:

> *The object of this Part is to provide for the business, property and affairs of an insolvent company to be administered in a way that:*
>
> *(a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or*
>
> *(b) if it is not possible for the company or its business to continue in existence — results in a better return for the company's creditors and members than would result from an immediate winding up of the company.*

We note, similarly, that the *Bankruptcy Act* does not have an overarching objects clause, but some newer divisions, subdivisions and schedules do.

Harmer, writing before the *Corporations Act* was enacted, set out a more extensive set of objectives:

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

- *An insolvency administration should be impartial, efficient and expeditious.*

- *The law should provide a convenient means of collecting or recovering property that should be properly applied toward payment of the debts and liabilities of an insolvent person.*

- *The principle of equal sharing between creditors should be retained and in some areas reinforced.*

- *The end result of an insolvency administration, particularly as it affects individuals, should, with very limited exceptions, give effective relief or release from the financial liabilities and obligations of the insolvent.*

- *Insolvency law should, as far as convenient and practical, support the commercial and economic processes of the community.*

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

An insolvency law should enable ancillary assistance in the administration of an insolvency originating in a foreign country.[11] In its 2015 Report, the PC said:

> *the objective of the insolvency regime should be to provide a genuine opportunity for restructure for economically viable companies, without providing incentive for strategic behaviour by debtors and creditors. If restructure is not possible, the insolvency system should aim to provide an efficient (expedient and inexpensive), effective and orderly process for winding up the company. This process should involve consideration of creditors, as well as other stakeholders, and provide certainty regarding future developments. The regime should foster a coordinated approach to recovery of a company, or its assets.*[12]

Elsewhere in this submission we argue that Australia's interests are best served by the enactment of a new, single corporate and personal insolvency law. Modern best practice drafting will require that such a law would have a clear statement of objectives, much of which is captured by the PC's observations above.

To start that discussion, we would suggest the following as an objects clause of a unified insolvency law:

(a) to provide a genuine opportunity for restructure of economically viable businesses, without providing incentive for inappropriate behaviour by debtors and creditors

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[11] ALRC Report 45 1988, General Insolvency report, Canberra, ("the Harmer Report"), p2.
[12] Productivity Commission 2015, Business Set-up, Transfer and Closure, Final Report 75, Canberra, p 353.

(b) where restructuring is not possible, to expeditiously and efficiently realise the value of the assets of the insolvent business at lowest reasonable cost
(c) to ensure directors and other relevant persons have acted in accordance with their duties, and where reasonable to do so identify any fraud or other malfeasance associated with the business
(d) where individuals become insolvent and have committed no offences, to discharge them from bankruptcy as soon as practicable
(e) to ensure that where there is a public interest extending beyond the enforcement of the law and the interests of the creditors (for example, the maintenance of critical supply chains or aviation services), that this is made clear to, and is properly had regard to by, the relevant insolvency practitioner; and
(f) to support the development and best practice regulation of the insolvency profession.

1.3 Insolvency isn't easy

During the course of this inquiry, the Committee will receive a wide range of submissions. Many will be from insolvency practitioners and other professional stakeholder groups such as accountants, credit managers and banks. But some will come from people who have had a bad experience with an insolvency and may have suffered financially and/or emotionally. We expect that members of the Committee will also have come across such cases in the course of their day-to-day electorate work.

People only come into contact with the insolvency system if something has gone wrong – a business has failed or is very close to it. They may be employees, suppliers to a business unable to pay its bills, or customers who have paid for goods and services that won't be delivered or seek to rely on guarantees or warranties that are unlikely to be honoured. They may be directors of small or large businesses in distress, they may have guaranteed a loan for a family member or mortgaged their house to develop their own small business. What can be certain is that in the vast majority of cases, they have little knowledge or experience of insolvency administration on which to base their expectations of the various processes they may become involved with.

Invariably, the insolvency practitioner arrives on the scene after the events leading to the business distress or failure – they are never the cause of the distress or failure. Acting as receivers, liquidators, administrators or bankruptcy trustees means they have a range of fiduciary, statutory and professional obligations they must discharge in circumstances where most of the people they are dealing with are distressed by the events surrounding the business.

ARITA accepts that, like all professions, there are a few rotten apples in the insolvency profession. We work hard to monitor and develop the skills and integrity of our members who account for over 80% of the registered insolvency practitioners. Beyond those licensed practitioners who choose not to be ARITA members, there is also a growing number of unlicenced pre-insolvency advisors, unsupervised by ASIC, AFSA or ourselves, who are engaging with distressed, usually smaller, businesses that we understand from our members are souring the experience of the insolvency system more generally. These people generally pedal false hope and deliver greater misery.

We proactively discipline our members when their conduct is unacceptable and work with ASIC and AFSA to exclude those who exhibit the most egregious behaviour. But no matter how thoughtful and compassionate our members are, the circumstances in which our members engage with the community means many people will come away from an encounter with an insolvency practitioner with a sour taste in their mouths – not through any fault of the practitioner who does an exemplary job, but because the nature of the process involves disappointment and grief.

There is a perception that the remuneration of insolvency practitioners is excessive. It is noteworthy that insolvency accountants are paid around 20% less than their audit or tax colleagues despite carrying significantly greater personal financial risk, suggesting that the market for insolvency services is at least workably competitive.

We agree with Hon Michael Kirby AC CMG:

> *"the task of insolvency administration is inherently expensive. Principally this is so because of the intensive nature of the investigation of accounts (sometimes in a shambles and sometimes deliberately deceptive) that the insolvency practitioners must analyse and understand. … It is unreasonable to demand that skilled professionals should perform their functions at low cost".*[13]

It is the case that very large firms attending to the most high profile of insolvencies receive significant fees but these are proportionate to the significant cost of expert staff and technical resources they bring to the task, as well as the scale of personal liability their principals accept. That said, in all liquidations and administrations the fees insolvency practitioners receive must be agreed by creditors or the courts.

However, in the vast bulk of cases, practitioner fees are modest. Indeed in 2018/19 (the last year for which ASIC data is available) around 37% of the businesses being liquidated had no assets and a further 31% had less than $20,000 in assets – most of these would not have had sufficient assets to fully remunerate the liquidator. But it is the statutory duty of registered liquidators to undertake this work for ASIC even if they don't get properly paid, or indeed paid at all. This problem was acknowledged in the PC's 2015 Report and despite a recommendation to fix the problem, nothing has been done to address this issue.

We estimate, based on rates in what is a very competitive market for insolvency services, the value of this public service is around $100 million per year[14]. This work has to be funded otherwise insolvency firms themselves would not be financially viable.

It is interesting to note that the ATO has recently decided not to wind up companies who owe it money when it is not commercially viable, that is, the tax likely to be recovered is expected to be less than the costs of the recovery process. Whilst not suggesting this is a flawed proposition, it stands in stark contrast to the obligations of liquidators to wind up companies

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[13] https://www.michaelkirby.com.au/images/stories/speeches/2000s/2010_Speeches/2453-SPEECH-INSOLVENCY-PRACTITIONERS-ASSOC-CONF-ADELAIDE-MAY-2010.pdf
[14] (2017) 29(1) ARITA J, State of the profession 2017, p4.

even if they have a reasonable assumption that they won't be able to recover their reasonable costs of doing so.

ARITA is a strong advocate of looking at ways of avoiding unnecessary work and reducing the costs of the work that truly needs doing in relation to failed firms – indeed we suggest a number of these in this submission. However, in doing so we acknowledge the absolute importance of maintaining a risk-based framework of investigations not only to ensure directors comply with their duties (however framed) but also to detect illegal phoenixing and other forms of fraud (such as underpayment of wages and entitlements and not paying taxes due and payable). Not only can fraud be the cause of insolvency but there are cases when the insolvency of the business has been used to disguise fraud[15], particularly where illegal phoenixing is involved.[16]

As discussed above and in the PC's 2015 report, the insolvency system plays an important, albeit often a personally distressing, role in boosting national productivity. To pursue policies in the long term that are directed at preventing poorly performing firms from exiting the economy, either voluntarily or by way of insolvency, is a bad idea. Indeed, the OECD has observed:

> *The available cross-country evidence suggests that firm exit makes an unambiguously positive contribution to aggregate productivity growth … while the direct contribution of firm entry is more mixed.*[17]

There is a better way:

- Better educate business operators of their obligations in circumstances where their firms are failing and the options that are available to them to turn the business around.
- Where possible, find ways to keep small creditors away from the insolvency system when firms fail – good examples of this are the Fair Entitlements Guarantee Scheme and AFTA Travel Accreditation Scheme (which holds payments made to travel agents).
- Simplify and clarify the law so that it is accessible to those who are its primary users – those who run small and medium businesses.
- Reduce the amount of unnecessary work done by insolvency professionals, thus reducing the burden on creditors where there is something to distribute and the burden on practitioners when there isn't.

[15] ASIC Media Release 22-055MR Former Kleenmaid director sentenced for fraud and insolvent trading https://asic.gov.au/about-asic/news-centre/find-a-media-release/2022-releases/22-055mr-former-kleenmaid-director-sentenced-for-fraud-and-insolvent-trading/
[16] Refer *Re Intellicomms Pty Ltd (in liq)* [2022] VSC 228.
[17] McGowan and Andrews (2016) p7.

- Government should fund the work currently undertaken without appropriate remuneration, thus reducing the need for practitioners to have to cross subsidise from turnarounds, restructurings and insolvencies that are not assetless.
- Have a regulator that actively pursues unlicenced and corrupt advisers and excludes them from the industry.

These and other issues are explored in this submission.

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2 Recent insolvency trends

Recommendation 3: That the Committee recommends that regulators be required to collate and make freely available all collected data on insolvency for academic study

2.1 Lack of availability of detailed corporate insolvency data

As ARITA submitted to the Productivity Commission Inquiry into Data Availability and Use in 2016, "there have been only a limited number of empirical studies of the performance of Australia's insolvency laws". This is despite large amounts of data being collected by ASIC which is never aggregated or released. Where the data is available, we note in that same submission that "ARITA has funded scholarships to promote empirical research into Australia's insolvency regime[18] and can confirm that the data-access costs of such studies are significant".

We further noted that the "value of such research was borne out by the Productivity Commission's Report on 'Business Set-up, Transfer and Closure' dated 30 September 2015" before concluding that "law reform proposals have been known to be deferred due to the lack of evidence-based support, but the costs of empirical studies are a substantial obstacle to sustaining the case for change".

It is likely that the Committee's work will be similarly frustrated by a lack of corporate insolvency data, instead only being able to review high level information.

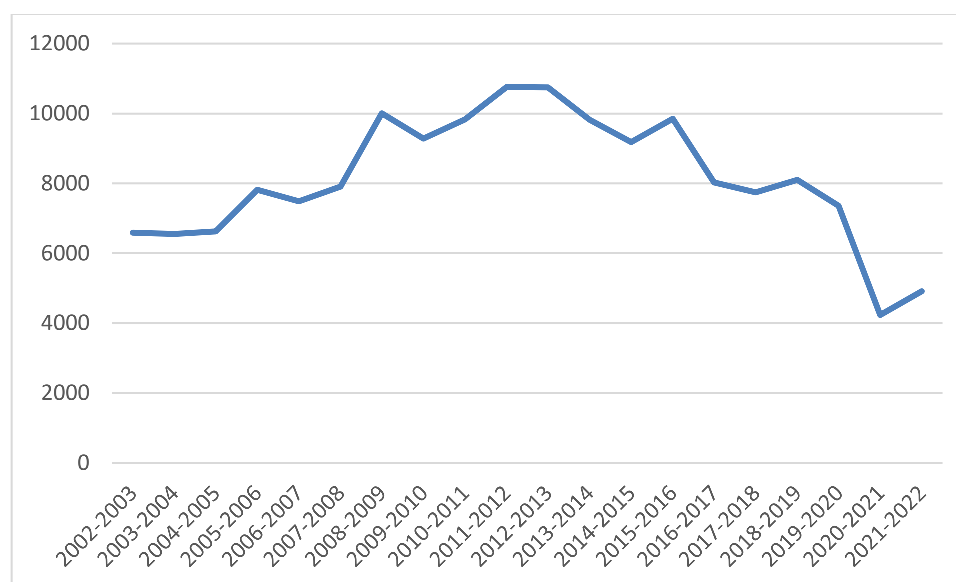
Registered liquidators are required to provide ASIC with extensive information and data about insolvencies that they are appointed to. That reporting includes such aspects as causes of insolvency including potential malfeasance, returns to creditors, number and size of creditors and much more. Academic review of this data would be enormously beneficial to policymakers in assessing future improvements to our regime. We therefore strongly suggest that the Committee recommends that ASIC be required to properly compile all data it receives and make it freely available for research purposes.

[18] Details and the research outcomes of ARITA's Terry Taylor Scholarship are available at https://www.arita.com.au/ARITA/About_Us/Arita_Terry_Taylor_Scholarship/arita-terry-taylor-scholarship.aspx

2.2 General recent trends in insolvency

Insolvency appointments in Australia have been in decline for over a decade. This is clearly correlated to the strength of the post-GFC economy that Australia enjoyed prior to the onset of COVID-19.

Chart: Companies entering external administration and controller appointments

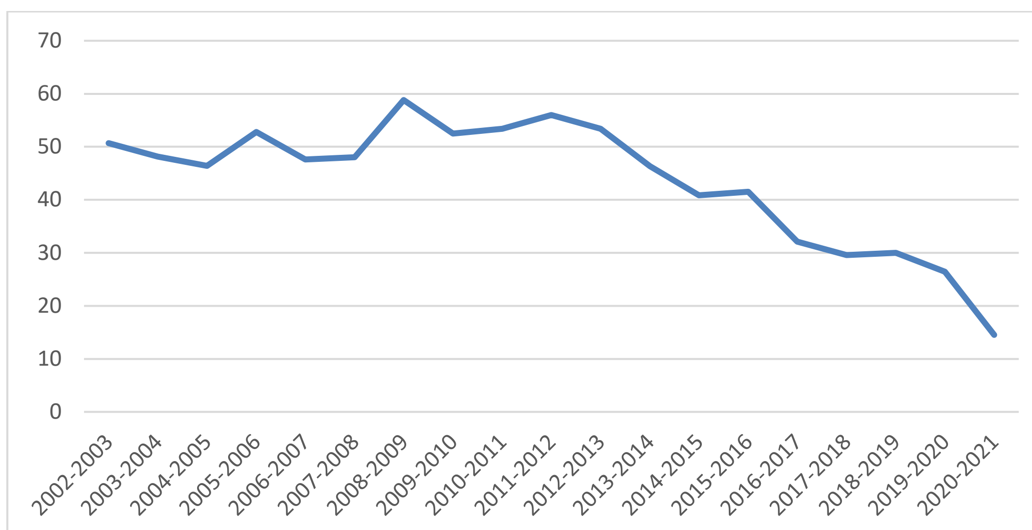


Source: ASIC data[19]

The decline of insolvency appointments is not only in raw numbers, but also especially clear when reviewed as a percentage of companies, as the number of companies registered in Australia has grown throughout this same period.

[19] https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics-up-to-31-july-2022/insolvency-statistics-series-1-companies-entering-external-administration-and-controller-appointments/

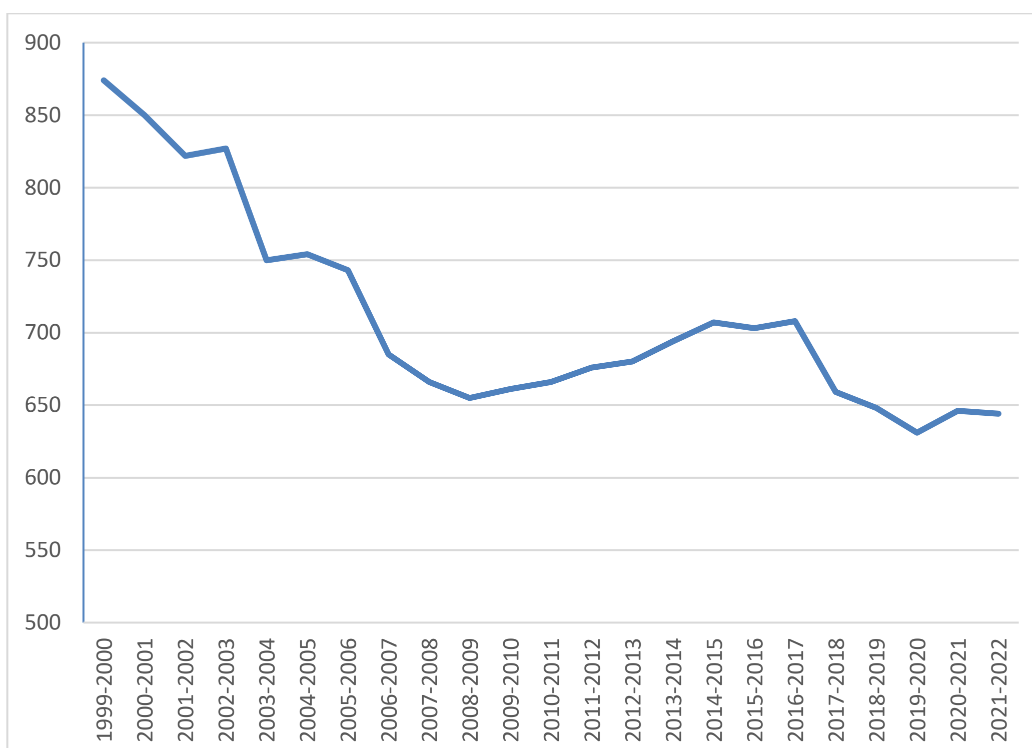
Chart: Corporate insolvencies per 10,000 companies



Source: ARITA analysis of ASIC and ABS data

This has also led to a long-term shrinking in the size of the insolvency profession, from some 874 registered liquidators in 1999-2000 to just 641 at the end of 2021-2022.

Chart: Number of registered liquidators



Source: Graph by ARITA of ASIC data[20]

[20] https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-4-quarterly-registered-liquidator-statistics/

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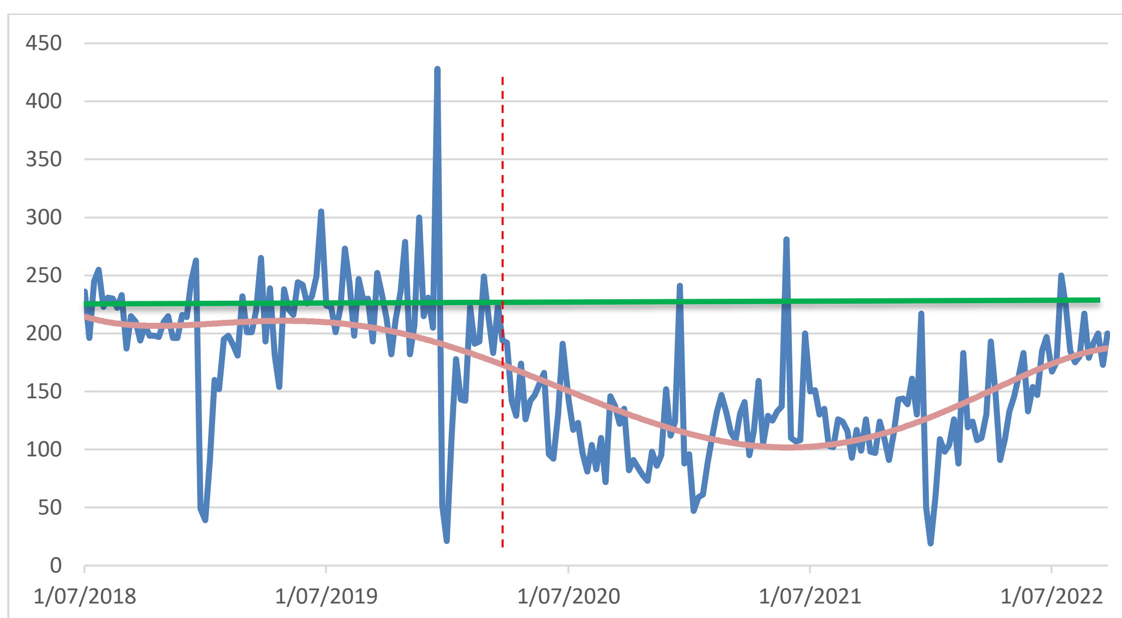
The economic impact of the onset of COVID-19, including lockdowns and business hibernations, was expected to lead to a dramatic upswing in insolvency numbers in Australia and most developed economies. However, in Australia and comparable economies, this did not occur. In fact, the number of external administrations in Australia halved almost immediately in April 2020 when the government announced JobKeeper and a variety of insolvency protections, including a moratorium on statutory demands, bans on insolvent trading actions and protections for leases. Critically, the ATO also virtually ceased all enforcement and collections activities at this time, including wind-ups, director penalty notices, garnishee notices and the issuing of general warnings.

These factors combined to send a clear message to company directors that the normal triggers identifying when a director should enter into an external administration were on hold.

As a result, corporate insolvency levels remained approximately 50% of pre-COVID levels until around April 2022, when the ATO finally began to reengage. Around that time, the ATO commenced issuing some 70,000 warning letters to directors and by the end of June 2022 was issuing around 150 Director Penalty Notices per day.

Chart: Weekly EXAD appointments



Source: ASIC data[21]

As a direct result, through July to September 2022, we saw an increase in insolvency appointments to levels close to pre-COVID numbers[22], noting that those pre-COVID levels were already at historic lows. However, in October 2022, insolvency appointments again dropped substantially to around 70% of pre-COVID levels.

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[21] https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-current/
[22] https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-current/

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2.3 Insolvency law reform in Australia

Australia's legal framework of insolvency is largely based on English law and has evolved from there[23]. In its current form, insolvency of individuals is administered via the *Bankruptcy Act 1966* and corporate insolvency is administered by the provisions of the *Corporations Act 2001*. However, many changes – both minor and significant – have been made to those two pieces of legislation since their adoption. Alongside legislative changes, insolvency law evolves on an almost weekly basis as Court decisions also shift the interpretation of our complex laws.

Major changes to Australia's corporate insolvency law can be summarised as follows:

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

[23] https://www.hcourt.gov.au/assets/publications/speeches/current-justices/edelmanj/EdelmanJ14Jan2019.pdf

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3 Recent international developments

3.1 Arrangements for MSMEs in emerging economies

Much of the pre-COVID focus of international insolvency law reform has been around the development of insolvency regimes for emerging economies. A unifying factor of reforms in these countries has been in creating mechanisms to support micro-small companies, which are predominant in emerging economies. Many of these economies did not have sophisticated regimes for handling Micro-Small-Medium Enterprises (MSMEs) or had no regime at all.

The general trend has been to try to facilitate the restructuring of these small businesses through debt-forgiveness regimes and leaving the owners of those business in charge during that process (debtor-in-possession) and with limited supervision (especially avoiding court involvement). The recent work of the Asian Business Law Institute and the International Insolvency Institute in producing their "Guide on the Treatment of Insolvent Micro and Small Enterprises in Asia" is instructive in outlining the thinking that predominates in these markets[24].

The trend for insolvency law reform in these markets around MSMEs, though, does not tend to reflect the cultural approach to business failure in Australia, where we have a primary expectation that creditors rights should take precedence. In addition, as we shall explain later, Australia is now relatively well-served by the existence of our safe harbour and small business restructuring frameworks to provide debtor-in-possession options.

ARITA acknowledges the policy advocacy work of INSOL International, the World Bank, Asian Development Bank and the International Insolvency Institute in this area[25].

3.2 Creation of restructuring hubs

The most significant shift in recent years for the treatment of large businesses in financial distress is the international competition to create "restructuring hubs". These tend to be in countries with a strong reputation for reliable and efficient courts, use of Common Law and stable governments.

These hubs aim to take the leadership role in managing the financial distress for large and complex corporates, especially where their assets or financiers are "cross-border" and they take advantage of the UNCITRAL framework[26], which Australia has also adopted.

While centres such as the New York and London have long had leading positions, other European centres have tried to increase their influence. Hong Kong continues to play a

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[24] Guide on the Treatment of Insolvent Micro and Small Enterprises in Asia - https://payhip.com/b/bkW12

[25] The World Bank Principles for Effective Insolvency and Creditor/ Debtor Regimes - https://documents1.worldbank.org/curated/en/518861467086038847/pdf/106399-WP-REVISED-PUBLIC-ICR-Principle-Final-Hyperlinks-revised-Latest.pdf

[26] United Nations Commission On International Trade Law - https://uncitral.un.org/en/texts/insolvency

significant role but this has started to wane due to recent political changes. Centres such as the British Virgin Islands and the Cayman Islands play an important role due to the number of entities technically domiciled there.

The work of the Singaporean government, though, warrants special attention. Much has been invested in increasing Singapore's work and influence as a global restructuring hub. The Singaporean Government has actively invested in this, alongside lifting their role as a global arbitration centre[27]. The Singaporean government strongly recognises the value to their economy of building the professional services sector that is required to support this type of work.

Australia has made no effort to compete in this space despite our legal and government frameworks offering the stability looked for globally.

3.3 Post pandemic outlook

The temporary changes brought in to protect businesses during COVID-19 have led many jurisdictions to start to consider what lessons can be taken from the shifts in behaviour that occurred. While the work of this Committee appears to be one of the first insolvency law reviews since the pandemic, academic papers are beginning to emerge on this theme[28].

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[27] "Building a Restructuring Hub: Lessons from Singapore" https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/02/building-restructuring-hub-lessons-singapore

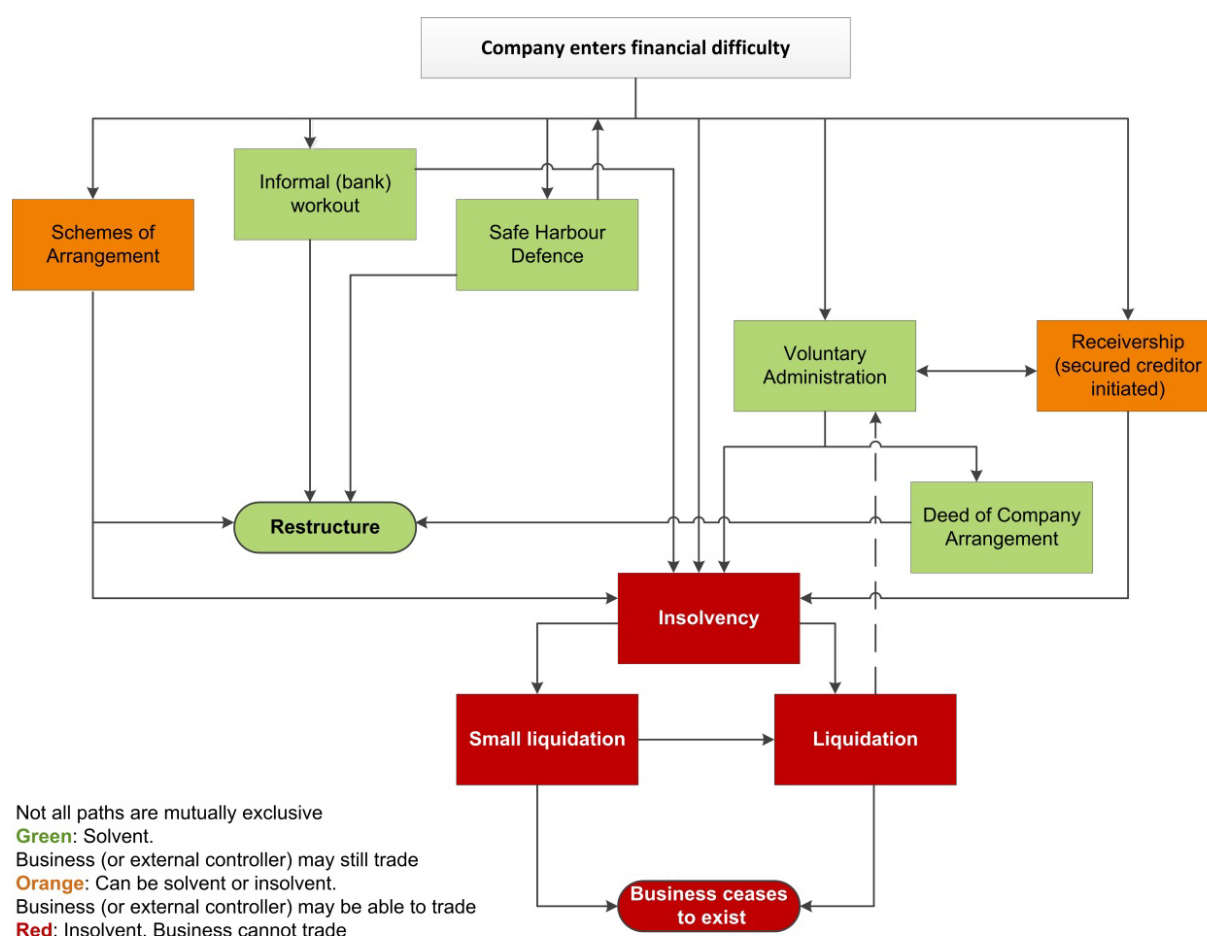
[28] "The Future of Insolvency Law in a Post-Pandemic World" - https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3916244

4 Australia’s current system

Recommendation 4: The Committee should recommend that the Attorney General provide the Australian Law Reform Commission with a terms of reference to develop a simplified, unified personal and corporate insolvency law to be administered by a new for purpose agency.

4.1 The basic framework

In its 2015 Report, the PC provided the following diagram that schematically set out Australia’s corporate insolvency framework in the event that its recommendations were accepted which, at least at a structural level, were.[29]



For the sake of brevity, we assume that the Committee is generally aware of what occurs within each of these “boxes” but in brief:[30]

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[29] Productivity Commission 2015, *Business Set-up, Transfer and Closure*, Final Report 75, Canberra, p27.
[30] More detailed explanations can be found in Chapter One of Peter Newman (ed) (2022) *The Restructuring Review*, Fifteenth Edition. The Law Reviews, London.

- *Informal workouts* occur entirely outside the formal frameworks of the law and rely simply on the law of contract. They are a circumstance where a creditor (or small group of creditors – typically financial institutions) will work with a business to restructure part or all of the business' liabilities to allow it to continue trading.

- *A Small Business Restructure* allows eligible businesses to compromise their debts with their creditors' agreement. It also allows for business owners to remain in control of their business during the restructuring period. There are restrictions on eligibility for this procedure. Directors are assisted through the restructuring process by a restructuring practitioner (RP), who must be a registered liquidator.

- *A scheme of arrangement* is a restructuring tool that can be used for either solvent or insolvent companies. It is a proposal to restructure the company in a manner that includes a compromise of the rights of one or all stakeholders, either creditors, shareholders or both. The process is overseen by the courts and requires agreement of all classes affected. Schemes of arrangement are becoming more common, especially in relation to complex restructurings that involve debt-for-equity swaps.

- *Safe harbour* sits outside the formal insolvency process but within the *Corporations Act*. It provides a defence for insolvent trading if a director, suspecting that insolvent trading may occur, takes a range of prudent steps to ensure the company's books and affairs are in good order and develops a restructuring plan with the support of an appropriately qualified professional.

- The purpose of a *voluntary administration* is to rescue – if possible – a company that's in financial difficulty. A voluntary administrator (registered liquidator) is appointed who takes control of the company and manages its affairs until the creditors decide the company's fate. The Deed of Company Arrangement documents the agreement between the administrators and the creditors as to settling the debts of the firm (in part or whole) in a way that allows the business, in substantial part or whole, to be returned to the control of the directors – this can involve a change in ownership of the business

- *Receivership* is a process which entitles a secured creditor to appoint a registered liquidator as a receiver to a company. The receiver's role is to take control of the secured assets to repay the secured debt. The loan agreement gives the creditor a right to appoint a receiver under certain conditions.

- *Liquidation* is a process which results in a company being shut down. All the company's assets are sold, and the money raised is used to repay its debts. The term 'winding-up' is also used. In a *creditors' voluntary liquidation*, the liquidator can also adopt a *simplified liquidation* process if the company is eligible and not more than 25% of creditors object.

Despite our general concerns about the complexity and structure of Australia's insolvency legislation discussed below and its regulatory institutions, and the specific concerns on

aspects of the system we express elsewhere in this submission, from a policy perspective Australia's insolvency system is broadly structurally sound.

Since the reforms arising from the PC's 2015 Report, Australia's insolvency system now strikes a good balance between providing businesses experiencing difficulty with tools to restructure their businesses whilst they continue to operate them (the first three in the list above – the so-called 'debtor in possession' approaches), while providing creditors (including employees) with confidence that when businesses fail, an external party will take control of the business and if it can't be saved, realise as much value as possible from the company and pursue those whose malfeasance may have contributed to the business' failure (the last three of the list above – the 'creditor in possession' approaches).

Inevitably in discussions about the broad structure of Australia's insolvency system, the question is asked "why don't we adopt the US Chapter 11 model?". The PC summed up the desirability of Chapter 11 in this way:

> *The Commission found that a wholesale switch toward an insolvency regime akin to that of the United States is unnecessary, unjustified and was not supported by participants in this inquiry. While the focus of the US approach to business restructure and the business retaining control of its operations seems appealing at first glance, the increased role of courts is unlikely to improve the speed or cost effectiveness of restructuring. Further, reviews of the US approach have noted that it is not suitable for the complexity of modern large companies and is too expensive for small ones. Finally, international comparisons suggest that while Australia's insolvency regime is costly, slow to get started and is less focused on restructuring, it is comparable with some other countries (including the United States) in terms of time taken, the proportion of funds recovered, creditor participation and the management of debtor assets. For example, the recovery rate in Australian insolvencies is around 82 per cent of secured debt, compared with 80 per cent in the United States and 89 per cent in the United Kingdom.*[31]

This view of the PC was correct in 2015 and it remains so today.

4.2 Legal complexity

Australia's corporate insolvency law is largely contained in the *Corporations Act,* the regulations made under it, the *Insolvency Practice Schedule (Corporations)*, the *Insolvency Practice Rules (Corporations) 2016* (Cth) *and the Cross Border Insolvency Act 2008* (Cth). The personal insolvency law, which often interacts with the corporate law in cases of small business insolvency, is largely found in the *Bankruptcy Act.* However, personal and corporate insolvency practitioners (and those running businesses in financial trouble) also need to be cognisant of the full suite of state and territory tax laws, laws which create ongoing environmental liabilities, the *FEG Act,* the Federal and Supreme Court Rules, trust law and the *Family Law Act 1975* (Cth) to name a few.

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[31] Productivity Commission (2015), p23.

Neither the Harmer Review nor the PC considered issues relating to the legislative complexity of the *Corporations Act,* let alone its interaction with the *Bankruptcy Act.* The President of the ALRC has recently noted that in its review of the financial services provisions of the *Corporations Act* stakeholders found the legislation "too complex and in need of simplification"[32]. This is a view that the vast majority of ARITA's members would concur with in relation to the insolvency provisions of the *Corporations Act*.

In a submission to the ALRC as part of the review mentioned above, we drew its attention to a wide range of deficiencies in the legal structure our members labour under, namely:

1. uncertainty in the role and duties of a small business restructuring practitioner
2. using a definition of "associate" that is not fit for purpose in an insolvency context
3. uncertainty in the operation of the safe harbour from liability for insolvent trading and creditor-defeating dispositions
4. inconsistency in eligibility requirements in relation to taxation obligations
5. the circularity of the voidable transaction provisions
6. the need for clarity on what can be considered "the company" in the statutory duty owed by directors under s181(1) of the *Corporations Act*
7. inconsistency in the terminology between the *Corporations Act* and ancillary legislation
8. unnecessary regulatory complexity in retaining cross references to the *Bankruptcy Act* in the *Corporations Act*
9. problematic structure of the *Corporations Act*, and
10. normal days versus business days.[33]

A piecemeal redrafting of the *Corporations Act* is not the reform required. In its *Interim Report B* the ALRC lays bare the structural issues with the *Corporations Act* that apply equally to its insolvency provisions:

> *The Corporations Act uses delegated legislation in unusual ways, creating unnecessary complexity, particularly through notional amendments and proliferating, but often unused, powers.*
>
> *The Corporations Act lacks a coherent legislative hierarchy in its placement of provisions in the Act, delegated legislation, administrative instruments, or regulatory guidance.*
>
> …

[32] (2022) 34(1) ARITA J, The changing face of law reform in Australia, Derrington, The Hon Justice Sarah, p7 and also https://www.fedcourt.gov.au/digital-law-library/judges-speeches/justice-s-derrington/s-derrington-j-20211111

[33] A link to our submission to the ALRC can be found at https://www.arita.com.au/ARITA/News/Submissions/Submission__ALRC_review_of_the_legislative_framework_for_corporations_regulation.aspx

> *Law design practices have struggled to cope with the complexity of the Corporations Act, and reforms are often designed and implemented over very short timeframes. As a result, subsequent amendments (often notional) and exemptions are frequently required to clarify the law and fix potential problems.*[34]

Moreover, whilst it is important for practitioners to be able to readily apply the law, the real issue is that directors and managers must be able to readily understand their obligations with respect to insolvency and their options when businesses experience difficulties, and also that creditors can easily understand their rights in relation to recovering the monies owed to them. This is critically important in the case of smaller businesses who may not have the resources to retain advisors, or even seek one-off advice, and there may also be complex interactions with the personal insolvency system.

The ALRC has recognised the importance of the law being accessible to non-practitioners when it set out its task in its financial services review. It said its task:

> *is not simply to 'tidy up' the legislative framework in service of theoretical objectives.* ***At the core of this Inquiry is the importance of ensuring the law is fit for purpose****, recognising the dynamic nature of the financial services sector and its significant contribution to the Australian economy. Further, the regulatory framework must meet the needs of consumers of financial products and services when navigating the law to understand their legal entitlements.*[35]

This approach needs to be applied to insolvency law. Indeed, assuming the Government accepts these sensible recommendations from the ALRC, it seems inevitable that the insolvency provisions in Part 5 of the *Corporations Act* would be redrafted – this means now is an ideal time to remove insolvency from the *Corporations Act* and develop a fit for purpose, unified insolvency law as discussed throughout this submission.

Within this submission we have provided links to a range of submissions we have made to Treasury on insolvency law reform. Some of those reforms have not delivered quality outcomes, such as with small business restructuring, and have exacerbated the drafting complexity of the *Corporations Act*. Our experience is that Treasury is not particularly skilled at consultation, and we suspect they will be particularly challenged by dealing with a wider range of stakeholders that will come with a fundamental review. Given these issues and the ALRCs recent experience with the *Corporations Act,* the ALRC is the best body to lead this important work given appropriate resource supplementation.

We have no doubt that in addressing the specifics of its terms of reference the Committee will make a number of recommendations that will improve Australia's insolvency law. But we cannot encourage it enough to adopt the views and approach of the ALRC and recommend that the Government undertake a fundamental redrafting and simplification of the insolvency law.

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[34] ALRC Report 139 Financial Services Legislation: Interim Report B, p6.

[35] ALRC Report 139 Financial Services Legislation: Interim Report B, p3

ARITA

4.3 A single insolvency law

Unlike the United Kingdom, the United States, New Zealand, Canada, Singapore, Hong Kong and many other countries, Australia maintains separate personal and corporate insolvency frameworks and regulators.[36]

As noted elsewhere in this submission, the vast majority of business insolvencies involve small businesses.[37] Crucially, because of issues with trusts, guarantees and funding arrangements (such as using the business owner's home as a security for a business loan), when small businesses become distressed the personal financial affairs of the directors and shareholders are very often similarly impacted. This involves different people acting as the liquidator of the company and the trustee(s) of any bankrupt persons, even though at the core of the problem there is just one business and generally one set of creditors. So, at the moment, two professionals (or potentially more if secured creditors are involved) are required to run different processes which require co-ordination.

It is ARITA's view that through a single insolvency framework these unfortunate circumstances could be dealt with more quickly and cheaply than is currently the case. Both the creditors and those involved with the insolvent business would be able to move on more quickly, and by reducing costs creditors could generally expect a superior return.

The question of a single insolvency law was considered by both the Harmer Review[38] and the PC Review – indeed the then Attorney General addressed the ALRC to this particular question.[39] It is fair to say that whilst both of these inquiries acknowledged the benefits above from a single law, their response was essentially that there were "bigger fish to fry".

Harmer observed:

> *While the Commission accepts that there are advantages in unified insolvency legislation it does not regard the goal of unity to be one of major significance. It is more important to concentrate on the particular reform proposals put forward in this Report than to be overly concerned with attempting to put the two very different aspects of insolvency law into one Act.*[40]

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[36] INSOL International Handbook – references to be provided to the committee under separate cover

[37] ASIC does not produce data on small business insolvencies. However, the ABS provides information on entries and exits of businesses. Based on this information, businesses employing less than 19 employees accounted for 97.3% of business exits in 2018/19, 97.5% in 2019/20, 96.7% in 2020/21 and 97.4% in 2021/22: https://www.abs.gov.au/statistics/economy/business-indicators/counts-australian-businesses-including-entries-and-exits/latest-release.

[38] ALRC Report 45 1988, General Insolvency report, Canberra, ("the Harmer Report"), pp 25-32.

[39] Productivity Commission 2015, *Business Set-up, Transfer and Closure*, Final Report 75, Canberra, pp 333-334.

[40] ALRC Report 45 1988, General Insolvency report, Canberra, ("the Harmer Report"), p14.

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In a similar vein, the PC observed

> *At this time, the Commission is not convinced that the net benefits from further consolidating regulation, particularly from merging the regulators, would be any more than marginal. Therefore, the Commission considers that the Government should maintain the separate personal and corporate insolvency frameworks, but should aim to align the requirements under personal and corporate insolvency laws where possible and practicable.*[41]

We would note that the Harmer Review reported some 34 years ago and prior to the enactment of the *Corporations Act* – the economy was entirely different in the time of Harmer, the importance and complexity of small business was not well understood and a very different statute and case law has developed since then.

The Committee will be aware of the recent appointment of voluntary administrators to the food delivery business Deliveroo – neither Harmer nor the PC considered the gig economy. This matter will inevitably raise issues as to whether delivery riders are employees or creditors and we expect may further expose issues with the interaction with the personal and corporate insolvency frameworks, including but not limited to FEG. It is our view that a single insolvency law is more likely to be able to adapt to these sorts of developments in the service economy than the current framework.

The PC received some evidence on the merits of combined frameworks but did not explore the issue in any great depth – it gave the issue less than two pages of consideration in its final report. It is noteworthy that the net benefit analysis alluded to by the PC was not provided in its final report.

That said, the then Government did act on the view of the PC via the *Insolvency Law Reform Act* in 2017 which sought greater alignment of the *Corporations Act* and *Bankruptcy Act.* However, before the legislation had even commenced, we saw a drifting apart of the requirements as each regulator needed amendments to cater for their particular approaches. There is a real risk that the two frameworks will continue their drift apart over time, requiring further legislation which is likely only to be motivated by issues emerging and persisting for some time. Whilst a single statute would not eliminate the need of periodic review and reform, it would certainly reduce the time and cost of doing so and the potential harm for people using or caught up in the insolvency law.

Despite the legislative complexities discussed in this submission, at a conceptual level the bringing together of the two frameworks may not be too difficult. As the following diagram shows, the regimes are structurally quite similar. Also, bringing the regimes together would facilitate a common, consistent set of definitions, a common approach to priorities for business insolvency, a single approach to professional regulation and a single regulator (as discussed below).

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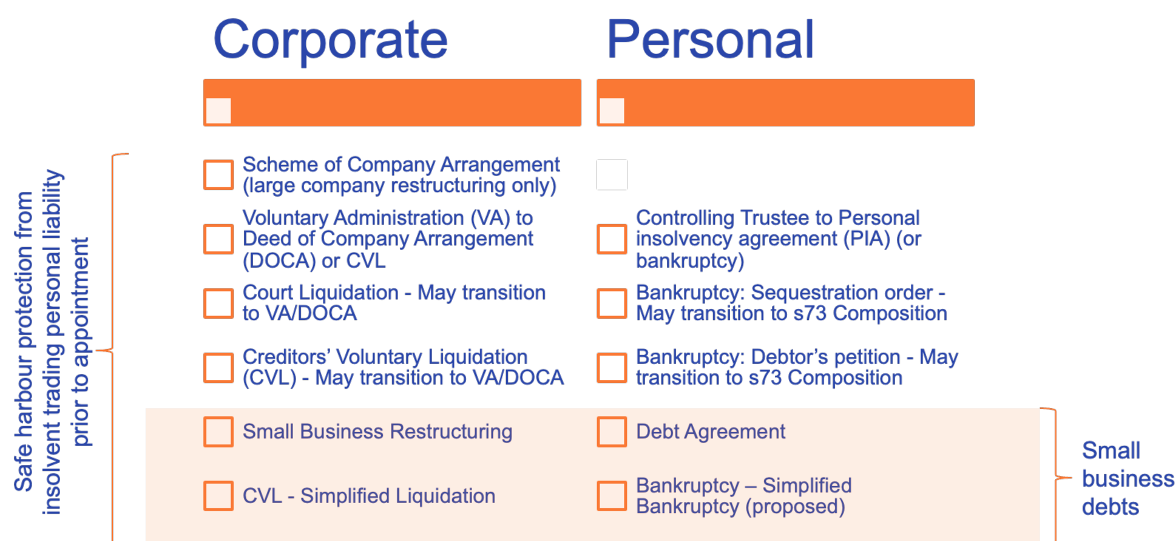
[41] Productivity Commission 2015, *Business Set-up, Transfer and Closure*, Final Report 75, Canberra, p 334.



4.4 A single best-practice insolvency regulator

Clearly, if a single insolvency law was developed, it would follow that there would be a single regulator.

The primary purpose of the insolvency law is the regulation of the conduct of people operating businesses experiencing financial difficulties. From this follows the need to protect the interests of creditors and the public interest through the proper administration of the law. The regulation of insolvency practitioners is important but follows on from these. As we have noted, the majority of businesses are smaller businesses and it is these businesses that should guide the design of the insolvency system.

Whilst central to the reform task, it is not enough simply to redraft the law to make it accessible to the main body of those it regulates. It is also necessary to have a world class insolvency and turnaround agency. In 2013 the PC released a report on regulator engagement with small business. That report documents at length why the conduct of regulators is as important as the written law in achieving regulator objectives and what regulators can do to raise their performance while delivering on their statutory duties. The Queensland Chamber of Commerce and Industry observed to the PC that:

> *"... in many cases it is the approach of regulators — their communication, advice and support, enforcement and reporting requirements — that have the most significant impact on business owner[s]"*[42]

In this report, the PC asked in relation to a regulator's culture *"does the regulator view its role as one simply enforcing regulation, or alternatively, as one of seeking to facilitate*

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[42] Productivity Commission 2013, *Regulator Engagement with Small Business,* Research Report, *Canberra*, p37.

business activity whilst mitigating the risks posed to the community".[43] Our strong view is that Australia needs an insolvency regulator that adopts the latter approach by seeing its audience as businesses in distress, creditors and insolvency professionals, particularly as an enforcement-focused regulator will do nothing to develop a more vibrant turnaround culture.

A dedicated insolvency agency, such as the United Kingdom's Insolvency Service, is needed. ASIC is a large organisation with a wide range of responsibilities and insolvency is a very small part of those. Indeed, we understand that the senior officer responsible for insolvency regulation has recently had the regulation of auditors added to their responsibility – this suggests ASIC's focus on insolvency is contracting.

In section 7.1, we discuss the relative regulatory engagement performance of ASIC and AFSA – the survey data presented there clearly shows that AFSA has superior engagement practices to ASIC. These survey results are reinforced by our experience with both agencies and a review of various materials on the engagement approach of the two agencies, both in relation to business operators and the profession. Clearly, AFSA is significantly closer to regulatory best practice than ASIC.

It is apparent that if ASIC was given responsibility for personal insolvency, the relatively good outcomes achieved by AFSA would be at significant risk and over time would tend towards the inferior outcomes currently achieved by ASIC.

We appreciate that the creation of a new agency will involve some costs to the Commonwealth. However, we do not think these will be any greater than those encountered with other administrative re-organisations regularly undertaken by the Commonwealth, such as those that occurred after the last election. Further, there is a real opportunity to create an organisation focused on insolvency and turnaround matters.

Whilst ARITA is firmly of the view that a single insolvency law is the best option available to the Australian economy, even if that law reform option was not chosen, there remains merit in a single agency being responsible for both personal and corporate insolvency law. The merit of this is self-evident: greater efficiency, better engagement, removal of duplication of agencies and lower costs to the community.

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[43] Productivity Commission 2015, *Business Set-up, Transfer and Closure*, Final Report 75, Canberra, p8.

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5 Recent reforms and needed reforms

The Terms of Reference seek views on a number of specific features of Australia's corporate insolvency system which we address in this chapter, along with several others which we believe the Committee should have some regard to.

5.1 Reducing unnecessary regulatory burden

Recommendation 5: The Committee should recommend that the Treasurer direct the Productivity Commission to undertake a focused study of the insolvency system to identify and recommend the reduction and/or elimination of unnecessary regulatory burdens to inform any future reform of the insolvency law.

Regulation that places a cost on professionals and does little to bring to justice directors and others who do the wrong thing and/or enhances the understanding and recovery by creditors is nothing more than an unnecessary regulatory burden.

Whilst we recognise the need for the insolvency process to be transparent to creditors, particularly small business creditors, we are aware that the vast majority of creditors do not read the reports provided and find the quantum and complexity of material overwhelming.

Disappointingly, in some instances, creditors perceive the extent of information provided as 'padding' to justify the remuneration sought by the practitioner. Instead of the reporting providing insights to inform creditors, the extensive reporting often leads to active creditor disengagement in the insolvency process, most of whom are just interested in how much money they will receive.

Whilst there is some potential that reduced reporting could reduce the likelihood of the identification of criminality, we think this would not be significant and that the benefits would outweigh the cost. We say this primarily for two reasons. The first is that a reduction in reporting does not imply a reduction in the investigatory activity undertaken by practitioners. Secondly, almost without exception, the registered liquidators doing this work are members of one of the three major accounting professional bodies in Australia, and are therefore subject to the professional requirements of those bodies[44].

One of the more egregious examples of these reporting obligations relate to the report about dividends to be given in certain external administrations required by the Insolvency Practice Rules (Corporations) 2016 (IPRC) and the remuneration reporting requirements as set out in IPRC and Insolvency Practice Rules (Bankruptcy) 2016 (IPRB).

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[44] Specifically APES 330: Insolvency Services, along with other relevant APES standards and guidance, and NOCLAR.

Reports about dividends

The legislation currently provides:

Corporations	Bankruptcy
IPRC 70-40 - Report about dividends to be given in certain external administrations *Simplified liquidation process* The liquidator must provide to the creditors of the company a report containing information on the following: • anything relating to the winding up of the company that has been done by the liquidator to date; • the date on which, in the liquidator's opinion, the winding up of the company is likely to end; • the likelihood of creditors receiving a dividend before the affairs of the company are fully wound up. *Not following the simplified liquidation process, or has ceased to follow the simplified liquidation process* The liquidator must provide to the creditors of the company a report containing information on the following: • the estimated amounts of assets and liabilities of the company; • inquiries relating to the winding up of the company that have been undertaken to date; • further inquiries relating to the winding up of the company that may need to be undertaken; • what happened to the business of the company; • the likelihood of creditors receiving a dividend before the affairs of the company are fully wound up; • possible recovery actions.	**Bankruptcy Act - 19 Duties etc. of trustee** The duties of the trustee of the estate of a bankrupt include … reporting to creditors within 3 months of the date of the bankruptcy on the likelihood of creditors receiving a dividend before the end of the bankruptcy.

We suggest that the prescriptive reporting requirements be removed from the legislation and replaced with simple requirements like the reporting requirements detailed in the *Bankruptcy*

Act (extracted above). Any reduction in the amount of information provided to all creditors is offset by the right of existing creditors to request information from appointees.

Remuneration reporting

Corporations	Bankruptcy
IPRC 70-45 - Reports about remuneration to be given before remuneration determinations are made The report must set out the following: • a summary description of the major tasks performed, or likely to be performed, by the external administrator; • the costs associated with each of those major tasks and the method of calculation of the costs; • the periods at which the external administrator proposes to withdraw funds from the administration account in respect of the administrator's remuneration; • an estimated total amount, or range of total amounts, of the external administrator's remuneration; • an explanation of the likely impact of that remuneration on the dividends (if any) to creditors.	**IPRB 70-45 - Reports about remuneration to be given before remuneration determinations are made** The report must set out the following: • a summary description of the major tasks performed, or likely to be performed, by the trustee; • the costs associated with each of those major tasks and the method of calculation of the costs; • the periods at which the trustee proposes to withdraw funds from the regulated debtor's estate in respect of the trustee's remuneration; • an estimated total amount, or range of total amounts, of the trustee's remuneration; • an explanation of the likely impact of that remuneration on the dividends (if any) to creditors

At a minimum, remuneration reports will comprise five pages if issued at the beginning of an appointment when seeking prospective remuneration approval. Remuneration reports issued later in an appointment can be 10 or more pages.

Notably, in relation to remuneration, we suggest that a minimum reporting requirement be set that enables a one to two page summary to be provided to creditors, with a full copy of the appointee's time information (work in progress report) to be provided on request. This enables creditors to undertake a fulsome analysis should they wish, without other creditors having to bear the cost.

In addition to the above, and as discussed elsewhere in this submission, the maximum statutory remuneration[45] should be increased to $10,000 (indexed and excluding GST), removing the need for liquidators to report and obtain approval for what is a reasonable amount of remuneration. We understand this amount is consistent with what is currently being provided by ASIC from the Assetless Administration Fund in relation to directors

[45] Section 60-15 Schedule 2 – Insolvency Practice Schedule (Corporations) and (Bankruptcy).

banning applications which similarly do not require creditor approval before remuneration is drawn.

In drawing these examples to the Committee's attention, we are in no way suggesting this is the extent of the problem, but rather that there is work to be done to ensure that the reporting and other requirements placed upon liquidators and other professionals do actually have value to creditors and deliver creditors what they need at least cost. This also shows that the requirements in the *Bankruptcy Act* can be simpler and cheaper than their equivalents in the *Corporations Act*. The bringing together of the corporate and personal insolvency systems would provide an excellent opportunity to flush out a lot of these unnecessary and wasteful requirements and fix them.

5.2 Safe harbour

Recommendation 6: The Committee should recommend that the recommendations of the Independent Review of Safe Harbour arrangements be implemented immediately irrespective of the progress of wider system reforms.

ARITA has long advocated for a defence from insolvent trading – we were the initial proponents of the concept in 2007 and part of the group of associations that created the framework in 2010 and then drove it as a key policy area from 2014 and its recommendation by the PC in its 2015 report. Safe harbour was designed to provide "breathing space", "opportunity" and "confidence". We believe that the safe harbour regime is doing what it was original conceived to deliver.

As part of our participation in the 2021 review of the safe harbour framework we undertook an extensive survey of our members[46]. Key areas for improvement identified by them centred on the clarification of key terms in the legislation which are largely reflected in the recommendations of the review, again reflecting the drafting issues with the *Corporations Act*.

There was consensus among respondents to ARITA's survey that the safe harbour regime is not being abused by directors to avoid reasonable and fair personal liability. The pre-conditions to accessing safe harbour prevent illegal phoenix activity and stop inappropriate and unviable candidates for restructuring from continuing to trade. Where a safe harbour is being conducted in accordance with the requirements of the law, neither employees nor creditors are being adversely affected.

For directors of larger companies, the desire to avoid liability for insolvent trading is an active consideration. Directors of these enterprises used the COVID-19 moratorium as an opportunity to seek advice to take steps to make safe harbour protection available to them at

[46] A copy of our submission to Treasury can be found at https://treasury.gov.au/sites/default/files/2022-03/c2021-205011-arita.pdf

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the end of the moratorium. It is these large businesses, rather than smaller businesses, that safe harbour was largely developed for.

Despite some successful and valuable deployments of safe harbour for small businesses, it appears to have made limited difference to the behaviour of directors of small businesses. These directors are more concerned about personal liability for personal guarantees and tax debts than insolvent trading. The view of our members was that the COVID-19 insolvent trading moratorium was used by directors of small businesses to 'kick the can down the road'.

The survey clearly indicated that there is not sufficient awareness of the safe harbour among advisers to small and maybe medium size businesses – correcting this is clearly the responsibility of a future insolvency agency. That said, recent market intelligence from ARITA's members is that in relation to larger businesses, including listed companies, safe harbour activity is increasing and perhaps most pleasingly, earlier in the distress cycle in a more strategic and planned way.

ARITA strongly endorses the immediate implementation of the recommendations of the Safe Harbour Review, and in particular recommendation 4 relating to increasing the awareness of small and medium businesses of the benefits the framework may afford them as an alternative to voluntary administration, small business restructuring or liquidation.

5.3 Small business restructuring

Recommendation 7: The Committee should recommend that the laws relating to Small Business Restructuring be amended to reduce complexity and cost and improve timeliness as outlined in Appendix A of this submission.

We have advocated for a restructuring tool for small and micro businesses since our thought leadership paper "A Platform for Recovery" in 2014.[47]

The concept ARITA advocated for was a restructuring tool targeted at micro-small businesses which was highly simplified. The simplified nature – streamlined processes with limited safeguards - would ensure low costs. Keeping the process to a very low debt threshold would reduce the consequences and risk of phoenixing or other nefarious activity. The limited safeguards, including compliance with having met tax reporting obligations and being largely up to date with meeting employee entitlements would work to ensure that a business was being properly run and a suitable candidate for business rescue.

This concept was largely adopted by the PC and subsequently taken up by parliament as a means of assisting with the economic outfall from the pandemic. Unfortunately, the Small Business Restructuring (SBR) legislative package has failed to live up to expectations due to the highly complex processes and legislation that have arisen from the lack of adequate consultation with the profession during the drafting phase. Like the simplified liquidation

[47] https://www.arita.com.au/documents/Technical/Public-policy/a-platform-for-recovery-2014.pdf

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process discussed elsewhere in this submission, SBRs are simply not fit for purpose and have failed to deliver the cost-effective mechanism contemplated by the PC and the parliament.[48]

It is evident that the approach of basing the SBR legislation on voluntary administrations does not work. As mentioned by the Independent Committee that recently reviewed safe harbour, "different challenges are faced by companies in the SME and mid markets compared to larger companies. It may be that "one size model" does not fit all"[49]. It is our view that one size does not fit all. The SBR legislation should reflect the less complex nature of the businesses dealt with, rather than being a modified cut and paste of Part 5.3A of the *Corporations Act* which is designed to deal with the voluntary administration of much larger companies.

The legislation is so complex with provisions found throughout the *Corporations Act*, Regulations, Insolvency Practice Schedule and Insolvency Practice Rules that even experienced registered liquidators struggle with it. The intended users, company directors of small businesses, really have little chance, explaining in large part, along with an inadequate education campaign by ASIC, why there has been limited take-up of this option: from the commencement of the scheme on 1 January 2021 until 30 October 2022 there have been 176 appointments as compared with with 5,862 creditors' voluntary liquidations and 1,459 voluntary administrations over the same period.[50]

As a debtor-in-possession type model for small business (that is, one where the directors of a distressed business remain in control of it during its restructuring and turnaround), it is essential that the legislation is simple and comprehensible so that directors can understand their obligations without having to overly rely on the restructuring practitioner. It also requires a well thought-out and ongoing information campaign which ASIC has failed to deliver. Over-reliance on the restructuring practitioner and complex requirements result in increased costs, which is contrary to all intentions on the introduction of the SBR.

The concept of the SBR is good, and with legislative reform the original policy intent can be achieved, as detailed in Annexure A and summarised as follows:

- Secured creditor debt should be excluded from the SBR process. Current requirements to determine the quantum of any deficiency to be compromised is excessively complex and uncertain, thereby defeating the purpose of SBR. Further, to ensure that the restructuring has an opportunity to succeed, secured creditors should be unable to enforce their security solely due to the appointment of a restructuring practitioner (commonly referred to as an "ipso facto" moratorium similar to that contained in ss 415D, 434J, 451E and 454N of the *Corporations Act* as

[48] A copy of our submission to Treasury can be found at https://treasury.gov.au/sites/default/files/2020-12/c2020-118203_arita.pdf.
[49] Review of the Insolvent Trading Safe Harbour Report, page 85: https://treasury.gov.au/sites/default/files/2022-03/p2022-p258663-final-report.pdf
[50] ASIC Insolvency Statistics at 31 October 2022 - https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/

recommended by the PC[51]). This would not prevent enforcement due to non-payment.

- Specifically recognise that the restructuring practitioner is an adviser to the company and its directors, and that the proposed restructuring practitioner needs to be able to work with the company prior to the appointment being made without affecting their independence.
- Automatic stay of any winding up applications.
- Modify the process to determine creditor claims before the proposed plan is issued, resulting in less likelihood of a variation to the plan and an extension of the proposal period.
- Allow plans to treat related party creditors differently to arm's length creditors. Currently, related party creditors (such as the owners and their families) are unable to elect to receive, say, lower or no payment, to enhance the offer to other creditors and thereby increase the likelihood of the business continuing.
- Remove creditors' rights to request information under the strict statutory process in exchange for enhanced reporting. Creditors will still be able to request information and this is likely to be provided, otherwise the creditor has the power to vote against the proposed plan.
- Limit plans to the payment of cash by the restructuring practitioner so the restructuring practitioner simply distributes funds as agreed under the plan. The current legislation allows for inclusion of non-cash assets in the plan and for the sale of those assets by the restructuring practitioner. The inclusion of non-cash assets is an unnecessary and potentially costly complication for an SBR process – where these are an issue, other processes are available.
- During the term of the plan, the company can propose a variation to the plan which is voted on by creditors. Currently only the Court can approve a variation to a plan which is too expensive and something that is more appropriately decided by the creditors affected.

We are also aware that the operation of certain state laws are frustrating the SBR framework and simply precluding them from restructuring. An example of this is that following the appointment of a restructuring practitioner to small residential builders in New South Wales, iCare cancels their eligibility to obtain new home builders warranty insurance from the date of appointment, thereby preventing any hope of restructuring.[52] Whilst appreciating the need to protect the community from dodgy builders, financial distress is not axiomatic with consumer detriment. Clearly this is another example of the frustration of the *ipso facto* reforms recommended by the Productivity Commission and a matter that should be looked

[51] Productivity Commission (2015), Recommendation14.5.
[52] Icare HBCF Eligibility Manual clause 9.1. Unacceptable risk scenarios which defines the appointment of an external administrator as a 'business closure' from the appointment date.

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at as part of the review of section 5 of the *Corporations Act* that is recommended elsewhere in this submission.

We are confident that this approach will significantly reduce the cost of SBRs (which we understand from a survey of ARITA members conducted in September 2022 are currently between $10,000 and $75,000) as well as improve timeliness. The survey respondents believe that 10–50% of costs would be saved if unnecessary tasks were removed from the process.

A detailed flowchart setting out how we, in our expert opinion, believe SBRs should work is provided at Annexure A.

5.4 Simplified liquidations

Recommendation 8: The Committee should recommend that the laws relating to Simplified Liquidation be amended to reduce complexity and cost and improve timeliness as set out in Appendix B in this submission.

While we have long advocated for a framework for dealing with small business financial distress, clear feedback from our members confirms that the practical operational concerns we expressed in response to Treasury's consultation on the *Corporations Amendment (Corporate Insolvency Reforms) Bill 2020* have led to a situation where the simplified liquidation process is, simply, not fit for purpose and has failed to deliver the cost-effective mechanism contemplated by the PC and the Parliament.[53]

It is evident that the 'simplified' liquidation process is actually less efficient and more costly than a full creditors voluntary liquidation process. The fact is that only 59 creditors voluntary liquidations have adopted the simplified process since it commenced on 1 January 2021.[54] For context this represents a mere 1% of the 5,862 creditors voluntary liquidations commenced in this period.

The failure of the simplified liquidation process is attributable to poor legislative drafting and a poor information campaign conducted by ASIC. Fortunately, with the support of an effective regulatory engagement, this can be relatively easily rectified so the original policy intent is achieved as detailed in Annexure B, which can be summarised as follows:

- A liquidator makes the determination to adopt a simplified liquidation process, including in the case of court ordered liquidations, and creditors have the right to contest.
- The ability to litigate within a simplified liquidation is, by its nature, counterintuitive to the process and should be removed. Liquidators have the power to recommend to

[53] A copy of our submission to Treasury can be found at https://treasury.gov.au/sites/default/files/2020-12/c2020-118203_arita.pdf.
[54] ASIC Insolvency Statistics to 31 October2022 – ASIC Insolvency Statistics

creditors to terminate the simplified liquidation process and revert to a full liquidation if litigation is required.

- A maximum statutory remuneration of $10,000 (indexed and excluding GST) is set removing the need for liquidators to report and obtain approval for a reasonable amount of remuneration commensurate to the required tasks.
- Streamlined reporting obligations, clarifying liquidator investigation requirements and removing the statutory right of creditors to make requests. Creditors would retain the right to discuss the liquidation with the liquidator but it would ensure that additional costs incurred for the benefit of the few, including ASIC and other government bodies, are not borne by the general body of creditors.
- Enable multiple dividends to be paid to priority employee creditors, ensuring they are paid as soon as possible.
- Remove the requirement to obtain clearance from the ATO prior to a dividend being declared and for proof of debts to be lodged for claims of less than $10,000. Creditors would retain the right to judicial determination of a rejection of their claim (this would not be captured by the prohibition on litigation).
- Offset removal of creditors' right to request information with a right to seek termination of the simplified process.

A detailed flowchart setting out how we, in our expert opinion, believe simplified liquidations should work is provided at Annexure B.

5.5 Unlawful phoenixing

Recommendation 9: The Committee should recommend that the law be amended to create a definition of, and offences relating to, illegal phoenixing that should be applicable to all parties involved, including advisors.

Recommendation 10: The Committee should recommend that any process to develop a new insolvency law should consider whether pre-insolvency advisors should be registered.

Recommendation 11: The Committee should seek a comprehensive explanation from ASIC as to why its level of enforcement activity in relation to illegal phoenixing seems to be so low.

Registered liquidators are at the frontline in discovering and pursuing illegal phoenixing activity. The success or otherwise of any reforms with a similar goal turns on how effectively they can be deployed by liquidators, and then how regulators engage positively with those liquidators to pursue the directors and unregulated advisers who are the drivers of this illicit behaviour.

Illegal phoenixing is a widespread swindle where directors intentionally shut down their companies after shifting their assets for little or no payment to new companies to avoid paying employees, creditors and the ATO.

A 2018 report by PricewaterhouseCoopers for the ATO, Fair Work Ombudsman and ASIC estimated that in 2016–17 illegal phoenixing cost the Australian economy up to $5 billion:

- $3.2 billion in unpaid trade creditors
- $300 million in unpaid employee entitlements
- $1.7 billion unpaid taxes and compliance costs.[55]

According to Professor Helen Anderson, formerly of the Melbourne Law School, the problem of illegal phoenixing exists because: "it is easy to do, cheap, highly profitable, relatively invisible and rarely pursued by regulators."[56]

Liquidators report around 10,000 suspected cases of suspected illegal director activity to ASIC each year. Very few of these directors are ever prosecuted by ASIC. Indeed, ASIC has notably taken more action recently against directors who make false statements on forms lodged with it to voluntarily deregister their companies than directors reported by liquidators.

While ASIC (for reasons we don't understand) no longer publishes specific information on alleged misconduct reports by liquidators, in its 2021-22 Annual Report[57] ASIC stated that it concluded 261 small business enforcement matters (86 matters ongoing). Of the 261 small business matters concluded:

- 163 convictions relate to individuals who failed to assist registered liquidators, one of which one received a custodial sentence
- 16 relate to criminal convictions prosecuted by the Commonwealth Director of Public Prosecutions, of which three received custodial sentences – ASIC does not provide a consolidated report of the nature of those matters
- 56 persons were disqualified from managing corporations, of which eight involved disqualifications of directors where ASIC found, in part, that the directors engaged in illegal phoenix activity; and
- the remaining related to convictions of companies that failed to lodge annual financial reports with ASIC or the cancellation or suspension of credit licences.

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[55] The Economic Impacts of Potential Illegal Phoenix Activity, July 2018 https://www.ato.gov.au/uploadedFiles/Content/ITX/downloads/The_economic_impacts_of_potential_illegal_Phoenix_activity.pdf

[56] Australian Government Treasury, Combatting Illegal Phoenixing (September 2017), Submission by Professor Helen Anderson, Professor Ian Ramsay and Mr Jasper Hedges, Melbourne Law School, and Professor Michelle Welsh, Monash Business School, Monash University https://treasury.gov.au/sites/default/files/2019-03/c2017-t221952-Professor-Helen-Anderson-et-al.docx

[57] ASIC 2021-22 Annual report https://asic.gov.au/about-asic/corporate-publications/asic-annual-reports/

By comparison, keeping in mind Australia's population is around 40% of the United Kingdom, in 2021-22 803 director disqualification orders and undertakings were made in the United Kingdom as a result of insolvency enforcement action.[58]

While the *Anti Phoenixing* Act goes some way to addressing illegal phoenixing, much more needs to be done to protect the community from this scourge. In 2018, ARITA made a substantive submission in response to the draft legislation of reforms to combat illegal phoenix activity[59], and many of our concerns remain unaddressed. The market needs stronger signals that poor director behaviour won't be tolerated, so that people who don't play by the rules don't receive an unfair advantage over their creditors,employees or competitors. Strengthening the legislation is part of this, a dedicated engagement-focused regulator is the other.

Insolvency practitioners are increasingly concerned about the rise of the unregulated 'pre-insolvency' advice market. Not to be confused with qualified professionals giving lawful advice, these 'pre-insolvency advisors' counsel their clients on how to avoid paying their debts and meeting their legal obligations. They are 'ambulance chasers' who prey on people and businesses in financial distress. They claim to be able to remove the worry of a dire financial situation, but they often encourage unlawful conduct such as hiding or stripping assets and illegal phoenixing.

The case of Intellicomms is an interesting example of illegal phoenixing. While we applaud the decision in Intellicomms, we note that this was an action against a related party purchasing entity and did not extend to the advisor who facilitated the transaction, notwithstanding that the decision noted the following:

As the essentially uncontroversial chronicle of the factual background reveals, Ms Haynes, apparently with the assistance of her advisors, de Jonge Read, executed a plan designed to place the assets of Intellicomms beyond the reach of its creditors. [60]

[58] The Insolvency Service, Official Statistics, Insolvency Service Enforcement https://www.gov.uk/government/statistics/insolvency-service-enforcement-outcomes-monthly-data-tables-202223

[59] A copy of our submission to Treasury can be found at https://treasury.gov.au/sites/default/files/2019-03/t313204-ARITA.pdf.

[60] *Re Intellicomms Pty Ltd (in liq)* [2022] VSC 228 at [229].

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Intellicomms

A recent example of this behaviour was set out in the decision in Re Intellicomms Pty Ltd (in liq) [2022] VSC 228, where the Supreme Court of Victoria held that a sale agreement of business assets immediately prior to a winding up of a company was a creditor-defeating disposition as established by the Illegal Phoenixing Act.

Intellicomms operated a business that provided translation services to commercial enterprises in Australia and New Zealand. On 8 September 2021, Intellicomms sold its business assets to Tecnologie Fluenti Pty Ltd (TF) under a sale agreement. Later that day, its sole director (Ms Haynes) convened a meeting and Intellicomms was placed into creditors' voluntary liquidation. This meeting was convened without informing major shareholders and creditors of the meeting. Liquidators were appointed in the winding up.

The evidence supports that Ms Haynes had planned the sequence of events carefully in close consultation with her business management consultants, de Jonge Read.

Two weeks prior to the appointment of the Liquidators, TF was incorporated for the purpose of acquiring and operating Intellicomms and its associated assets. The sole director and shareholder of TF was Ms Haynes' sister (Ms Gigliotti). Ms Gigliotti was previously employed by Intellicomms as a financial and payroll administrator.

Ms Haynes arranged for several valuations of Intellicomms to be obtained over a comparatively short period of time based on increasingly pessimistic inputs as to future trading revenue provided by her, which had the effect of dramatically decreasing the value of Intellicomms from $11.277 million as at 30 June 2020 to $57,000 in September 2021. The consideration payable under the sale agreement was commensurate with lower valuations obtained.

We are unaware of any subsequent action being taken against de Jonge Read in relation to its behaviour as described in the decision.

Almost invariably, pre-insolvency advisors are not registered liquidators or trustees, not lawyers or tax practitioners, typically not part of any professional body and don't hold Australian Financial Services Licences. They are totally unlicensed, operate without scrutiny and have no indemnity insurance should things go awry. They all exploit one thing: they know that the regulators are unlikely to chase them.

A 2019 ARITA survey found that almost 50% of registered liquidators who responded had seen an increase in the extent of influence of illegitimate pre-insolvency advisors compared to 2017, alarmingly 20% of the respondents said this influence had greatly increased.[61]

[61] (2019) 31(2) ARITA J, State of the profession 2019, p11.

Respondents believed that more effective enforcement action was needed to shut down these dodgy advisers (39%) and that pre-insolvency advisers should be regulated (30%) and licensed on the basis that the advice being offered by them constitutes corporate or personal insolvency and/or financial advice.

Fundamentally we remain of the opinion that:

- substantially more enforcement actions need to be taken directors and facilitators of illegal phoenixing
- more needs to be done to strengthen existing anti-phoenixing tools within the law rather than creating quasi-duplicate mechanisms. This is consistent with the ALRC's recent recommendation that 'offence and penalty provisions in corporations and financial services legislation should be consolidated into a smaller number of provisions covering the same conduct.'[62]
- an actual "phoenixing" offence needs to be created. Its absence hinders any effective communication strategy to drive cultural change to call out and mitigate this behaviour.
- a lack of adequate funding and documentary evidence available to liquidators will continue to hamper the effectiveness of the reforms, including the ability of ASIC to make any recoveries via the administrative recovery regime.

5.6 Personal Property Securities Act corporate interaction

Recommendation 12: That the Committee should recommend that the insolvency law allow an external administrator to give notice to claimants on the PPS Register to verify their claims within a set period, failing which their claims will be treated as unsecured or not at all.

It is accepted as fundamental in insolvency that secured creditors have priority and can stand outside the insolvency process. This is provided for under the *Bankruptcy Act* and the *Corporations Act* and we would expect in a consolidated insolvency law[63]. It is also fundamental that all secured creditors be able to prove their status as a secured creditor and, if necessary, the quantum of their debt.

An aim of the PPS Act is to regularise and make clear the status of priority creditors with interests in personal property of the company (for example inventory, motor vehicles, leased property), to the same level as those with security interests in the company's real property, being land and buildings.

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[62] ALRC Financial Services Legislation: Interim Report B, p 147 - https://www.alrc.gov.au/wp-content/uploads/2022/09/ALRC-FSL-Interim-Report-B-139.pdf.

[63] Security is relevant to a number of issues in insolvency, including how and for what amount a secured creditor's debt can be proved, the release of the insolvent from liabilities, the validity of the security, whether and how secured creditors can petition for a winding up order, the rights of the liquidator to deal with the security, and including a secured creditor's right to vote.

The winding up of a company generally operates according to a legal process of expedition. That expedition is required in order to facilitate a prompt resolution of the winding up for as little cost as can be managed consistent with creditors and other parties' rights. Insolvency law therefore places the onus on those with claims in the liquidation to prove their priorities and claims, and often within strict time limits.

The regime established under the PPS Act seeks to ascertain and determine the position of secured claims against the personal property of the company as expeditiously as possible. This needs to allow for the inherent complexities of commercial claims, for example, where individual items are so physically united with others such that the original identities of the individual items are lost – this is often referred to as the commingling of products.

Whilst the PPS Act and its intention may be reasonably clear, in practice the conduct of parties and the PPS Register itself does not afford liquidators the benefit of clarity in relation to PPS claims. Insolvency practitioners can spend considerable time and cost in determining such claims from the PPS Register, in trying to obtain information from PPS claimants about their interests, and in dealing with those who claim to have interest, but whose interest cannot be readily verified.

These problems arise from the unsatisfactory state of the PPS Register, creditors' inadequate use of it, and the fact that the register allows 'stale' interests to persist.[64] We contrast that with land title registers, acknowledging the more stable nature of land as collateral. The case of the Hastie Group provides an interesting example.

[64] This appears to arise from inattention to the obligation on a secured party to remove the PPS registration if there are no (or no longer) reasonable grounds for the secured party to believe that it has a security interest (s PPS Act s151). We also note the amendment demand regime allows a person with interest in the collateral to demand the registration be removed if there is no longer a security interest (s187).

Hastie Group

In the administration of the Hastie Group, there were 995 registrations noted against the Group's companies in the PPS Register. The Group's records inadequately described the nature and location of all the plant and equipment, some of which had been moved between companies within the Group, and between different building sites, without records being kept.

The voluntary administrators wrote to all creditors who had an interest recorded in the PPS Register but 80% failed to respond, and many of the responses received were of little assistance to the administrators. The administrators also wrote to a number of financiers who appeared to have a secured claim in respect of the plant and equipment, and they placed advertisements in newspapers across Australia.

The administrators were able to identify approximately $2 million worth of assets, but the end result was that 77% of the total number of items of plant and equipment remained unclaimed. This necessitated court intervention and directions to allow the administrators to sell the assets despite the PPS interests.

[65]

Once a company enters external administration, insolvency laws take over, with their different focus and policy approach, in particular to ensure the efficient and prompt winding up of the company's affairs. Existing security interests and priorities are recognised, but on terms and under processes applied by insolvency law. However, insolvency laws do not currently allow external administrators to deal efficiently or effectively with PPS Act securities to determine their status.

Whilst it is generally incumbent upon creditors to prove the validity of their claim, practically, it will often be the liquidator with the skills and access to available company records who is called upon to either prove or disprove such claims. As is apparent from the Hastie Group administration, dealing with PPS claims can involve considerable time, and therefore remuneration accrued by the external administrator, to the diminution of funds available for creditors generally.

We suggest that insolvency law allow an external administrator, whether in a liquidation or voluntary administration, to give notice to claimants on the PPS Register to verify their claims within a set period, say 15 business days, failing which their claims will be treated as unsecured or not at all.

There is precedent for this approach in the *Corporations Act* in respect of creditors proving their unsecured claims. Corporations Regulation 5.6.65 provides that a liquidator must give

[65] See *Carson, in the matter of Hastie Group Limited (No 3)* [2012] FCA 719. The correctness of that decision and the utility of such directions was questioned as "unsound" in PPS Register – Unclaimed good and the decision in Hastie Group (2013) 25 (1) A Insol J 20, David Walter.

notice of an intention to declare payment of a dividend from the company's funds and, relevantly, a creditor that does not respond with a proof of its claim within the set time is excluded from participating in the dividend.

5.7 Unfair preferences

Recommendation 13: That the Committee should recommend the law be amended to designate all related party preference payments to be unfair preferences in the first instance. Provision should be made to allow the related party to demonstrate to the liquidator that the payment was not an unfair preference.

Recommendation 14: That the Committee should recommend the law be amended to ensure all unfair preference demands be accompanied by a version of an "unfair preferences rights" guide that is approved by the regulator.

Recommendation 15: That the Committee should recommend the law be amended so thar unfair preference claims for "uncommercial" amounts be prevented – a minimum claim being set at $4,000 in line with the recently adjusted statutory minimum for statutory demands.

Recommendation 16: That the Committee should recommend that the Government commission a review of the interaction of the insolvency law with state and territory laws and in particular the operation of section 5 of the *Corporations Act.*

Unfair preference payments are one of the most vexed issues in corporate insolvency. The unfair preference regime seeks to ensure the *pari passu* principle for the payment of unsecured creditors – an important tenet that all unsecured creditors should be treated equally and that none should be able to leverage greater proportional recoveries than others.

The unfair preference regime supports this by looking at payments made in the months before a business collapses. This is important because powerful creditors often have greater insight into a debtor's actual financial circumstances than a small creditors (for example, some large retail property landlords get daily trading data from their tenants. They can therefore clearly see their financial performance. In contrast, most suppliers of stock to that retailer would have no such insight. The landlord may be able to use this knowledge to force payments of debts where the product supplier would be blind to the need to manage its credit exposure.)

On the other hand, it can be argued that the unfair preferences regime can undermine good credit management. The role of a credit professional is to assess the risk of those they are providing trade credit to, thereby protecting their business from non-payment. Their second role is to manage credit levels and get their debts paid. Under the guidance of a good credit professional, their business should indeed get paid before others who are less careful in managing debts owed. The existing unfair preference regime doesn't deliver on this.

At a minimum, we believe that the ability to recover preference payments from related parties should be simplified. All related party payments within the relevant period should be

designated to be unfair preferences in the first instance and provision should be made to allow the related party to demonstrate to the liquidator that the payment was not an unfair preference. This ensures that related parties, who have access to trading data and are ordinarily aware of any financial distress, are less likely to avoid repayment of preference payments simply because a liquidator has insufficient information or funds to pursue the recovery.

Alongside this is the issue that the unfair preferences regime is constantly being undermined anyway. Over the years, governments (state and federal) have decided that certain unsecured creditors should have elevated rights for priority payment. This is not only clearly shown by the edited and re-edited numbering of s556 of the *Corporations Act*, which shows the waterfall of priority payments ahead of general unsecured creditors. Prominent examples including the payment of employee entitlements first (see also our section on FEG) and state-based claims that environmental remediation obligations should have priority. The current “Security of Payments” debate in regard to payments to construction industry sub-contractors is yet another example. Each of these exceptions cuts down the pool that goes to pay general unsecured creditors.

Despite section 109 of the Constitution, it was the intent of the Commonwealth Parliament when it enacted the *Corporations Act* (in s5G) that, where there are conflicts between the Act and certain state and territory laws, the relevant state or territory law would prevail providing that the jurisdictional parliament makes a declaration that s5 of the *Corporations Act* is applicable. Whilst not wishing to upset this arrangement, which we believe was part of the agreement between the Commonwealth and the states to refer all corporations powers to the Commonwealth, the passage of time, the expansion of the remit of the Commonwealth by the High Court in cases such as *WorkChoices*[66], and general changes in the national and global economies would suggest it is timely to review the interaction of state and territory laws and the insolvency system, and in particular the operation of section 5G of the Act.

The insolvency profession is frequently unfairly maligned with a belief that unfair preference recoveries are only undertaken to get those insolvency professional’s fees paid. Unfair preference recovery plays an important role in funding an insolvency process, such funding is necessary to ensure insolvency practitioners can maximise returns to creditors. As the Chapter 11 Review Commission in the United States reads:

> *the notion that money paid to professionals belongs to creditors is true only if the creditors could realize that value without the professionals* [67]

Further, as discussed elsewhere in this submission, the current obligations of an Australian insolvency practitioner encapsulate much wider tasks than merely recovering money for the

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[66] *New South Wales v Commonwealth (2006)* HCA 52.

[67] American bankruptcy Institute, Commission to study the reform of Chapter 11, 2012-204, Final Report and Recommendations, p57

benefit of creditors (such as investigations, reporting and administration) for which they have a reasonable expectation to be remunerated for.

We are aware of inappropriate use of unfair preference demands by some liquidators. This may entail "scattergun" sending of demands to all creditors who received a payment within the prior six months regardless of there being any evidence that the payment was an unfair preference. This type of activity may intimidate some creditors – especially small business creditors – into repaying amounts that were rightfully theirs, either out of a lack of knowledge of their rights or simply because it's too hard or expensive to fight back.

This practice is strictly prohibited by ARITA's Code of Professional Practice and would be the basis of a conduct enforcement action. However, whilst we are aware of this practice, we have not had a genuine and verifiable complaint about one of our members undertaking this activity in the last decade. This is almost certainly due to a lack of knowledge on the part of small creditors, something which a best practice regulator would take action to correct.

In the short term, the situation could be ameliorated by excluding small payments from recovery and providing those parties who are the subject of demands to be provided with a plain English guide to their rights. ARITA is in the process of drafting such a guide for our members. The exclusion of small payments would be achieved setting a statutory minimum in the same way as a statutory minimum is set for statutory demands under s459E of the Corporations Act[68]. There is a logical equivalence here and the statutory minimum was revisited last year and permanently doubled as part of the COVID-19 measures. Further, we would suggest that these amounts should be annually indexed.

5.8 Trusts

Recommendation 17: The Committee should recommend that the relevant laws be changed to allow registered liquidators appointed to a trustee to access assets held in the relevant trusts without recourse to the courts.

Recommendation 18: The Committee should recommend that the establishment of a national register of trusts and until it is established, the ATO and other government agencies holding information that identify the relationship between trusts and their trustees should be authorised to disclose that information to an external administrator appointed to a corporate trustee.

Recommendation 19: The Committee should recommend that the relevant laws be changed so that the relevant insolvency regimes are applied to insolvent trust funds as standalone economic entities.

As the Committee would be aware, the Treasury has been conducting a major review of the treatment of trusts under insolvency law. To support our recent submission to that review[69]

[68] As prescribed in Regulation 5.4.01AAA of the *Corporations Regulations 2021 (Cth)*
[69] A copy of our submission to Treasury can be found at https://treasury.gov.au/sites/default/files/2022-04/c2021-212341-arita.pdf.

we surveyed our professional members about the prevalence of trading trusts in their insolvency administrations and the costs of necessary court applications. The survey showed that trusts were a common feature of insolvency matters and that practitioners having the power to deal with trust assets and make distributions to creditors without court involvement would be of substantial benefit to most external administrations involving trusts.

Broadly speaking, ARITA supports the fundamental recommendations in relation to corporate trading trusts from the Harmer Review in 1988[70], noting that some changes and additional reforms are required due to the passage of time, changes in market practice and changes to the available insolvency processes under the *Corporations Act*.

The nub of the problem is that a trust comprises two distinct economic entities – the trustee and the trust itself – but insolvency law only recognises one of them, the *legal* entity that is the trustee. This has led to uncertainty and unpredictability in how the assets of trusts are to be dealt with. Under current law, they are dealt with as part of the administration of the trustee if the trustee is insolvent or near to insolvency, subject to obtaining the necessary court orders. However, the law currently does not address a situation where the trustee is solvent while the trust is not.[71] In short, it means that whenever there is a trust in an insolvent business, a liquidator should invariably head to Court. This adds significant unnecessary cost and delay to the process for no reason.

ARITA's position is that, for the purposes of insolvency law, trusts should be treated as economic entities (but *not* legal entities) separate from their trustee, and legislation should enliven the existing insolvency regimes so that they can be applied to insolvent *trusts* as if they were standalone entities. Conceptually, this is largely in line with the recommendations made in the Harmer Report.

ARITA does not support the development of a separate specific regime for insolvent trusts or interfering with the freedom to structure trusts as participants wish, such as forcing trusts to become companies or another form of legal entity.

If a corporate trustee is put into external administration, then all trusts of which it is trustee would automatically also be under administration. As noted above, currently, whilst the external administrator has access to the resources of the trustee, the external administrator must gain permission of the court to access the resources of any trust. Whilst this is normally granted, it is time consuming and expensive and as such, largely an unnecessary regulatory burden. At a minimum, the administrator, having advised the beneficiaries of the trust, should be given access to the trust fund assets with the court empowered to intervene only in exceptional circumstances.

If the external administrator of a trustee controls a solvent trust, they should, within a fixed period after appointment, in consultation with the beneficiaries, be able to declare that the

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[70] ALRC Report 45 1988, General Insolvency report, Canberra, pp221-271.

[71] If a trust does not have an external creditor, that is someone other than the trustee or a beneficiary, then it cannot be insolvent.

trust will be transferred to a new trustee. It is not necessarily appropriate for an external administrator to be responsible for managing a viable and solvent trust as part of their duties. Naturally, sufficient time needs to be allowed for the external administrator to identify a suitable new trustee and arrange the transfer once the declaration is made.

Although not something that commonly happens, it is possible for a trust to be insolvent whilst the trustee is solvent say, if a trustee is protected via trustee limitation of liability clauses negotiated into contracts with creditors. The problem in this scenario is that currently almost none of the insolvency provisions will operate unless and until the trustee is insolvent.

There needs to be a clear mechanism for creditors of an insolvent trust fund to be able to apply to the court for the appointment of an external administrator to the trust. That administrator could take control of the trust away from the trustee and make an assessment about the future of the trust. If appropriate, the administrator could appoint or become a voluntary administrator (or equivalent) of the trust who can restructure the assets and liabilities of the trust via something similar to a deed of company arrangement. Alternatively, the fund could be put into liquidation and wound up, with distributions made to creditors in accordance with a legislated priority regime the same as for companies. Where appropriate, the external administrator could exercise claims and actions against the trustee such as to make good losses to the trust caused by breaches of trust.

A common problem, particularly with small businesses, is that the directors are not aware of the implications of the company being a trustee and do not disclose this information to the external administrator. It would assist external administrators if there was an independent source that could advise if the company is a trustee. A national register of trusts would greatly simplify matters and may have other public uses. We appreciate that such a register will take time to develop and require engagement by the Commonwealth with the states and territories. A viable interim measure would be for the ATO or other government agency to be authorised to disclose to an external administrator if the company they have been appointed to is a trustee according to the agency’s records.

Where the trustee is an individual, similar changes should be made to the *Bankruptcy Act* to allow for the effective administration of the estate in corresponding circumstances, which was also recommended in the Harmer Report.

The resolution of issues with insolvent trusts would be simplified within a merged corporate and personal insolvency framework especially if it is focused at those businesses most regularly facing financial difficulties, namely small businesses. In any event, any significant reform of insolvency laws must address insolvent trusts and in particular those issues raised in our December 2021 submission to Treasury.

5.9 Members' voluntary liquidations

Recommendation 20: The Committee should recommend that the law relating to members' voluntary liquidations be amended to remove the requirement to obtain clearance from the ATO prior to a distribution being made.

Recommendation 21: The Committee should recommend that the law be amended to remove any provisions that give creditor's rights in the members' voluntary liquidation process.

Recommendation 22: The Committee should recommend, in order to ensure competitive neutrality, members' voluntary administrations be excluded from any industry levies applied to registered practitioners.

A members' voluntary liquidation (MVL) is not an insolvency administration.

It is a method provided for in the *Corporations Act* to wind up a solvent company voluntarily under the control of a liquidator, who realises the company's assets, pays all creditors in full, and distributes the surplus amongst the shareholders according to their entitlement, following which the company ceases to exist. Importantly, the "liquidator" in an MVL does not have to be a registered liquidator and is often not.

Solvent companies are usually wound up because they no longer have any commercial use or where the members perceive some benefits can be gained. If a company in MVL subsequently turns out to be insolvent, the liquidation converts to a creditors' voluntary liquidation.

Like a voluntary deregistration, a company in MVL needs to ensure all of its debts have been paid,[72] including having all tax lodgements up to date and payments remitted. Data provided by ASIC indicates that there are approximately 1,500 MVL appointments each year and 80,000 voluntary deregistrations.[73]

While MVLs provide an effective method to dissolve a company if it doesn't meet the requirements for voluntary deregistration,[74] there are some inefficiencies and disparities that could be addressed to make the process cheaper and more timely, reducing the time taken by several months.

We suggest removing:

- the requirement to obtain clearance from the ATO prior to a distribution being made. Tax clearance is not required when following a voluntary deregistration process and it should be sufficient for a liquidator to rely on information from the Australian Taxation

[72] Or are paid within 12 months of the date of liquidation.
[73] (2022) 34(2) ARITA J, Is ASIC deregistering more 'abandoned companies'? What the data shows, Eszenyi, T. p40.
[74] a company with assets worth $1,000 or more cannot be deregistered on request, instead the liquidator will distribute those assets to the members as part of the winding up process.

Office, such as information on the company's ATO portal, confirming lodgement and payment without the need to obtain specific clearance.

- any references in the *Corporations Act* that give creditor's rights in an MVL process. Given all creditors are paid in full, enabling creditors to participate in the process only adds unnecessary time and cost.

The *Corporations Act* acknowledges the different nature of a MVL by allowing unregistered individuals to be appointed as liquidator.[75] This differential means that unregistered individuals who undertake MVL's do not incur an ASIC industry funding levy, while registered liquidators incur a charge for undertaking the same functions.

This disparity gives unregistered individuals an unfair advantage and the ASIC industry funding model should remove levies that relate to solvent liquidations.

We believe that streamlining the MVL process will enable more companies which do not qualify for voluntary deregistration to be properly wound down more cheaply and quickly and reduce the over 50,000 abandoned companies that ASIC historically deregisters each year.[76]

[75] Section 532(4) of the *Corporations Act* provides that a members' voluntary liquidator is not required to be a registered liquidator if winding up a proprietary company.
[76] (2022) 34(2) ARITA J, Is ASIC deregistering more 'abandoned companies'? What the data shows, Eszenyi, T. p40.

6 Profession issues

Recommendation 23: The Committee should recommend, as did the Productivity Commission in its 2015 Report, that in instances where a liquidator is unable to recover funds to cover their own fee, and where the regulator is satisfied that the activities are not excessive, the liquidator should be able to apply for the balance of the fees to be paid by the regulator.

Further, the Assetless Administration Fund should be renamed the Public Interest Administration Fund (PIAF) and its objectives and funding modified to reflect this new function.

To the extent that this requires additional funding, it should be raised by increasing the annual review fee for company renewals.

Funding should also be available from PIAF in instances where the regulator initiates further investigations beyond those required by the relevant liquidation process.

Recommendation 24: The Committee should recommend that the law be amended to add the same academic requirements as registered liquidators to the restructuring practitioner registration criteria alongside a minimum experience requirement of a lower level than registered liquidators.

Recommendation 25: The Committee should recommend that more focus be placed on diversity and inclusion initiatives by regulators and the profession.

At its highest level the insolvency profession in Australia comprises a small group of highly skilled professionals. There are 652 registered liquidators[77] and 209 registered (bankruptcy) trustees[78], noting that many registered trustees are also registered liquidators.

These registered practitioners are advised and assisted by lawyers and other specialised restructuring professionals, many of whom are members of ARITA and where appropriate subject to regulation by other professional bodies.

6.1 Role

Every year, tens of thousands of businesses will face financial distress, putting jobs in jeopardy. Insolvency practitioners work with financially struggling businesses and individuals, both inside and outside of statutory insolvency and restructuring procedures. These processes help financially distressed and insolvent companies and individuals to repay what they owe – and to turn their fortunes around where possible.

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[77] As at 31 October 2022 https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-4a-registered-liquidator-lists/
[78] As at 31 October 2022 https://services.afsa.gov.au/insolvency-dashboard/practitioner/public/registered-trustee/search/1

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Insolvency practitioners and restructuring professionals play a vital role in ensuring that Australia maintains its reputation as one of the best places in the world to do business. The following diagram shows the work of the insolvency and restructuring profession.

As mentioned earlier in this submission, insolvency isn't easy. When a company becomes insolvent, an insolvency practitioner is usually appointed as an office holder (for example, as a liquidator or administrator). When acting as an office holder, insolvency practitioners are personally responsible for protecting the interests of the company's creditors, and can be held personally responsible for the company's actions.

Insolvency practitioners seek to maximise returns to the company's creditors – which often include the employees and small businesses. Insolvency practitioners are also required to investigate the actions of company directors, which can involve them investigating cases of fraud. And, where rescuing the company as a going concern is not possible, they will wind-up the company in an orderly fashion.

6.2 Remuneration

Insolvency fees face frequent scrutiny and criticism. Media headlines have often focused on the amount charged by insolvency practitioners in high-profile cases, with insolvency practitioners depicted as profiting from the plight of the insolvent company and its employees. Unfortunately, a great deal of the detail behind the headlines often gets missed – leading to an unfair representation, and understanding of, the insolvency profession and the fees they charge for the work they carry out.

Contrary to common misconceptions, insolvency fees are highly regulated and must be approved by the creditors of the insolvent company or individual. They vary hugely from case to case. And, as we explain elsewhere in this submission, insolvency practitioners are often not paid in full for the work they have carried out, due to the very nature of insolvency. Indeed, the headline grabbing amount charged, more often than not, bears little resemblance to the amount insolvency practitioners are actually paid at the end of the day.

The levels of insolvency fees are largely a direct result of the regulatory requirements that insolvency practitioners must follow and carry out. These requirements, and the work that insolvency practitioners undertake, are set by statute and regulations which are, in turn, set by Government and approved by Parliament. Insolvency practitioners must meet a series of strict legal obligations when appointed, due to the great trust placed on them to uphold the law, act ethically, and protect and restore economic value. All the activities involved in meeting these obligations incur a cost to the insolvency practitioner and their team. The range of requirements and duties that insolvency practitioners must fulfil has a direct impact on the fees that they charge.

Various factors can complicate a case, requiring an insolvency practitioner to spend more time fulfilling their legal duties and charge for this additional time spent working on a case. However, very large cases – the ones often cited in media headlines – make up a very small proportion of the total number of cases each year and the fees involved for these do not reflect what most insolvency practitioners earn.

It is particularly common in smaller matters for the insolvent company to have insufficient assets to pay an insolvency practitioner in full. In fact, insolvency practitioners working on smaller matters are frequently paid none of their time costs – smaller practitioner firms often write off tens of thousands of dollars from the amount they should have been paid for a single matter.

Sometimes creditors may negotiate a lower fee after the insolvency procedure has taken place. Again, this means the insolvency practitioner will not receive full payment for the time they have spent on a matter. Or an insolvency practitioner may sometimes agree to waive part of their fee in order to return more money to creditors.

Criticisms of insolvency practitioner fees usually overlook the significant personal liability insolvency practitioners face when carrying out their work, the strict regulatory requirements they must adhere to, the complex and numerous activities they must carry out, and the complicated and unpredictable nature of their cases. Insolvency practitioners often accumulate unexpected time costs, particularly where fraudulent behaviour on the part of the company's directors has occurred and the insolvency practitioner only becomes aware of these actions late in a case.

Ultimately, fees are a necessary part of the insolvency framework which, in turn, plays a crucial role in the regeneration of the economy, ensuring that Australia remains one of the best places in the world to do business. As outlined in this submission, there are, however, some reforms that can be made to cut the time and costs of insolvencies in Australia.

6.3 Financial viability

Prior to COVID-19, a prolonged period of financial stability in Australia had resulted in historically low levels of insolvency appointments, both corporate and personal.

Notwithstanding the record low levels of matters, when the government effectively placed a moratorium on insolvency in response to the pandemic, the restructuring and insolvency profession – whose brand promise is expertise in financial distress – found itself in some difficulty of its own. "As a liquidator, my pipeline was all but wiped out with the stimulus packages," one insolvency practitioner observed in our members 2020 COVID-19 survey.[79]

The survey revealed that with the contraction of insolvency work, many insolvency firms were concerned they would struggle to make it through the last six months of 2020, which could have left the market severely depleted.

More than half of all insolvency firms registered for JobKeeper, signalling that revenue was at least 40% down year-on-year and almost 14% of insolvency firms implemented redundancies in their own firms. Medium sized firms (3-10 partners) were the most likely to have accessed the JobKeeper program (close to 80%), with small firms (1-2 partners) the next hardest hit with around 63% having accessed JobKeeper.

While the number of corporate insolvency matters has almost returned to pre-COVID levels, personal insolvency appointments remain well down (assisted by record low unemployment levels), however the split between business and consumer debts remains consistent.

Notwithstanding the expectation that appointments will continue to rise, as noted earlier in our submission, the majority of liquidations do not have sufficient assets to fully remunerate the liquidator.

But it is the statutory duty of registered liquidators to undertake work for ASIC even if they don't get properly paid, or indeed paid at all – we estimate, based on rates in what is a very competitive market for insolvency services, the value of this public service is around $100 million per year[80]. If this work is to continue to be required to completed unfunded, more will ultimately leave the profession resulting in resource and capacity constraints in the industry and reducing competition.

The PC examined this issue in its 2015 Report.[81] Consistent with its more general view that regulators must be properly funded to undertake their work, it made the following recommendation with respect to the funding of low-asset administrations.

> *In instances of small liquidations where a liquidator is unable to recover funds to cover their own fee[82], and where the Australian Securities and Investments*

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[79] (2020) 32(2) ARITA J, COVID-19 Update, p4.
[80] (2017) 29(1) ARITA J, State of the profession 2017, p4.
[81] Productivity Commission (2015) pp410-412.
[82] We take fees here to include any reasonable costs and disbursements.

Commission (ASIC), is satisfied that the activities are not excessive, the liquidator should be able to apply for the balance of their fees to be paid through ASIC.

The existing Assetless Administration Fund should be renamed the Public Interest Administration Fund and its objectives and funding modified to reflect this new function.

To the extent that this requires additional funding, it should be raised by increasing the annual review fee for company renewals.

Funding should also be available from the Public Interest Administration Fund in instances where ASIC initiates further investigations beyond those required by the small liquidation process.

We strongly support this proposal. We see it has a number of merits:

- It will have no impact on the fiscal position of the Commonwealth as the additional costs are borne by those who benefit most from the insolvency system – companies.
- It is likely to encourage entry of new practitioners which may help with the diversity issues faced by the insolvency profession.
- It will significantly reduce, or eliminate, the need for cross subsidisation between large and small matters, with the benefits of lower fees being most likely to be felt in relation to medium size matters.
- It in no way restricts registered liquidators pursuing matters they feel should be pursued in the absence of funding support from the PIAF, nor from taking action to recover through other means their costs in doing so, such as by way of a creditors' indemnity or litigation funding.

The financial viability of insolvency practitioners is further eroded by the ASIC Industry Funding Levy. The Government has commenced a review of the ASIC Industry Funding Model (IFM) and ARITA has made a comprehensive submission outlining liquidators' unique relationship with ASIC, concerns regarding the ex-post nature of the IFM, alternative models and commenting on the cited benefits and design objectives of the IFM.[83]

While the ASIC IFM levies registered liquidators personally based on events occurring in their appointments, AFSA imposes a "realisations charge" to fund the cost of certain activities undertaken by it that benefit the personal insolvency system. The realisations charge is calculated as a set percentage of receipts[84] in personal insolvency matters and is attributable to the appointment rather than the appointee.

As it currently stands the ASIC IFM model levies immediate costs on an appointee regardless of whether there are any funds available in the appointment to cover the cost. Inexplicably, this may leave the appointee out of pocket just for accepting the appointment, without even having done any work. A levy based on dividends paid to unsecured creditors

[83] A copy of our submission to Treasury can be found at https://www.arita.com.au/ARITA/News/Submissions/Practice_alert__ASIC_IFM_Review_discussion_paper.aspx.

[84] Currently 7% and reviewed periodically.

ensures that appointees can at least cover the levy fees and are not unfairly penalised for merely accepting an appointment. Calculating the levy as a percentage of dividends to unsecured creditors also ensures that funds available for priority creditors (usually employees) are not affected.

6.4 Registration

Registered liquidators and trustees are bound by strict legal obligations and duties due to the great trust placed on them to uphold and enforce the law, act ethically, and protect and restore economic value. To obtain registration, insolvency practitioners must demonstrate to a Registration Committee that they have the qualifications, experience, knowledge and abilities as prescribed and meet other eligibility requirements, including being a fit and proper person to be registered.[85]

The high threshold to be registered is reflective of the obligations and responsibilities placed on insolvency practitioners.

That said, as part of the small business reforms introduced in 2020, the Government introduced a sub-class of registered liquidators, who may only take appointments as restructuring practitioners. The qualification, experience, knowledge and abilities requirements for applicants for registration to practice only as a restructuring practitioner are significantly less than those for full registration as a registered liquidator.[86]

The creation of this sub-class undermines much of the progress made to increase the competence and capability of the profession through the *Insolvency Law Reform Act 2016* (ILRA). The ILRA was enacted in response to two decades of reviews into the regulation of liquidators including the ALRC; the Working Party to review the regulation of corporate insolvency practitioners; the Parliamentary Joint Committee on Corporations and Financial Services; and the Senate Economics References Committee (Senate Committee) in 2010.

The explanatory memorandum to the ILRA's predecessor bill noted:

> *The insolvency profession must be skilled, honest and accountable in order for the insolvency regime to operate efficiently. …. Regulation that promotes a high level of professionalism and competence of insolvency practitioners is therefore essential to retaining confidence in the insolvency system as a whole. [5.5]*

The registration requirements for restructuring practitioners require applicants to be 'recognised accountants', however they fail to recognise the specialised expertise of insolvency practitioners.

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[85] Section 20-20 Schedule 2 – Insolvency Practice Schedule (Corporations) and Schedule 2 – Insolvency Practice Schedule (Bankruptcy).
[86] Section 20-2 Insolvency Practice Rules (Corporations) 2016.

To date only one individual has been registered under this sub-class, however we hold significant concerns about the qualification, experience, knowledge and abilities requirements for applicants.

Given the complexities of the SBR process, including mirroring many voluntary administration provisions, and the need for a restructuring practitioner to be able to advise directors on the best course of action available to the company when they are consulted about the company's financial distress and to undertake a "better outcome test", at a minimum we strongly recommend that restructuring practitioners should meet the same academic requirements as registered liquidator but may be able to be granted a lower experience level requirement.

In addition, we also reiterate the profession's significant concerns regarding the increase in unregistered pre-insolvency advisors and the facilitation of illegal phoenix activity, as set out earlier in our submission.

6.5 Conduct

As well as being regulated by ASIC and AFSA, registered liquidators and registered trustees are generally subject to professional oversight by at least one professional body,[87] with many of these bodies also empowered to notify the respective regulators if they have reasonable grounds for the regulator to take disciplinary action.[88]

ARITA Professional Members, who make up around 80% of all registered liquidators and trustees, are subject to professional oversight by ARITA and ARITA actively investigates complaints about the professional conduct of members. We also investigate concerns about the professional conduct of members that come to our attention other than by way of a complaint.

We acknowledge that some registered liquidators and registered trustees do not maintain the high standards of professional and ethical conduct required and we have discretionarily terminated the membership of individuals whose conduct has failed to reflect these standards.[89]

In addition to its constitutional powers to oversee the conduct of our members, we are a professional body empowered to notify a regulator if we have reasonable grounds for the regulator to take disciplinary action. Since the commencement of specific powers implemented as part of the ILRA we have lodged six 'Form RL35 - Notice by industry body of possible grounds for disciplinary action' with ASIC having identified significant concerns regarding the conducted of registered liquidators. It is our understanding that the lodgement of these notices has resulted in three matters being subject to investigation and action by ASIC, however despite two matters having been lodged in 2020 and 2021 we are yet to see

[87] A comprehensive, but not exhaustive, list of industry bodies is detailed in section 40-1 of Insolvency Practice Rules (Corporations) 2016 & Insolvency Practice Rules (Bankruptcy) 2016.
[88] Section 40-100 Schedule 2 – Insolvency Practice Schedule (Corporations) and Schedule 2 – Insolvency Practice Schedule (Bankruptcy).
[89] Eight ARITA memberships have been discretionarily terminated since 1 July 2017.

ARITA

an outcome. The other matter was referred and resolved by a disciplinary committee convened by ASIC.

Conversely, ARITA has never had cause to lodge a 'Form RL35 - Notice by industry body of possible grounds for disciplinary action' with AFSA regarding a registered trustee. It would appear that AFSA's practitioner review processes are much more adept at identifying conduct issues which can then be resolved by informal or formal mechanisms available to AFSA.

In the last four years, there have been only two known examples of truly egregious liquidator behaviour brought to real justice. Those were two cases of significant fraud that were uncovered and reported to both the police and ASIC by the firms where those individuals worked – these occurrences were not exposed by any regulatory oversight activity.

Despite concerns often expressed about alleged misconduct by insolvency practitioners, the vast majority of complaints received by ARITA, ASIC and AFSA are shown to be educative in outcome for the complainant. Given ARITA's activities in upholding professional standards, including its statutory ability to report concerns regarding the conduct of both members and non-members to ASIC and AFSA, we believe that much of the work associated with the regulation of insolvency practitioners is obviated.

6.6 Diversity

We acknowledge that there is a representational imbalance within the restructuring and insolvency profession.[90] This imbalance is largely a result of social bias, inflexible job demands and expectations, and entrenched cultures and stereotypes.

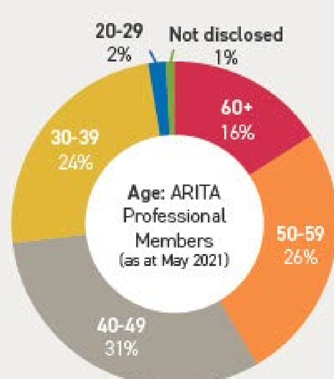
ARITA is committed to improving diversity and inclusion in the profession through its Balance Taskforce,[91] focusing initially on gender and age diversity. While we acknowledge and applaud the proactive measures implemented by AFSA in relation to gender diversity, as outlined later in this submission, more needs to be done to build and advise on programs and policies to ensure the profession is more reflective of the community that it serves.

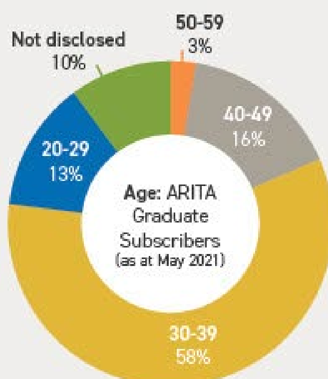
We believe having a diverse and inclusive profession which reflects the community we serve makes sound business and ethical sense.

[90] As at September 2021 11% of registered trustees and 9% of registered liquidators are female.
[91] More about ARITA's Balance Taskforce can be found at https://www.arita.com.au/ARITA/About_Us/Diversity___Inclusion/ARITA/About_Us/Diversity_and_Inclusion.aspx.

Diversity by the numbers

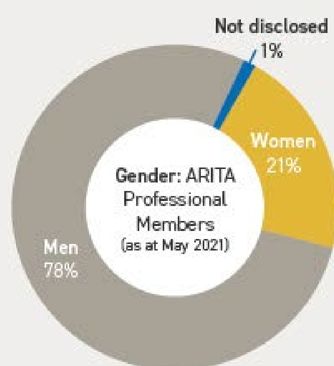
ARITA **Age** Demographics

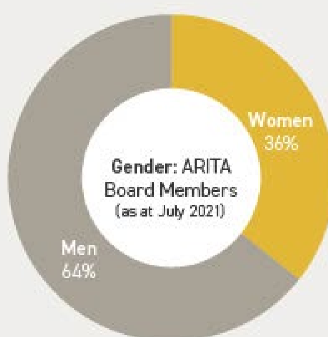


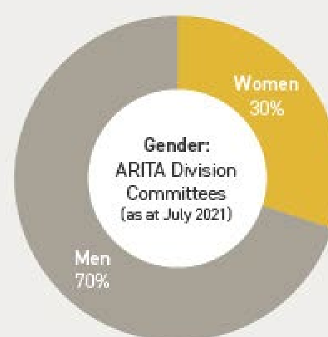


ARITA is committed to **improving diversity and inclusion** in our profession, focusing initially on gender and age diversity.

ARITA **Gender** Demographics







8.5%

As at the end of March 2021, **only 8.5% of all Registered Liquidators in Australia were women.** To get to just 10%, we would need to add 11 women and 0 men.

52%

As at the end of March 2021, 52% of all Registered Liquidators in Australia were **aged 50 or older.**

According to the WGEA Data Explorer (accessed 23 August 2021) Legal and Accounting Services within Australia comprise of **58.8% women** and **41.2% men.**

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7 Government agencies

7.1 Australian Securities and Investments Commission

Recommendation 26: The Committee should recommend that there be a single dedicated regulator established to regulate both corporate and personal insolvency in Australia and this regulator should be modelled on the Australian Financial Security Authority.

Recommendation 27: The Committee should recommend that ASIC publish the algorithm that it applies to reports lodged by registered liquidators and demonstrate how it aligns to its published enforcement priorities and the reporting obligations of registered liquidators.

Recommendation 28: The Committee should ask ASIC to demonstrate that its decision to terminate the National Insolvency Trading Program was consistent with regulatory good practice.

Recommendation 29: The Committee should recommend that greater investment should be made in educating company directors in proactively managing financial distress and in advising creditors of their rights and obligations in an insolvency.

Corporate insolvency and registered liquidators are regulated by ASIC. ASIC's regulatory portfolio is wide, ranging from auditors and liquidators, to companies, banks, financial services, market operators, financial advice and insurance. Based on information provided as part of ASIC's industry funding model reporting, registered liquidators are one of ASIC's smallest regulated populations, making up only 1.64% of its budget.[92]

This wide portfolio and the small size of the registered liquidator population means that ASIC is not focused on insolvency. Our experience is that this impacts on the decisions that are made, the relationship that ASIC has with registered liquidators, its ability to properly engage with those it regulates, and its responsiveness to feedback and consultation submissions, as well as the quality of reporting and statistics.

We also hold the view that ASIC has a disproportionate interest in the activities of liquidators, despite very limited examples of poor behaviour, compared to a very limited interest in the poor behaviour of directors who lead their business into insolvency even when registered liquidators identify and report this poor behaviour.

ARITA makes every effort to be an engaged and involved professional body, actively representing the views of our members with ASIC. We respond to all ASIC consultations that impact on our members, including the annual draft Cost Recovery Implementation Statement and ASIC's annual self-assessment of its performance. We hold regular, formal consultation meetings with senior ASIC staff (and in tripartite meetings also involving AFSA).

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[92] ASIC CRIS 2021/22 (https://asic.gov.au/about-asic/what-we-do/how-we-operate/asic-industry-funding/cost-recovery-implementation-statement/cost-recovery-implementation-statement-2021-22/) $5.125 million of a total amount to be recovered of $312.774 million.

7.1.1 Registered liquidator ratings of ASIC performance

To ensure that we are representing the views of our members, we survey them annually regarding their assessment of ASIC's performance against its key performance indicators. We have conducted this survey for four years. ASIC did not request us to provide feedback in their most recent performance assessment and there are no submissions listed on the ASIC website, so it appears that ASIC did not seek any feedback prior to issuing this most recent report[93] – this is not good regulatory practice. During the four years we provided feedback, our members raised consistent concerns about ASIC's performance as their regulator. From our perspective, these concerns have been disregarded.

The following tables summarise our members' views of ASIC's and AFSA's performance against three common KPIs. The survey used required rating the regulators' engagement performance out of 5 and the results have been tallied into a net promotor score. Whilst the two survey groups are different, as noted elsewhere, there is significant overlap between the professional regulated populations of AFSA and APRA which gives weight to the comparability of the two surveys.

	Net promoter score for year ending 30 June				
	2017	2018	2019	2020	2021
Regulator does not impede the efficient operation of regulated entities					
ASIC	-48%	-17%	-22%	-27%	
AFSA			50%	59%	71%
Communication with regulated entities Is clear, targeted and effective					
ASIC	-24%	-6%	-7%	-1%	
AFSA			61%	72%	57%
Actions undertaken by the regulator are proportionate to the regulator risk being managed					
ASIC	-30%	-23%	-24%	-12%	
AFSA			45%	70%	50%

What is clear from the survey results is that, notwithstanding some modest improvements with respect to many of the questions, the regulated liquidator population continues to hold concerns regarding ASIC's regulatory engagement approach.

Our members' concerns were raised with the Financial Regulator Assessment Authority (FRAA) during its 2022 review of the effectiveness and capability of ASIC.[94] Our concerns were not addressed in the FRAA's report.[95]

The contrast between ASIC's consistent negative rating by the profession and AFSA's positive rating is startling. If a major reform task is to be embarked upon, the engagement skills and approach of a new regulator will be critical to that reform's success. This data

[93] 2020/21 published May 2022: https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-727-regulator-performance-framework-asic-self-assessment-2020-21/
[94] https://fraa.gov.au/sites/fraa.gov.au/files/2022-08/226579-arita.pdf
[95] https://fraa.gov.au/publications/effectiveness-and-capability-reviews-australian-securities-and-investments-commission

strongly suggest that a new regulator should be built around the approach taken by AFSA, not ASIC.

7.1.2 ASIC reporting

Reporting on specific details of the regulation of the insolvency sector is lost in ASIC's generalised reports that attempt to cover all of its obligations. We find this usually results in meaningless generalised discussion about planning,[96] performance[97] and outcomes.[98] This reduces accountability not only of ASIC but directors and the profession and reduces the capacity of bodies like the PC and the Committee to undertake evidence based public policy development.

7.1.3 Insolvency statistics

We acknowledge recent improvements in reporting of external administration data, however there are a number of issues with ASIC's statistics which make it difficult for the profession and others to understand what is happening with insolvency in Australia:

- There are often reconciliation issues between reporting years or between the same numbers reported in different places.
- The information reported can change or cease (for example, reporting dormant company deregistrations by ASIC ceased in 2007/2008, reporting all deregistration numbers ceased after the 2016/17 annual report).
- Members' Voluntary Liquidations are not included in reporting of external administrations even though they are an external administration under the *Corporations Act*. Members' Voluntary Liquidations are not publicly reported anywhere by ASIC.
- ASIC has not reported openly on company deregistrations.
- ASIC ceased reporting statistics from external administrators' reports after the 2018/19 financial year. These statistics provided important information about matters such as assets and liabilities of companies in external administration, causes of failure, possible misconduct of directors, unpaid employee entitlements, unpaid taxes and remuneration. ASIC's website advises that it intends to provide this information in a different format in FY23, however, it is unclear whether information will be provided for the intervening years.[99]

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[96] Annually updated Corporate Plan (https://asic.gov.au/about-asic/what-we-do/our-role/strategic-priorities/asic-s-corporate-plan-2019-23/).
[97] Regulator Performance Framework: ASIC self-assessment issued annually (https://asic.gov.au/about-asic/what-we-do/how-we-operate/performance-and-review/regulator-performance-framework/).
[98] Annual report (https://asic.gov.au/about-asic/corporate-publications/asic-annual-reports/).
[99] https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-3-external-administrator-reports/

- Reporting on the regulation of registered liquidators ceased after the 2018/19 year after being produced annually since 2011.[100] This report provided useful industry-specific information.
- Statistics (other than those on external administration appointments) are not reported year on year in one source, making it very difficult and time consuming to track statistics through annual reports or other documents.

7.1.4 ASIC website and insolvency information

ASIC's website reflects the diversity of its regulatory remit: as such, there is a lot of information for a lot of different purposes. This makes it hard to actually find information when it's needed, particularly for lay people who may not be aware of the technical terminology to search for. In comparison, AFSA's website is much easier to navigate and is an excellent start for a single platform for insolvency information and administration in Australia.

Even if information is located on ASIC's website, it tends to be difficult to understand, making it hard for:

- directors of companies in financial distress to understand their options and who they should turn to for help, and
- creditors to understand what their rights are and what they should expect from the insolvency process.

The lack of easy to find and understand information leads to increased complaints against registered liquidators, with ASIC recognising that the vast majority of complaints against registered liquidators had an educative outcome for the complainant.[101]

7.1.5 ASIC action against directors

It is clear that very little action is taken by ASIC as a result of the thousands of reports alleging offences by directors that are lodged by registered liquidators every year. Given ASIC's primary function is the regulation of companies this is a curious position. The community and government would reasonably expect that the "corporate regulator" would take an active and engaged approach to any evidence of malfeasance by company directors, especially where it is identified by the required investigations work of qualified, senior experts like registered liquidators.

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[100] https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-658-asic-regulation-of-registered-liquidators-july-2018-to-june-2019/

[101] In 2018/19, in 83% of complaints about registered liquidator conduct there was either insufficient evidence of an offence or the registered liquidator did not breach the Corporations Act (generally ASIC helped resolve the inquiry and did not pursue the matter further) – Report 658 (https://download.asic.gov.au/media/5555304/rep658-published-14-april-2020.pdf). Note that ASIC stopped publishing this detail of information about the regulation of liquidators after the 2018/19 report.

Registered liquidators report that despite lodging reports about poor director behaviour that include key words such as "fraud" and "creditor defeating dispositions", "phoenixing" and "failure to keep adequate books and records", they receive automated notices of "no further action" within 30 seconds of submission. There is no transparency of ASIC's algorithm and as such, it is impossible for registered liquidators to understand ASIC's enforcement priorities or how best to assist ASIC in identifying director behaviour of concern. This simply increases costs that are borne by creditors or our members if there are insufficient funds to meet their costs and remuneration. Further, and more concerningly, it is likely that malfeasance is going undetected by ASIC. The solution to this problem is:

1. Review the current arrangements to identify unnecessary burdens – the Productivity Commission has extensive experience in such analyses;[102]
2. Make clear ASIC's filtering algorithm is transparently available to registered liquidators, demonstrate its alignment with ASIC's enforcement priorities and align those with the obligations of reporting by registered liquidators; and
3. Introduce more human consideration – the dangers of algorithmic law enforcement are plain to see from the Robodebt matter.

Disqualifications and action against directors for failing to assist liquidators:

ASIC Annual Report[103]	Failure to assist liquidator	Disqualification from managing corporations	Disqualifications relating to illegal phoenix activity
2021/22	163	56	8
2020/21	750	49	4
2019/20	1,235	51	10
2018/19	820	62	Not reported

Offences by directors reported by external administrators and action taken by ASIC:

ASIC Annual Report[104]	Initial reports	Reports with suspected offences	Follow up reports requested by AISC	Referrals by ASIC[105]
2021/22	4,313	3,767	593	118
2020/21	4,566	3,810	709	85
2019/20	8,040	7,163	1,070	246
2018/19	8,621	7,227	515	123

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[102] These issues were not addressed in Productivity Commission 2010, *Annual Review of Regulatory Burdens on Business: Business and Consumer Services*, Research Report, Canberra.
[103] https://asic.gov.au/about-asic/corporate-publications/asic-annual-reports/
[104] https://asic.gov.au/about-asic/corporate-publications/asic-annual-reports/
[105] Referral for compliance, investigation or surveillance action.

7.1.6 Project to encourage directors to seek assistance

In 2005 ASIC established the National Insolvency Trading Program (NITP) which ran until the end of the 2009-10 financial year.[106] A key objective of the NITP was to encourage directors to identify insolvency indicators relating to their company and to seek professional advice at an early stage.

Via the NITP, ASIC:

- visited over 1,530 companies displaying solvency concerns during the period from 2005–06 to 2009–10
- provided an awareness of director duties and ASIC's expectations of professional advisers when companies are experiencing financial difficulties
- encouraged directors to seek advice from an insolvency professional about the appointment of an external administrator where significant insolvency indicators were identified, and
- observed that 15% of companies reviewed by us were subsequently placed into external administration – mostly by the directors.

This project is an excellent example of what a corporate regulator acting proactively can achieve. Unfortunately, in 2010 ASIC's attention was moved from directors to registered liquidators following the poor conduct of a single registered liquidator who lost his registration and was jailed.[107] ASIC has not recommenced the NITP nor provided any explanation for what seems to us to be a decision not consistent with general regulatory best practice.

7.1.7 Contrasting a generalist regulator with a specialist regulator

In Australia, corporate insolvency is performed by approximately 650 registered liquidators regulated by ASIC – a generalist regulator. Personal insolvency is performed by approximately 200 registered trustees regulated by AFSA – a specialist regulator. Most registered trustees are also registered liquidators, and so have dealings with both regulators.

AFSA provides excellent comprehensive and easy to access statistics on all aspects of personal insolvency and registered trustee conduct. It is a progressive regulator embracing the move to online reporting to the regulator by trustees and online inspections, using pictorial representation of statistics, implementing mental health programs and measures to encourage gender diversity in the profession.

AFSA has historically taken a pragmatic approach to regulation, with an established inspection program and clear categories for any non-compliance identified during the review process. To assist in assessing the seriousness and relevant regulatory response, and to

[106] REP 213 National insolvent trading program report | ASIC
[107] https://www.arita.com.au/ARITA/News/ARITA_News/Former_Liquidator_Stuart_Ariff_sentenced.aspx

alert practitioners of the issues and possible repercussions, non-compliances are classified as category A, B or C depending on the level of seriousness.[108] Category A are very serious with possible loss of registration, category B are serious and the trustee is counselled with remedial action required, category C are one-off practice or procedural errors which are brought to the trustee's attention. ASIC does not apply this approach to regulation and ASIC's responses are less predictable and certain for liquidators involved. These different approaches are likely to do with the fact that there is consistency with the services reviewed by a specialist regulator, versus the diversity of offerings from the different regulated populations regulated by ASIC.

The Bankruptcy Act also provides for an infringement notice regime which is administered by the Inspector-General in Bankruptcy.[109] ASIC does not have this power and again this is likely to be because of the diversity of its regulated population.

As a regulator that also undertakes appointments as the Official Trustee, AFSA has a deep and practical understanding of the implementation of insolvency law. AFSA is also empowered under the Bankruptcy Act to review and approve trustee remuneration, thus removing the need to involve the Courts, which reduces costs significantly for bankrupt estates. It is AFSA's practical knowledge which makes this possible.

AFSA's website and insolvency information

AFSA's website is focused on personal insolvency. We recognise that AFSA also has responsibility for the personal property securities system, however, AFSA has separated this role onto a separate website.

AFSA online information is organised in a way that makes it easy for lay person users to find the information they need. The information is also written in easy to understand English, avoiding technical jargon.

AFSA's prosecution of offences by bankrupts

Enforcement	2018-19		2019-20		2020-21		2021-22	
Offence Referrals received	984		772		865		596	
Accepted for investigation	744	76%	552	72%	534	62%	307	52%
CDPP briefs prepared	112	11%	77	10%	123	14%	126	21%
CDPP briefs accepted	105	11%	63	8%	87	10%	123	21%
Total persons prosecuted	96	10%	94	12%	69	8%	95	16%

[108] https://www.afsa.gov.au/resource-hub/practices/practice-guidance/monitoring-and-inspection-bankruptcy-trustees-and-debt-agreement-administrators
[109] https://www.afsa.gov.au/resource-hub/practices/practice-guidance/infringement-notices

We note that a much higher percentage of offence referrals to AFSA are prosecuted than those reported to ASIC. This may be due to several factors:

- reporting to ASIC in liquidations is required except in very few instances[110] resulting in a large numbers of reports. In the vast majority of liquidations there will have been some type of offence, default or breach of duty. There is no discretion for liquidators to not report minor offences or where insufficient evidence is held, and ASIC has prosecuted liquidators for not investigating and reporting offences.[111]
- Whilst registered trustees are required to report offences, AFSA encourages registered trustees to contact them and discuss whether offences should be referred. Trustees are not required to report offences in situations where there is insufficient evidence to support the allegation.[112]
- AFSA's resources are dedicated to personal insolvency and as such regulatory resources do not have to be allocated amongst competing activities.

7.2 Australian Taxation Office

Recommendation 30: The Committee should recommend that the ATO should not be given any greater priority of payment over other unsecured creditors, especially noting their increased knowledge of the solvency of a business.

Recommendation 31: The Committee should recommend that in addition to being a model litigant as required under the *Legal Services Directions 2017*, the ATO must be required to act as a model creditor at all times, and that its compliance with both requirements be reviewed annually by the Inspector General of Taxation.

Recommendation 32: The Committee should recommend that the ATO must substantially increase its internal knowledge/training of insolvency law given other creditors look to them for guidance.

Although considered an ordinary unsecured creditor, the Australian Taxation Office (ATO) plays a pivotal role in insolvency for the following reasons:

- It is one of the largest influences on insolvency decisions by directors given its use of winding up applications, warnings, garnishees, Director Penalty Notices (DPNs) and rights of offset. Any action by the ATO is the most likely to make small business owners face their financial difficulties.
- The ATO is privy to more information about a business' financial situation than other creditors and is usually the first creditor to be unpaid, or alternatively have

[110] S533 requires liquidators to report to ASIC on possible breaches or if the company may be unable to pay unsecured creditors more than 50 cents in the dollar.
[111] Court enforceable undertakings register | ASIC; Registered liquidator disciplinary decisions | ASIC
[112] https://www.afsa.gov.au/resource-hub/practices/practice-guidance/referring-offences-against-bankruptcy-act-1966-inspector-general

lodgements cease.[113] Failure by the ATO to take action allows businesses in financial difficulty to not face up to their issues and continue to incur debt with other small business creditors, who are less likely to be aware of the financial difficulties. In a liquidation, the financial consequences of lower levels of recovery are proportionally far greater for small creditors than they are for the ATO.

- Failure by the ATO to act and enforce collections in a timely manner leads to an unfair advantage to non-payers over compliant businesses.

- The ATO's conduct and decisions are looked to by all other creditors during the insolvency process as the ATO is perceived to understand more about the process. As a result, changes in the ATO's conduct affects market conduct and market conditions. For example, the recent decision by the ATO to only to wind-up derelict companies if it is commercially viable to do so will leave many more derelict companies on the register.

In order for the ATO to be effective in this role, it is essential that ATO staff dealing with debt recovery and liaising with registered liquidators and trustees and their staff are well trained in all aspects of insolvency. Whilst some staff at the ATO are highly trained and knowledgeable, this is not consistent across the relevant parts of the ATO's workforce.

We recommend that there be more focus by the ATO on substantially increasing its staff's knowledge of insolvency law so that the ATO can be an active, informed creditor in insolvency processes.

It is also essential that the ATO act as a model creditor in all insolvency matters as less knowledgeable creditors look to the decisions made by the ATO when considering how to approach issues themselves. In our view some of the characteristics of a model creditor include:

- not abstain from voting at meetings
- attending all meetings, whether by sending a staff member or by providing a proxy to the Chairperson
- supporting resolutions in relation to appointee remuneration wherever it is for necessary work, properly performed
- not taking advantage of external administrators who have insufficient resources to pursue a claim against it
- not seeking to prioritise the ATO's position above other ordinary unsecured creditors
- ensuring requests for information made in accordance with creditor rights are reasonable in the circumstances
- reporting potential breeches of the law to relevant regulators. For example, where the ATO identifies a derelict company that should be deregistered but it does not seek to

[113] The ATO is currently building predictive AI to identify the likelihood of individual taxpayers failing – such is their data insight.

liquidate the company for commercial reasons, it should nevertheless advise ASIC that the company should no longer be registered.

Nearly 30 years ago a policy decision was made that tax debt be treated *pari passu* with other unsecured creditors.

> *"When it comes to distribution of scarce assets in corporate insolvency, it has historically been the view of law reform bodies that the collection of taxation revenue should not be made at the expense of other unsecured creditors. It was on the basis that the 1988 General Insolvency Inquiry (Harmer Report) recommended that the principle of pari passu, that is, all unsecured creditors should receive a proportionate share of the assets available for distribution in insolvency, should prevail and the statutory priority enjoyed by the Commission of Taxation in relation to certain withholding taxes should be abolished. These recommendations were eventually enacted in 1993 by way of amendments to both the Corporations Act 2001 (Cth) and various taxation Acts."*[114]

Since the removal of the statutory priority, the ATO has found other ways to prioritise its debt above other unsecured creditors, thereby frustrating the expressed intention of Parliament – these are not the behaviours of a model creditor. For example:

- The ATO can garnishee monies owed to the company from debtors or the company's bank account.[115] This garnishee creates a priority claim which can survive the appointment of an external administrator. Any other creditor prioritising old debt by obtaining security would have received preferential treatment and monies would be subject to recovery by a liquidator, but payments under a garnishee are specifically excluded from being a preference.[116]
- The ATO can offset amounts[117] and, unlike other entities wanting to do a set-off, are not limited by the requirements for mutuality and not knowing that the company was insolvent at the time of extending or receiving credit.[118] These restrictions under the *Corporations Act* apply to other entities with a creditor/debtor relationship with the company. However, the ATO's right of offset is under the taxation legislation and has no such limits. Offsets done by the ATO also cannot be recovered as a preference.[119]
- The ATO is entitled to payment of all capital gains tax (CGT) arising on the sale of an asset during an external administration as a priority debt of the administration,[120] notwithstanding that in most cases the gain in value would have occurred prior to the appointment of the external administrator. This means that creditors will not obtain

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[114] Brown C, Revisiting the priority of taxation in Corporate Insolvency: An application of Dworkin's rights thesis and equality theories", 2019: https://eprints.qut.edu.au/134140/1/Catherine_Brown_Thesis.pdf
[115] s 260-5 of the *Taxational Administration Act 1953.*
[116] *DFC of T v Donnelly & Ors* 89 ATC 5071; *Macquarie Health Corp Ltd v FC of T* 2000 ATC 4015.
[117] S 8AAZL of the *Taxation Administration Act 1953.*
[118] S553C *Corporations Act.*
[119] *Driver* (*as liquidator of Tilse Building Pty Ltd) v Federal Commissioner of Taxation (1999*).
[120] Once an assessment is rendered by the ATO - *Commissioner of Taxation v Australian Building Systems Pty Ltd* (in liq) [2015] HCA 48.

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the full benefit of any increase in value of an asset that is sold in an external administration, as compared to a sale prior to the external administration where any CGT is simply a provable debt.

- The ATO can issue a DPN to a director in respect of a company's unpaid taxes. A DPN is effectively a personal guarantee from the directors that the directors have no choice but to provide. Whilst other creditors have the ability to request a personal guarantee, without leverage (such as providing a product or service that cannot be obtained elsewhere) a small business may not have the power to make this happen.
- If a liquidator recovers amounts from the ATO as a preference, any amount repaid by the ATO for PAYG and SGC as an unfair preference can then be claimed by the ATO against the directors personally.[121] No other creditor has this right.

These issues can result in very different outcomes from an external administration for the ATO versus another unsecured creditor. Whilst we recognise that the ATO has no choice in whether to extend credit to a business, this is counteracted by the ATO's access to information and their power to force a business to take action in a timely manner.

It is our view that the policy decision taken by Government to remove the priority for ATO debts should be enforced, and the ATO should not have any greater priority than other unsecured creditors.

7.3 Fair Entitlements Guarantee

Recommendation 33: The Committee should recommend that the law be amended to ensure that the approved remuneration and reasonable expenses of a liquidation should be paid out of any circulating assets prior to the distribution to employees or creditors with a security over such circulating assets.

Recommendation 34: That the Committee should recommend that the FEG Recovery Program consult with the profession, employee and employer organisations to develop guidance which when implemented gives effect to the objectives of voluntary administrations currently set out in s435A of the *Corporations Act.*

Recommendation 35: The Committee should recommend that where the FEG Recovery Program requires information from a voluntary administrator or liquidator that goes beyond accepted best practice, such as is set out in ARITA's standardised remuneration report which reflects the Insolvency Practice Rules (Corporations) 2016, that the FEG Recovery Program should reimburse the administrator or liquidator for their reasonable costs.

Recommendation 36: FEG Recoveries Branch must be required to act as a model litigant in all circumstances.

[121] s 588FGA of the *Corporations Act.*

When payments are made under the FEG program for the benefit of employees, the FEG Recovery Program is responsible for seeking recovery of those monies from the relevant external administration. The FEG Recovery Program is very proactive, however, there are a number of issues with the approach taken which we believe may lead to the unnecessary closure of businesses and the loss of jobs.

7.3.1 Uncertainty regarding the priority of employee entitlements, secured creditors and liquidator remuneration

The legislation governing the priority of employee entitlements in a liquidation is incredibly complicated and subject to various interpretations as is often the case with regulatory regimes constructed under the *Corporations Act*.

Generally, in a liquidation, section 561 of the *Corporations Act* provides that:

- when a company has given a security interest over its circulating assets[122] (also known as a circulating security interest) to secure a debt; and
- there is insufficient non-charged property available to the company to meet the priority claims of former employees (whether subrogated or otherwise);
- the former employees are to be paid their entitlements in priority to the claims of secured creditors holding circulating security interests.

In situations where s561 does not apply, the company's assets are distributed in accordance with the priorities set down in s556 which in brief results in the payment of the costs and expenses of the liquidation, then employee entitlements and then unsecured creditors.

While we support the intention that section 561 will apply when 'the free assets of a company are insufficient to meet the payment of employee entitlements, and there exists a secured creditor which holds a circulating security interest', differing views exist regarding the interpretation of the section as it relates to meeting the expenses and remuneration of the liquidator.

At a very basic level, we understand that the FEG Recovery Program takes the view that if there is a secured creditor at the commencement of the appointment and the security includes circulating assets, section 561 is "enlivened" and will continue to apply even if the secured creditor is totally repaid from fixed charge assets. This effectively means that employees' unpaid entitlements are paid in priority to the costs and expenses of the liquidation – costs which are necessarily incurred precisely to maximise the realisation of the insolvent business' assets and are recognised as having a higher priority under s556.

Conversely, ARITA and many registered liquidators and restructuring lawyers take the view that the purpose of section 561 is to protect the employees from the secured creditor and not

[122] These are the general trading assets of the business, such as cash, stock and debtors.

to give the employees a super priority over the costs of the liquidation and the normal section 556 priorities.

To add further complication to this matter, as a consequence of the unsatisfactory state of the existing law, when circulating assets are realised (even if not yet distributed) by a liquidator, according to the most persuasive case law authority that we currently have[123] the funds held by the liquidator cannot be used by the liquidator to meet their general liquidation expenses and remuneration (as distinct from expenses specifically incurred in the direct realisation of the circulating assets) ahead of the payment of a creditor holding security over those circulating assets.[124]

In the context of broadly similar provisions to sections 556 and 561 of the *Corporations Act* which existed at the time in the UK, the House of Lords held in Buchler that the priority given to a liquidator's general expenses and remuneration (ahead of the payment of employee entitlements) in the equivalent of section 556 of the *Corporations Act* is invoked only when funds are distributed from the uncharged assets of the company. Consequently, the equivalent of section 561 operated to defer the payment of a liquidator's general expenses and remuneration to after the payment of employee entitlements.

Further, it was held in *Re S & D International Pty Ltd* [2009] VSC 225 that a liquidator cannot rely on the general law 'salvage' lien recognised in *Re Universal Distributing Co Ltd (in liq)* (1933) 48 CLR 171 to claim first priority in relation to the payment of general expenses and remuneration (again, as distinct from expenses incurred in the direct realisation of a particular asset).

There has not been direct consideration of Buchler, or the proposition for which it stands, in Australia to date. We believe that the FEG Recovery Program is relying on this uncertain state of the law to justify the approach it is taking in numerous liquidations and wishes to place the onus on liquidators to conduct test cases if they want to challenge FEG's approach.

In this regard, expecting registered liquidators to litigate matters to clarify the law, often at their own expense or at the expense of the creditors is an inappropriate position. This sees the Commonwealth taking an opposing stance in litigation for a less than model reason. We specifically point to the Commonwealth's obligations under the Legal Services Direction 2017, especially Appendix B (2)[125]:

> (e) where it is not possible to avoid litigation, keeping the costs of litigation to a minimum, including by:
>
> > (i) requiring the other party to prove a matter which the Commonwealth or the agency knows to be true

[123] House of Lords decision in *Buchler v Talbot* [2004] UKHL 9.
[124] This position can be contrasted with a voluntary administration where the Corporations specifically prioritises the remuneration and expenses of the voluntary administrator over a secured creditor in respect of assets subject to a circulating security interest (s 443D).
[125] https://www.legislation.gov.au/Details/F2018C00409

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   - (ii) not contesting liability if the Commonwealth or the agency knows that the dispute is really about quantum
   - (iii) monitoring the progress of the litigation and using methods that it considers appropriate to resolve the litigation, including settlement offers, payments into court or alternative dispute resolution, and
   - (iv) ensuring that arrangements are made so that a person participating in any settlement negotiations on behalf of the Commonwealth or a Commonwealth agency can enter into a settlement of the claim or legal proceedings in the course of the negotiations
- (f) not taking advantage of a claimant who lacks the resources to litigate a legitimate claim
- (g) not relying on technical defences unless the Commonwealth's or the agency's interests would be prejudiced by the failure to comply with a particular requirement

Accordingly, FEG Recoveries Branch must be required to act as a model litigant in all circumstances.

The decision in Buchler eventually sparked legislative amendment in the UK, ensuring that liquidators' general expenses and remuneration have priority over other preferential debts where general assets are insufficient.[126]

We believe that such amendments are necessary in Australia to recognise that the ultimate priorities set in s556 always apply and to avoid wasting scarce capital that would be spent on running expensive test cases against the FEG Recovery Program's position, and for removing the considerable disincentives for liquidators to act in matters where they know their general expenses and remuneration may go unpaid.

7.3.2 Failure to recognise the overarching purpose of a voluntary administration

The object of Part 5.3A of the *Corporations Act* which sets out the voluntary administration process is to provide for the business, property and affairs of an insolvent company to be administered in a way that:

- maximises the chances of the company, or as much as possible of its business, continuing in existence; or
- if it is not possible for the company or its business to continue in existence, results in a better return for the company's creditors and members than would result from an immediate winding up of the company.

Recent statistics indicate that approximately 700 companies enter voluntary administration annually, although prior to the pandemic, annual voluntary administration appointments of

[126] This recognises the order for payment from the company's assets as specified under the equivalent section to section 556 of the *Corporations Act* and is also consistent with the priority given to voluntary administrator's remuneration over circulating assets in a voluntary administration (s 443D and 443E).

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around 1,200 were maintained. Of these appointments, historical data shows that about 35% progress to a Deed of Company Arrangement,[127] with the balance being liquidated.[128]

Evidence suggests that the number of voluntary administration appointments is slowly returning to pre-pandemic levels. We are concerned that if the FEG Recovery Program's approach (as detailed below) is maintained it will jeopardise the future restructuring of many of these companies with the otherwise unnecessary termination of the employment of hundreds of workers. It seems to us that this approach fails to recognise that the overarching purpose of a voluntary administration is to enable the business to keep trading and otherwise to maximise the returns to all creditors, including employees.

It is generally accepted that the restructuring of a company via a Deed of Company Arrangement, or a sale of the business to maximise the chances of its continued existence, requires a business to continue to trade through the voluntary administration process. As discussed previously, this is likely to provide a greater return to creditors, whether that be the partial payment of their debts and/or ongoing employment and trading arrangements.

During this period the voluntary administrator undertakes the fulsome investigations required by the *Corporations Act* and reports to creditors so that they may vote on the future of the company.[129] They may commence a sale of business process.

Based on the specific circumstances of the appointment, it is not unusual for voluntary administrators to seek Court approval for an extension of the period to hold the meeting of creditors.[130] This may be to allow additional time to finalise the terms of the proposed Deed or to complete investigations. There will also be a corresponding longer trading period.

ARITA has had numerous discussions with the FEG Recovery Program regarding its expectations of voluntary administrators when making applications to the Court to extend the voluntary administration period.

A decision to prolong the trading period requires careful consideration by the voluntary administrators, as the *Corporations Act* provides that they are personally liable for any debts they incur during this period. Best practice dictates that voluntary administrators document their decision process in deciding to trade on, and ordinarily, that will include a cashflow analysis for the trade on period. In the expert professional opinion of the voluntary administrator, it may be that company funds on hand at the start of the appointment may be dissipated during the trading period in the informed expectation that there will be an overall gain in the end.

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[127] ASIC Insolvency Statistics 2020-2021, 2021-2022 – ASIC Insolvency Statistics

[128] Control of a company may also return to the directors following a voluntary administration, however this is extremely uncommon.

[129] A Voluntary Administrator issues a detailed report to creditors following which a meeting is held where creditors can decide whether to accept a Deed of Company Arrangement (if proposed), liquidate the company or return the company to the Directors (happens rarely).

[130] Ordinarily 25 business days of being appointed (or 30 business days if the appointment is around Christmas or Easter).

By contrast, if the business does not trade on and is liquidated, the *Corporations Act* provides that, subject to some specific priorities, the company funds on hand are to be available for the payment of employee entitlements – including FEG under section 560 of the *Corporations Act* for any advances provided.

We believe that the FEG Recovery Program's apparent desire for voluntary administrators to detail the benefits and detriments to employees in an extension versus immediate liquidation simply creates an unnecessary regulatory burden on voluntary administrators and is contrary to the statutory objective of voluntary administration.

Such an analysis implies that, notwithstanding the greater benefits that may be available to all stakeholders as a result of the extension and continuing to trade, FEG may prefer the business to immediately cease trading and liquidate to procure a greater benefit to the Government through its subrogation rights.

Not only would an immediate liquidation crystalise the likelihood that workers will need to rely on FEG for the payment of their entitlements, we also query whether workers generally would agree that this outcome would justify the immediate loss of their employment compared to the counterfactual of continuing employment. The preparedness of workers to work with voluntary administrators to maximise employment going forward can be seen in the recent successful voluntary administration of Virgin Australia.

We are concerned that the current approach taken by the FEG Recovery Program seeks to prefer a liquidation process to a possible sale or renewal of a business via a Deed of Company Arrangement which may unnecessarily cost jobs.

7.3.3 Arduous information expectations

In addition to the above, we are concerned about the expectation of the FEG Recovery Program for the voluntary administrator to disclose the expected allocation of costs to asset classes as a result of any extension of the administration. At the time of making the application to Court this is likely to be little more than guesswork.

Feedback received from our members suggests that the FEG Recovery Program has been requesting external administrators to provide detailed analysis of their work in progress by allocating specific time against specific assets realised or expected to be realised.

It is our understanding that the FEG Recovery Program's requests for such an allocation to particular assets goes beyond the general classification of time and expenses between the seven major task areas and general descriptions set out in ARITA's standardised remuneration report, which is generally accepted as best practice. This allocation to major tasks is also consistent with the requirements of the Insolvency Practice Rules (Corporations) 2016 (IPR) section 70-45 which applies to all external administrators.

Obviously where relevant priority provisions are enlivened, actual or anticipated asset recoveries, time and expenses should also be categorised according to unsecured assets, trading activities (where applicable), circulating security interests, and non-circulating security interests.

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ARITA does not believe there is any necessity at law or in best practice to allocate time and expenses incurred to specific asset realisations such as specific debtor recoveries (eg debtor A, debtor B, etc).

We acknowledge the FEG Recovery Program's statutory right to request information pursuant to Insolvency Practice Schedule (Corporations) section 70-55. However, we also note IPR 70-55 provides for the Government to bear the cost of providing information or a report or document requested by the FEG Recovery Program if, in the opinion of the external administrator, there is not sufficient property available to comply with the request for the information, report or document – that is to say, the Government is only required to pay for FEG's requests when there is no money to meet the cost the external administrator incurs to provide the information.

In circumstances where there are resources to fund inquiries that are specific to the FEG Recovery Program's needs, but those requests go beyond what best practice and the law requires of voluntary administrators, it is our strong view that it is not appropriate that the general creditor body, including employees, or the external administrator be responsible for bearing the potentially significant cost. In such circumstances, the FEG Recovery Program should reimburse the administrator or liquidator for their reasonable costs.

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Appendix A: Flowchart - How SBRs should work

Phase	Proposed process	Additional comments	Change	Cost & time savings
Pre-appointment	Directors identify that the company is having financial difficulties and seek assistance from a registered liquidator			
	Liquidator reviews company's financial position and future prospects, assesses eligibility for a small business restructuring (SBR)	Company pays for this work separately to the SBR process. Debt threshold for eligibility remains at $1M, but excludes any secured creditor deficiency and any related entity claims.	Threshold currently includes secured creditor deficiency and related party claims	
	The liquidator works as an adviser to the company and assists the directors to liaise with secured creditors to ensure their support (as secured creditors are outside the SBR), establish a list of creditors and amounts outstanding, start the process to get tax lodgements up to date and determine any outstanding employee entitlements and payment of those entitlements.	Ipso facto on all secured creditors due to the appointment of an RP - does not prevent enforcement due to other breaches, such as non-payment.	Secured creditors are currently bound for any amount that their debt exceeds the value of the security, which sounds great, but the problem is that the value of the security is an estimate that would be difficult to determine and agree with the secured creditor. Without support of secured creditors, company would not be able to restructure. If secured debt needs to be compromised, VA may be a better option.	The RP is able to do more work in the pre-appointment period to assist the company to ensure eligibility and obtain support of creditors. This ensures that the process runs smoothly once the appointment is made. **Timeframe:** This period should take as much time is necessary (considering other issues that may force the company to act quickly).
	Act specifically recognises that the RP can work with the company prior to appointment.	Act should specifically recognise that the RP is able to assist the company prior to appointment as RP without impacting independence, as the RP's role is to assist the directors through the SBR process.	Currently independence requirements would prevent the prospective RP from working with the company extensively prior to appointment.	
	The directors appoint the liquidator in writing (liquidator must consent prior to appointment) that has been assisting the company as Restructuring Practitioner (RP) - after declaring company is insolvent or likely to become insolvent, that the company is eligible to do an SBR and approving the RPs remuneration for the RP (proposal and acceptance period)		Eligibility is currently done within 5 BD of appointment as is a extra step which is not necessary if RP is assisting company prior to appointment and can assist with directors making this determination at the time of appointment.	
Proposal period	Automatic stay of any winding up applications		Not currently an automatic stay - company has to go to Court which is a big expense	Significant cost saving as company will no longer have to apply to Court for a stay of the winding up application and RP will not have to assist company. Will not distract company and RP from the SBR process.
	Secured creditors unable to enforce security solely due to the appointment of an RP	Restructuring ends if RP terminates it, liquidator or VA appointed, Court Orders or directors terminate.		
	Company trades in the ordinary course of business with RP to approve any transactions outside the ordinary course of business, has to disclose "restructuring practitioner appointed"			
	RP by first BD after appointment: - lodgement with ASIC of appointment and company eligibility - PNW advertisement of appointment - notice of appointment, DIRRI and call for confirmation of claim to creditors - PNW advertisement calling for creditor claims	Confirming creditor claims at this point in the process means that once the plan is developed, the return to creditors will be more certain (there will not be changes to the amount of debt), the voting process will not be delayed if there are disputes about claims. A date should be set for claims to be lodged (in the same way that they are for dividends in liquidations - suggest 15 business days). If claims are not made by this date then the creditor is not bound by the plan (if accepted) - this will encourage directors to ensure that al creditors are included in order to bind them all. Creditor can dispute in Court if they want to be part of the Plan. If dispute goes to Court, the Proposal period should automatically extend. If the final list of creditor claims is greater than the threshold, the restructuring should terminate.	Creditor claims are currently dealt with in the acceptance period which can result in multiple variations being sent to creditors, which also necessitates creditors being able to change their vote during the acceptance period multiple times. Currently changes to creditor claims which result in the debt threshold being exceeded do not result in termination of the restructuring, which is an incentive for under estimating creditor claims.	This change will reduce costs as there will be less uncertainty regarding creditor claims and there will no longer be a need for RPs to include allowance in their fixed fee for variations of the proposal and extensions of the Acceptance Period.
	Company should assist creditors with reasonable request for information. RP not required to provide information that will be sent to all creditors with the plan proposal.	Creditors' rights to request information should be limited in an SBR in view of the fact that this is meant to be a short and cost effective process, there are already many reporting points to keep creditors informed and it is proposed that better information is provided to creditors with the plan proposal.	Currently RPs are required to comply with all reasonable requests for information in the same way as a liquidator or voluntary administrator. Requests should be made to the company rather than RP. RP's limited to how a SBR works, how this SBR will work, what creditors will get, alternatives, other creditors, timing of payments - all provided in report, therefore RP should not be required to provide separately.	Current requirements result in uncertain costs as RP doesn't know how many queries will be received. RP has to include an allowance in the fixed fee even if there ends up being no queries. Creditors are still protected as they can ask queries - if they are not happy with response from company (or RP) then they will vote no.

	Proposed process	Additional comments	Change	Cost & time savings
Proposal period	With assistance of RP, the company prepares a restructuring plan. Plan can create a second class of creditors for related party creditors and that class can be treated differently. All arms length creditors have to be treated the same under the plan. Secured creditors are not bound by the plan but the ipso facto on enforcement solely due to the appointment of the RP will continue to apply. Plan cannot be conditional, cannot involve the transfer of any assets other than cash and cannot give the RP for the plan the power to realise assets. Plan specifies the percentage of funds received from the company that are paid to the RP for remuneration.	For small closely held companies, directors often want to exclude related entities from participating in the plan in order to be able to improve the offer to unrelated creditors but this cannot currently be done. Conditions, transferring assets and sale of assets can result in increased costs - plans under SBRs should be straight forward simply involving the collection and distribution of cash. Any complex arrangements should be dealt with via a VA.	Creditors (including related party creditors) all have to be treated the same - related party creditors cannot be excluded from a payment under the plan. Conditions, making property (other than cash) available under the plan and giving the RP the power to sell assets on the company's behalf are currently allowed. Currently remuneration is a percentage of funds paid to creditors (assumable as assets other than cash can be made available as part of the plan). As it is proposed that only cash can be paid into the plan - remuneration should be expressed as a percentage of receipts.	Flexibility to exclude related creditors will result in better returns for creditors.
	RP prepares a statement about the plan setting out a minimum amount of information: - company assets - company secured debt - company creditors - contingent employee entitlements - potential return in liquidation excluding costs and recoverable property - a statement as to whether they have seen any evidence of transactions which may be recoverable in a liquidation (but no positive obligation to investigate) - a statement on their opinion as to whether the company is likely to be able to meet the obligations under the plan and any conditions on that opinion - a declaration that the information is correct to the best of their knowledge	The Act should be clearer about what the RP is required to do. Although current information requirements look to be low, the Act states that the RP commits a strict liability offence if the RP does not make reasonable inquiries into, and take reasonable steps to verify, the company's business, property, affairs and financial circumstances. It is not clear what this obligation is and as a result, extra costs will be incurred so the RP can undertake work which may not be necessary in order to protect themselves from a strict liability offence. However, it is important to get the balance of information right - onerous investigation and reporting obligations are costly. If the company's affairs are complex, a VA may be more appropriate as there are detailed reporting requirements for VAs.	Current reporting requirements are very limited - largely a declaration that the company is eligible, the company is likely to be able to discharge obligations under the plan, reasonable grounds that the company has set out information required. The limited information required to be provided does not enable creditors to make an informed decision about how to vote. The ATO (a common creditor) requests additional information before it will make a decision on how to vote.	This may cost a little more, however should prevent creditors needing to request more information in order to make an informed decision. It is important however that reporting is not complex and detailed - as if that level of reporting is necessary, a VA is a better option.
	Company must have paid all employee entitlements that are payable and have made all tax returns before the RP can send the plan to creditors.			**Timeframe:** Currently 20 business days, with ability to extend by a further 10 business days.
	All creditor claims settled by this date.			Period will be dependent on how much time is given to creditors for the confirmation of claim process - will need to be either 10 or 15 business days, could be 10 business days since communication is via email. Could express the period as up to 20 business days so proposal could be sent before the end of the 20 business days (ie as soon as creditors confirmation period ends). RP should still be
	RP to send to creditors and lodge with ASIC the restructuring plan, proposal, standard terms, declaration and statement. RP to ask creditors to vote (not related party creditors).		Currently there is a confirmation of claim and dispute process here too - we have recommended this be moved to the proposal period rather than the acceptance period.	
	Once the plan is sent, the company is insolvent. If the plan is cancelled, not made or terminated, control cannot be returned to the directors (company is insolvent). The company either has to go into VA or liquidation. RP cannot be appointed as administrator or liquidator.	As the company is insolvent, control cannot be returned to the directors. The company needs to progress to another form of external administration.	Currently if the plan is cancelled, not made or terminated (unless it is because of liquidation or VA) the control of the company is returned to the directors. This is not appropriate as the company is insolvent under law.	
Acceptance period	Creditors vote		Creditors can currently change their vote as many times as they want during the acceptance period due to the dispute process. No longer necessary.	Reduced costs as there is only one voting process - no variations and no "revoting" by creditors.
	RP assesses creditor votes and determines if the plan has been made (majority in value of arms length creditors - not secured creditors)		Secured creditors currently count for the amount of any deficiency	
	If a creditor comes forward that is not on the schedule of claims, the company has the option of varying the plan once to bind the extra creditor(s) - extra cost to the company so that the RP does not have to factor this into fixed fee quote. The company does not have to vary the plan - they can accept that the creditor is not bound.		Currently variations in the schedule of claims can result in extensions of the period	Variation of plan to bind extra creditors would only happen occasionally.
	If plan not accepted, company is insolvent (due to plan being proposed) and RP has to appoint a liquidator. Liquidator can then appoint a VA if a VA is a better option.	Directors would appoint liquidator recommended by RP - therefore no difference to the RP making the appointment. Retain CVL process after appointment of liquidator so creditors can replace liquidator.		Cost effective transition to liquidation so that creditors do not have the added cost of applications to Court if directors do not act. **Timeframe:** Currently up to 20 business days - proposed changes will be 15 business days

	Proposed process	Additional comments	Change	Cost & time savings
Plan period	Plan made - RP for company becomes RP for plan unless company resolves to appoint someone else			
	RP within 2 BD of plan being made: - lodges notice of appointment with ASIC - lodges voting outcome with ASIC - advertises that plan made on the PNW - gives notice to creditors		At the moment there is a double up on lodgements with ASIC which can be streamlined (plan lodged again, details of debts and claims lodged again. Lodgement timing and what is lodged can be streamlined	
	Company can propose a variation of the plan which is voted on by creditors in the same way as the initial proposal. Company needs to pay RP extra to send variation information and determine voting outcome.	SBRs are corporate debt agreements. In debt agreements creditors can approve a variation.	At the moment it is only the Court that can approve a variation which is very expensive.	Process streamlined and more cost effective with company being able to offer a variation rather than having to go to Court and a more reasonable time period to rectify defaults. Cost of plan will not need to be made higher for variation as this will be an extra cost to the company and only if necessary.
	Where the company fails to comply with the plan, it has 30 days to either comply with the plan or propose a variation. If either of these do not occur, the RP terminates the plan and notifies creditors and ASIC. The company must then be placed into liquidation or voluntary administration - it cannot be returned to the control of the directors.		At the moment the directors must notify the RP of contravention or likely contravention. RP then must notify ASIC and creditors of non-compliance within 2 BD. The RP is best placed to determine non-compliance. 2BD is too short for a small business. The business must be given a reasonable timeframe to try and comply or else vary the plan.	
	RP to appoint liquidator once company is non-compliant. Liquidator can then appoint a VA if a VA is a better option. Liquidator to follow CVL process, including the option for creditors to request a meeting of creditors to replace the liquidator.	Directors would appoint liquidator recommended by RP - therefore no difference to the RP making the appointment. Ensures that liquidator can be appointed immediately on failure of the plan. Retain CVL process after appointment of liquidator so creditors can replace liquidator.	At the moment there is no automatic appointment of a liquidator, so if directors dont appoint, creditors have to incur further costs to apply to Court.	Appointment of a liquidator is quicker and cost effective and ensures that creditors are not left having to incur further costs to get a liquidator appointed if directors fail to act. **Timeframe:** Depends on the length of the plan - this will not change.
	RP collects payments under the plan and distributes funds to creditors.	Creditors do not have right to ask questions of he RP - RPs will deal with straightforward questions about the plan in the ordinary course without legislation. If creditors are unhappy with RP performance and/or payments not being made they can complain to ASIC.	At the moment the RP has the power to realise property but we propose that only cash can be dealt with under the plan, so this power is not required.	
	RP to lodge notice with ASIC, company and creditors when plan is complete (final payment made to creditors)	Directors do not notify RP of completion - RP knows when final payment to creditors is made.		

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Appendix B: Flowchart - How Simplified Liquidations should work

	Proposed Process	Additional comments	Change	Cost & time savings
Appointment & adoption	Court or Directors initiate the appointment or other triggering event occurs and liquidator appointed	Every step from triggering event to adoption must occur within 20 business days otherwise simplified liquidation is not an option	Process continues to start as normal creditors voluntary liquidation but should be extended to be available in a Court liquidation	
	Directors provide liquidator with Report on Company Affairs and Property and make declaration of eligibility for simplified liquidation. If appointment initiated by Directors, declaration of eligibility to be provided at time of resolution, otherwise within 5 business days of appointment.	Declaration requirements only refer to director resolutions and do not cater for other types of triggering events	Incorporate a strict liability offence provision for making incorrect declaration.	In addition to providing significant cost savings, enabling the liquidator to commence a simplified liquidation process and giving creditors the right to opt out provides greater clarity and certainty for the liquidator and removes significant confusion about the current adoption process.
	Liquidator makes determination to adopt simplified liquidation process based on review of eligibility and notifies creditors and of adoption.		No notification requirements to members	The current adoption process is red tape intensive, simplifying the process will streamline the adoption process and remove the additional time added by the current requirements.
	Creditors have 10 business days to contest adoption of simplified liquidation		Creditors contest use of the simplified process once adopted, rather than objecting to the adoption	
Investigation & reporting	Liquidator proceeds to realise assets, recover voidable transactions and pursue insolvent trading if in the interests of creditors	Offence report must be lodged with ASIC if liquidator has reasonable grounds to believe misconduct has occurred	Remove ability to undertake litigation in simplified liquidation (except as part of proof of debt process). Liquidator may recommend to creditors and seek resolution by proposal to terminate simplified process and revert to full liquidation if litigation is to be pursued.	Litigation creates significant costs in liquidations, these costs are counterintuitive to a streamlined process and should be removed. Litigation can often add years to a liquidation process. Removing the ability to litigate from the streamlined liquidation process could enable simplified liquidations to be finalised years earlier.
	Liquidator may issue proposals seeking approval of resolutions including remuneration (must supply remuneration report), compromise of debts and arrangements longer than 3 months	Objections to proposals being resolved without a meeting do not apply in simplified liquidation	Increase statutory maximum remuneration a liquidator may receive without need to obtain approval to $10,000 (excluding GST) indexed, currently $5,725 (excluding GST)	An increase in the maximum statutory fee for streamlined liquidations would remove or limit the reporting and approval of remuneration from creditors. Fulfilling the reporting and approval process has a substantive cost and many liquidators may choose to take a reasonable statutory fee, rather than incurring the additional time and cost of reporting and seeking approval for a streamlined liquidation.
	Liquidator issues simplified Statutory Report by Liquidator within 3 months of appointment		Streamline reporting requirements and clarify the extent of investigations required by the liquidator. Remove statutory obligation for liquidator to respond to creditor requests for information, however give creditors right to seek to terminate simplified process.	While liquidators do not have a requirement to comprehensively report on the company's business and affairs, it is unclear whether these matters must still be investigated to enable a liquidator to determine if reasonable grounds exist to lodge a misconduct report with ASIC. These investigations create significant costs and are arguably only for the benefit of ASIC. Similarly, while creditors should always have a right to discuss the liquidation with the liquidator and obtain information as a stakeholder in the process, removing the statutory obligation to respond would ensure that a small number of creditors do not add significant costs to the process with multiple and/or lengthy requests for information that offer no benefit to the general body of creditors.
Dividend & finalisation	If there are sufficient funds, liquidator advertises notice of intention to declare dividend and notify creditors (payment of interim dividends permissible to priority employee creditors and a single dividend for ordinary unsecured creditors).	All recovery actions MUST be finalised prior to dividend being declared as legislation only allows for a single dividend to be declared and distributed to all classes of creditors, including employees	Remove the requirement to obtain tax clearance from the ATO (noting tax documentation must be up to date to be eligible for simplified process). Remove current optional duplication of advertising for proofs of debt.	While enabling additional dividends to be paid to priority employee creditors will not have any direct time and cost savings, it is unreasonable for employees to have to wait for the conclusion of the liquidation to be paid (noting that not all priority employee amounts can be paid by the Fair Entitlement Guarantee).
	Liquidator receives and adjudicates on proofs of debt. Creditor may appeal to Court if liquidator rejects all or part of their claim.	All Court proceedings MUST be finalised prior to dividend being declared as legislation only allows for a single dividend to be declared and distributed to all classes of creditors, including employees	Remove the requirement for creditors to prove for debts of under $10,000 (liquidator to confirm admission without need to formally prove).	Time and cost savings would be made by removing the requirement to get tax clearance from the ATO (it can still prove for the debt owing and historically it has taken 90-120 days for the ATO to provide clearance) and the need for small creditors to lodge a proof of debt.
	Once all recoveries and any proceedings regarding proof of debt are finalised, liquidator declares final dividend for all classes of creditors (must be first & final for ordinary unsecured creditors), issues notice of declaration and payments	An ordinary unsecured creditor who does not prove prior to the dividend is not entitled to an equalising dividend	Priority employee creditors entitled to equalising dividend.	
	Liquidator finalising liquidation and ASIC deregisters company after 3 months			
Cessation	Must cease simplified process if: - eligibility criteria no longer met - company or director engaged in dishonesty which as material adverse effect on interests of creditors - creditors resolve		Extend to include right of creditors to terminate following a resolution by proposal issued at discretion of liquidator or request of creditors (subject to 25% threshold)	While this would not offer any time or cost savings it would ensure integrity in the system and protect creditor rights.