ARITA
AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

12 December 2023

The Hon Stephen Jones MP
Assistant Treasurer
The Treasury
Langton Crescent
PARKES ACT 2600

By email: stephen.jones.mp@aph.gov.au, daniel.edmonds@treasury.gov.au & prebudgetsubs@treasury.gov.au

Dear Assistant Treasurer

Pre-Budget Submission

Introduction

The Australian Insolvency, Turnaround and Restructuring Association (ARITA) represents around 85% of Australia's insolvency, turnaround and restructuring professionals. Our members primarily have legal and accounting backgrounds. We provide professional development for our members, have a statutory role in relation to their registration and professional conduct and undertake policy development and advocacy in relation to insolvency matters in their interests, and we strongly believe, that of the Australian community.

Our budget proposals are directed primarily at addressing the failures of the previous government that, given the current economic environment, may have immediate and material adverse impacts and providing appropriate funding to push forward with the recommendations made by the Parliamentary Joint Committee on Corporations and Financial Services (PJC) in its report on Corporate insolvency in Australia. Moving forward with these important recommendations will ensure Australia has an insolvency system fit for the twenty-first century.

Macroeconomic context

Due to the extent of stimulus payments throughout developed economies, insolvencies dropped to record lows. Coupled with the ATO taking almost no recovery or enforcement action during the COVID period, in Australia the number of personal and corporate insolvencies was around 50% of pre-COVID levels.

It is no surprise that we have seen a rise in insolvencies as inflation and interest rates rise, with numbers of insolvency appointments reaching pre-pandemic levels for the first time in July 2022. Insolvency numbers have returned to immediate-pre-Covid levels for all types of corporate insolvency appointments except court liquidations (which are the main creditor made appointment for companies). We believe this is due to creditor recovery actions (including from the ATO) still not being at pre-COVID levels, potentially as creditors have been pragmatic about recovery of COVID debts. Directors themselves, though, have been taking action to appoint either a liquidator or voluntary administrator in relation to their distressed companies, usually as a result of some type of external stimuli such as warning letters or Director Penalty Notices from the ATO.

Increased insolvencies are unavoidable and seeking to further divert or delay unavoidable business closures is not in the interests of employees, creditors or the broader economy. We are keen to work with the Albanese Government to ensure that viable businesses are effectively restructured whilst allowing unviable, insolvent businesses to exit efficiently and with the least harm to their creditors, employees and where possible their owners. Importantly, this needs to be done without reducing necessary and efficient investigation and enforcement by liquidators, administrators and ASIC.

Policy background

Arising from the Productivity Commission’s 2015 Inquiry into Business Setup, Transfer and Closure, the Coalition Government legislated for the safe harbour framework, restriction of enforcement of *ipso facto* clauses and the introduction of Director Identification Numbers, all of which had been ARITA policy positions for some time.

The previous Government also initiated and responded to an Independent Review of the safe harbour regime, which has shown its relative success. However, in other regards, attempts at reform have been a dismal failure. That failure is directly and obviously attributable to not listening to industry experts such as ARITA and to not consulting properly. As a result, we have new regimes like Small Business Restructuring and Simplified Liquidations that have proven to be awkward and difficult to implement in practice, with very slow uptake over the first two years. Though registered liquidators have worked very hard at making this complex legislation work, and the increasing numbers of appointments are a credit to the profession encouraging directors of small, distressed companies to embrace the opportunity provided.

We were delighted when in September 2022, the PJC commenced its inquiry into corporate insolvency in Australia (PJC inquiry), tabling its excellent report making 28 recommendations for the improvement of Australia’s corporate insolvency system in July 2023. A significant recommendation arising from the PJC review was that “as soon as practicable the government commission a comprehensive and independent review of Australia’s Insolvency law, encompassing both corporate and personal insolvency”. This was complemented by a series of near-term actions implementing reforms to safe harbour, small business restructuring, simplified liquidations and trusts.

It is these recommendations that ARITA would like to see funding provided for in the upcoming budget.

Proposed Budget Measures

1. Comprehensive review of insolvency system

The profession strongly supports the PJC inquiry recommendation for a comprehensive review of Australia's insolvency law. In fact, ARITA has been calling for a root and branch review of Australia's insolvency laws for a number of years.

An independent comprehensive review of Australia's insolvency laws is long overdue, the last one having occurred 34 years ago. ARITA on reflection considers that this review be best undertaken by the Productivity Commission from within its existing appropriation. It may need supplementary funding of up to $0.5 million for legal assistance.

2. Implementation of the PJC Inquiry immediate reforms

The PJC Inquiry made a number of recommendations for immediate potential reforms that would address clear and broadly recognised failings in the current law.

We strongly agree that a number of the immediate reforms would result in significant improvement to, and reduced cost of, some of Australia's insolvency processes. Specifically, we think the most significant improvements could be realised by:

- implementing the recommendations of the Safe Harbour Review
- reforms to simplify the small business restructuring and the simplified liquidation pathways, and
- improving the insolvency process for trusts.

3. *Correction of drafting errors and anomalies and implementation of safe harbour review recommendations*

Over time, ARITA and its members have identified a range of anomalies and drafting errors in the current law that should be corrected. A list of these is provided in Appendix A. Legislation to correct these could also incorporate the drafting changes recommended by the Independent Review of the Safe Harbour Framework. We do not believe such legislation will be contentious and the cost of this reform would be limited to the cost of drafting, much of which has already been discussed by the professions and government agencies.

Should you have any queries concerning this submission please contact me (02 8004 4355 or jwinter@arita.com.au) or our Special Advisor, Dr Warren Mundy (0409 911 554 or wmundy@arita.com.au).

Yours sincerely,

John Winter
Chief Executive Officer

ARITA

Appendix A

Drafting errors and anomalies in the Corporations Act

The following further errors, issues and anomalies in the legislation - i.e., Schedule 2 to the *Corporations Act 2001* ('IPS') and the Insolvency Practice Rules (Corporations) 2016 ('IPRs') - have been identified since the introduction of the amendments:

Issue
Proposals without meetings are not available for matters under the Corporations Act: Proposals without meeting have been a hallmark of Bankruptcy Act administrations for some time. ARITA's understanding is that the ILRA was intended to provide a similar streamlined mechanism for voting in corporate external administrations. However, the new provisions as drafted appear to restrict the use of proposals without meetings to a very narrow range of matters. Other than remuneration approvals in administrations commencing on and after 1 September 2017 or consent to early destruction of books and records, it is difficult to see what practical use can be made of proposals without meeting in corporate external administrations. For corporate external administrations, the problem arises because a proposal without meeting under s 75-130 of the IRSs can only be used to pass a mere 'resolution' for the purposes of the Insolvency Practice Schedule (Corporations). If a resolution is required under a provision of any part of the Corporations Act **other than the Insolvency Practice Schedule**, then **the amended definition of 'resolution' in s 9 of the Corporations Act require a meeting to take place**. This problem extends to matters such as: • varying or terminating a DOCA (ss 445A and 444E); • approving certain acts of a liquidator under s 477; and • seeking approval of remuneration where the appointment was prior to 1 September 2017 (the ILRA provides that the old Act provisions will continue to apply to the approval of remuneration in ongoing. The continued inability to be able to use proposals without meetings for all types of resolutions, particularly more procedural matters such as approval of compromises of debts (s477XX) and entering into arrangements longer than three months (s477XX) is resulting in inefficiencies and increased costs for external administrations. It also does not make sense that an appointment after 1 September 2017 can use a proposal to approve remuneration, but one before that date cannot. As time goes on, this transition becomes more and more confusing and is more likely to result in inadvertent use of the proposal process to approve remuneration in old external administrations.
Funds Handling provisions in Division 65 of the IPS: Applications to Court have been necessitated by the strict application of the funds handling provisions in Division 65 of the Insolvency Practice Schedule (Corporations). It is less than ideal that the new legislation is necessitating such applications to the Court for relief.

ARITA

Issue
It appears that an amendment needs to be targeted at (or focused on) both group appointment scenarios and pre-appointment account arrangements which are either impractical or prejudicial to company/creditors to terminate.
Prohibition of Committee of Inspection ('COI') member benefit: Section 80-55 of the IPS prohibits a member of a COI deriving any profit or advantage from the external administration of the company. Section 80-55(2)(b) provides that a COI member is taken to have derived such a benefit from the external administration if the member derives a profit or advantage from a creditor of the company. Therefore, if in the ordinary course a COI member deals with a creditor the terms of s 80-55 are breached and the COI member commits a strict liability offence: s 80-55(7). These sorts of breaches are not a matter of the EA's duties but are a real risk for creditors who choose to participate as a COI member. Indeed, the strict terms of s 80-55 and the risk of breaches create a disincentive for creditors to participate in external administrations through COI membership. This would appear to work against the spirit and intention of the ILRA changes. Unless some sort of 'ordinary course' exception is introduced into IPS s 80-55, it may become more difficult to encourage creditors to nominate for COI membership and COIs themselves may become defunct.
Initial notification to creditors: IPR 70-30(3)(c) appears to require a replacement liquidator in a court liquidation to provide the information under IPR 70-30 to creditors within 20 business days of their appointment. This requirement does not extend to replacement voluntary administrators (under IPR 70-30(3)(b)) or liquidators in a creditors' voluntary liquidation (under IPR 70-30(3)(d)) due to the different events that trigger the requirement. Is the fact that court liquidators are required to do this a drafting error? We think a preferable solution is to provide for a consistent requirement for insolvent liquidations (both CVL and Court-ordered), so that for an incoming liquidator who has been appointed under s 90-35 of the IPS, that 'new' liquidator be obliged only to send the information in IPR s 70-30(2)(a) within 10 business days of his/her appointment. The other information in subsection (2)(b) through to (f) does not need to be sent again. Such an obligation would also trigger the requirement to send an IRN under IPR s 70-35(5)(b) (it appears that this rule would need no amendment).
Statutory report by a liquidator: IPR 70-40 will require a replacement liquidator in either a court liquidation or creditor's voluntary liquidation to provide a statutory report to creditors within 3 months of their appointment, notwithstanding when their appointment occurs and whether the incumbent liquidator has already provided one. If the liquidator was replaced multiple times by creditors, each and every replacement liquidator would have to provide this report. Is this the intention or an unintended consequence of the amendment to IPR 70-40? We tend to think that it makes sense that a three-month report be required again, given that it might be a perception of inadequate investigations or reporting which prompted creditors to make the replacement in the first place.

Issue
Requirement to send an IRN in a MVL IPR 70-35 requires a liquidator in an MVL to send an IRN to creditors (where there are any creditors) even though it is members that approve the liquidator's remuneration. This should be excluded for an MVL, or specified to be sent to members where it is intended that a remuneration determination will be sought? It may not be appropriate to be sent to members as generally remuneration is approved at the meeting appointing the liquidator, which is what is contemplated under IPR 60-10(2).
Anomalous rights of creditors in a MVL Following on from the point above, the following provisions provide for certain rights of creditors in MVLs which appear anomalous: a. IPR ss 70-30 and 70-40 require a liquidator in a MVL to give initial information (including about creditors' rights) and/or a 3-month report to any creditors which may exist in a MVL at the time when the information and/or report is due. b. IPS ss 75-15 and 90-35 appear to grant creditors in a MVL the right to request a meeting and to replace the liquidator. In a 'solvent winding up' (MVL), where creditors will ultimately be paid in full, these rights of creditors are difficult to understand and justify. If a company in MVL turns out to be insolvent, then the MVL is converted to a CVL under s 496 of the *Corporations Act*. Accordingly, we contend that MVLs should be 'carved-out' or excluded from the reach and application of these four provisions. An example of where this has been done is IPS s 85-5: MVLs are excluded from this provision which provides creditors the right to give directions to an external administrator.
Remuneration reporting requirement in an MVL: Based on the wording in IPS 60-10, it appears that a proposed liquidator in an MVL can seek a resolution to approve a remuneration determination at the general meeting of the company at which he or she is appointed liquidator. The remuneration reporting requirements in IPR 70-45(4) only apply to an external administrator, not a 'proposed' external administrator. Prior to that meeting in an MVL, the proposed liquidator is not yet the liquidator so technically is not required to comply with IPR 70-45(4). The former section that dealt with this situation for MVLs prior to 1 September 2017 specifically provided for the 'proposed liquidator' to report to members prior to the approval of remuneration: repealed s 495(5). So, we suggest that both IPS s 60-10(2) and also IPR s 70-45(4) be extended to also cover 'proposed' external administrators in a members' voluntary winding up. We also query whether provision might be made for remuneration approval in an MVL to be obtained via a proposal without meeting (such proposals presently being limited to creditors and contributories: IPS s75-40). We consider this to be appropriate since remuneration in other external administration are able to be obtained via a proposal and it is a cost effective way to obtain the approval.
Replacement of external administrators (process). There are a number of apparent anomalies in the procedural requirements for the replacement of external administrators under IPS s 90-35 and IPR s 75-265.

ARITA

Issue

a. The inconsistent notice periods for the meeting in IPS 90-35(2) and IPR s 75-20. We think the preferred solution is simply to repeal s 90-35(2) and then the various meeting notice provisions for those meetings covered (or not covered) by s 75-20 should operate effectively. It would also be helpful if the Rules made it clear that a resolution for removal and replacement of an external administrator will not be valid or effective if notice of that resolution is not included in the notice of meeting sent to creditors (as a safeguard against 'ambush' resolutions at meetings convened for another purpose).

b. It is unclear whether it was intended that IPS s 90-35 and IPR 75-265 (or parts thereof) apply to replacements of voluntary administrators at a first meeting in a VA (s 436E of the Act). IPR s 75-265 provides that it applies to removal and replacement of an external administrator under IPS s 90-35 which would appear to mean that this rule does not apply to replacements pursuant to s 436E of the Act (first meeting in a VA). However, we also note that IPR s 75-265(3) places specific obligations on replacement voluntary administrators and it would appear this could only apply to a first meeting in a VA, as creditors do not have the power to request a meeting in a voluntary administration.

c. If IPR s 75-265 is intended to apply to replacements of VAs at the s 436E meeting, then subsection (4) of the rule needs to be amended to exclude s 436E meetings (because it is not practically possible for a DIRRI of an incoming administrator to be sent with the first meeting notice).

d. The lodgements required under IPR s 75-265(6) are required regardless of whether the removal and replacements resolutions were successful. We do not think that the DIRRI and consent of the proposed incoming external administrator should need to be lodged if that external administrator did not end up being appointed.

e. The note at the foot of IPR ss 75-265(2) (3) creates confusion and, in our view, should be deleted. Two of the provisions cited in the note – ss 436DA and 506A of the Act – do not related to 'incoming' administrators but refer to appointments made when the external administration is commenced in the usual way.

f. A similar issue as to how IPS 90-35 and IPR-265 applies arises in the situation where a company converts from a MVL to a CVL. The liquidator is required to convene a meeting of creditors and creditors have a right to replace the liquidator (s 496). Again, it is impossible for creditors to comply with the requirements of IPR 75-265 where they only find out about the insolvency of the company and their right to replace the liquidator when the notice of meeting is sent out.

There is no clear mechanism by which, upon receiving notice of a meeting to replace an external administrator, creditors can propose an *alternative* incoming administrator to the one whose DIRRI is sent out with the notice under IPR s 75-265(4). Is it possible for an amendment which would allow for this, on the condition that the DIRRI of the alternative incoming administrator is tabled at the meeting?

Issue
The heading to IPR s 75-145. While it is strictly not part of the Act, we suggest that the heading to this rule be amended to accurately reflect the fact that the rule applies to all types of meetings concerning companies under external administration (not just meetings of creditors). See IPRS 75-1 and IPR s 75-145(3).
Exercise of casting vote and operation of IPR s 75-115 during transition between forms of appointment. Doubt has arisen in practice over the operation of IPR s 75-115, particularly during the transition period between forms of external administration. When a company transitions from a voluntary administration to a creditors voluntary liquidation, by the operation ss 439C(c), 446A(1) and 499(2A) the Act has the effect that this is treated as a "new appointment" rather than a "removal". However, there appears to have been inconsistency in the interpretation of the restrictions on the exercise of an external administrator's casting vote in IPR s 75-115(5) in these circumstances. The doubt concerning the operation of IPR s 75-115 is illustrated by apparent differences in reasoning in two recent decisions, particularly when considering the interaction between s 75-115(5) and IPS s 75-43. In the decision of the Supreme Court of New South Wales, *In the matter of Glenfyne Farms International AU Pty Ltd (in liq)* [2019] NSWSC 16, there was a vote at the second meeting of creditors to change external administrator. One creditor proposed that an alternative external administrator be appointed as the incoming liquidator of the company. The resolution was defeated on the voices and a poll was taken, the result of which was a spilt between numbers and value. The incumbent external administrator (who had acted as voluntary administrator) exercised his casting vote against the resolution (effectively maintaining his own appointment). In that decision, Rees J found (at [39] to [40]) that there had been a breach of IPR s 75-115(5) by the incumbent external administrator but the application made by the creditor was based on IPS s 75-43 and the requirements for that provision had not been satisfied in the circumstances of this case. As a result, the matter was treated as if the resolution for change of external administrator had simply failed to pass and the incumbent moved to become liquidator by operation of the Act. In contrast, the decision of Justice Black in *In the matter of Iris Diversified Property Pty Ltd (in liquidation)* [2018] NSWSC 834 applied IPS s 75-43 and noted that s 75-115(5) would have operated to prevent the exercise of the casting vote and made orders to give effect to the replacement. In this case, the resolution for replacement of the liquidators was made at a specifically convened meeting of creditors, as opposed to during the transition between forms of appointment. ARITA has concerns with the uncertainty and whether the amendments are operating in accordance with their intended effect.