6 July 2015

Dr Warren Mundy
Presiding Commissioner
Business Set-up, Transfer and Closure
Productivity Commission
GPO Box 1428
CANBERRA ACT 2601

By email: business.inquiry@pc.gov.au

Dear Commissioner Mundy

Business Set-up, Transfer and Closure
Productivity Commission Draft Report May 2015

ARITA acknowledges the work of the Productivity Commission in this inquiry and thanks the Commission for the opportunity to cooperatively work with you on the restructuring, turnaround and insolvency aspects of the Inquiry.

We concur with the Productivity Commission's commentary that, with few exceptions, businesses are not designed with failure in mind, that fear of being associated with failure negatively modifies behaviours. We support the draft report to the extent that it seeks to reduce the focus on business failure and promotes the need for early intervention and constructively either restore business viability or to more productively recycle the assets of the business.

ARITA believes that Australia has a fundamentally effective insolvency regime but that it needs some improvement, as detailed in our previously provided Platform for Recovery Discussion Paper and Policies Positions papers. Our goal is to encourage businesses to seek help earlier in the financial distress spectrum to avoid costly shutdown but, if that is not possible, to ensure the rapid and efficient recycling of productive capital to the economy.

In this regard we have focussed this overview on the personal insolvency and business restructuring aspects of the draft report, i.e. chapters 13 - 15.

It is important to note that the suggested reforms supported by ARITA cannot be implemented on a stand-alone basis and their effectiveness is interdependent.

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Key points

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1. generally supports the Commission's recommendation to reduce the period of bankruptcy to one year
2. agrees with the Commission's draft findings 14.1 and 14.2
3. has concerns with draft recommendation 15.1
4. has concerns with draft recommendation 15.2
5. generally supports draft recommendation 15.3
6. generally supports draft recommendation 15.4
7. supports draft recommendation 15.5
8. sees significant practical implementation issues with draft recommendation 15.6
9. supports draft recommendation 15.7; and
10. supports draft recommendation 15.8.

I note that the response to the Commission's draft report closes the public consultation period for the inquiry. However please do not hesitate to contact me should you require any clarification of the matters raised in this response or other restructuring, turnaround or insolvency matters related to the inquiry.

Yours sincerely

John Winter
Chief Executive Officer

About ARITA

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

We have more than 2,000 members including accountants, lawyers, bankers, credit managers, academics and other professionals with an interest in insolvency, turnaround and restructuring.

Some 76 percent of registered liquidators and 86 percent of registered trustees are ARITA members.

ARITA's mission is to support insolvency and restructuring professionals in their quest to restore the economic value of underperforming businesses and to assist financially challenged individuals.

We deliver this through the provision of 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.

The Association promotes best practice and provides a forum for debate on key issues facing the profession. We also engage in thought leadership and advocacy underpinned by our members' knowledge and experience.

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1 Non-business exit draft recommendations

ARITA does not wish to comment on these draft recommendations, except for the following brief comments.

1.1 Draft Recommendation 3.1 – Commission's previous reports on business regulation

ARITA supports performance benchmarking that enables consistent reporting of financial performance for financially distressed entities.

We also note that differences and inconsistencies in state and territory laws create problems for insolvency practitioners, in particular in administering national or intra-state businesses. Examples are the laws in relation to worker health and safety, business licensing, and transport. In the same way that these add to the costs of doing business in Australia, they add to the costs of administering those businesses in insolvency.

We draw your attention to recommendation 4.3 in the Commission's Annual Review of Regulatory Burdens on Business, of 12 October 2010, that a taskforce should be established to identify personal and corporate insolvency provisions and processes that could be aligned; and that the case for making one regulator responsible for both areas of insolvency law should also be examined. While to some extent the Insolvency Law Reform Bill 2014 attends to some aspects of alignment, there are many other areas that need alignment, and simplification.

1.2 Draft Recommendation 10.1 – implementation of Harper Review's industry-specific anti-competitive regulation recommendations

Again, we only generally comment that certain state regulations can impinge upon insolvency regulation. An example is the requirement under NSW law for a liquidator or administrator being appointed to a NSW registered club to have that appointment approved by the relevant NSW authority: see *Correa v Whittingham* [2013] NSWCA 263. This requirement is not found in other state laws.

1.3 Draft Recommendation 11.2 - Government assistance programs

ARITA notes that any program should ensure that only viable businesses are assisted.

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2 Voluntary business exits

2.1 Draft Recommendation 12.1 - streamlined formal merger exemption processes

ARITA supports the removal of any unnecessary restrictions and requirements that improve the efficiency and effectiveness of business transfer processes, while at the same time ensuring that the transparency, integrity and legality of the process is maintained.

2.2 Draft Recommendation 12.2 – rationalisation of small business capital gains tax concessions

In addition to the matters set out in the draft recommendation, ARITA also believes that any rationalisation of capital gains tax concessions should extend to the consideration of capital gains tax consequences in insolvency. A capital gains tax issue presently due for hearing before the High Court has followed some years of uncertainty about the liability and priority in insolvency on the sale of an asset. This has created delay and cost in the finalisation of administrations[1] and some distortion in the sale processes.

2.3 Draft Recommendation 12.3 - planning for business exit

On the basis that the vast majority of exits are non-insolvency related, ARITA agrees with the draft recommendation.

In relation to the proportion of business exits that are insolvency related (reported as 6%), ARITA notes that there is also a public interest aspect in planning for business exit in addition to commercial considerations. If left to commercial considerations only, many companies may leave little or no funds for insolvent exits, without considering the impact on the external stakeholders or business environment.

We have noted the evidence and submission of Associate Professor Helen Anderson as to the estimated large number of companies that are deregistered without going through any insolvency process. She has concerns about the extent to which these may serve to conceal unlawful phoenix or other misconduct. We share those concerns and ARITA has been asked to assist her in examining this issue further. To some extent the issue may be assisted by the proposals of ARITA for streamlined liquidations.

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[1] An appeal by the Commissioner from the decision in *Commissioner of Taxation v Australian Building Systems Pty Ltd (in liq)* [2014] FCAFC 133, being heard by the High Court on 8 September 2015.

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3 Personal Insolvency

3.1 Draft Recommendation 13.1 – Period of bankruptcy

Key point 1: ARITA generally supports the Commission's recommendation to reduce the period of bankruptcy to one year

ARITA generally supports the Commission's recommendation to reduce the period of bankruptcy to one year for the reasons given in the draft report. Consequences would be that the period in which income contributions would be paid, under the current law, would be limited to that one year; as would the period in which after-acquired property would vest in the trustee.

ARITA's support of the recommendation is subject to the requirement that a trustee should retain power to extend the bankruptcy period to up to eight years if there are concerns regarding the debtor's conduct. We believe that a one year bankruptcy period would not be appropriate for individuals who have previously been bankrupt and that such conduct would automatically extend the bankruptcy period to 3 years, with further extension possible subject to the trustee's determination.

We highlight that there is a potential for forum shopping by way of debtors from nearby jurisdictions, such as New Zealand which has a 3 year bankruptcy period, seeking to establish residency here in order to reduce the period of their bankruptcy. There is evidence that this is happening in the UK following the change to its bankruptcy period.

At present there is generally a blanket restriction on a bankrupt being a company director, or holding many other trade and professional positions. The reasons for a person going bankrupt are very broad in scope and we consider this unjustified in many cases. ARITA supports the ability of bankrupts to continue as directors in circumstances where there has not been fraud or malfeasance leading to their bankruptcy. Legal criteria would need to be set.

We also note that a company director whose business fails as a result of fraud or malfeasance has no such restriction, including no restriction on their ability to take on further directorships. We have also pointed out that a director who refuses to co-operate with a liquidator of their insolvent company can still be a company director, unless some positive regulatory action is taken; for example by failure or refusal to complete a RATA. In contrast, a co-operative and financially competent bankrupt cannot be a director.

In that respect we have previously recommended to Treasury that director misconduct in insolvency be more regulated; but that recommendation has not been accepted.

ARITA is not aware of any general shortcomings in the existing statutory powers under the *Bankruptcy Act 1966* ("Bankruptcy Act") or other laws to recover assets. In fact, bankruptcy law offers more streamlined remedies - to recover assets, for example under s 139ZQ; and to investigate financial dealings, for example by way of more informal examination processes under s 77C.

However ARITA is recommending a general review of our insolvency laws including those in personal insolvency. As with corporate dealings, the structuring of the financial affairs of individuals has changed significantly in the last 30 years. There is a need for bankruptcy law to be able to more effectively deal with trust and other family and personal asset protection structures.

4 Business Restructuring

4.1 Draft Findings 14.1 & 14.2 – Wholesale change to insolvency system is not required

Key point 2: ARITA agrees with the Commission's draft findings 14.1 and 14.2

ARITA agrees with the Commission's draft findings 14.1 and 14.2 and notes that they are consistent with ARITA's Policies Position Paper dated February 2015.

The data in the information request is not readily available but ARITA is prepared to facilitate a survey of its members in consultation with the Productivity Commission.

4.2 Draft Recommendation 15.1 – Company can only appoint a voluntary administrator if it still solvent, but may become insolvent

Key point 3: ARITA has concerns with draft recommendation 15.1

ARITA has concerns with draft recommendation 15.1.

As noted by the Commission in its discussion of the safe harbour proposal, the ability to determine the solvency or insolvency of a company can be difficult, in real time, in prospect and in retrospect. In real time, this is particularly the case where the company is in the "twilight zone" and is not clearly one or the other.

ARITA believes that viability, or potential viability, is a better measure than solvency for various reasons.

A once-off event may make a viable business insolvent, or different business units within one company may be viable despite an overall insolvent position, or a business may be viable if operated by an owner without the necessary capital to maintain/inject into the business.

In terms of what constitutes viability, ARITA believes that, like insolvency, there are a number of factors which must be considered. These would include, but not be limited to:

- that there is a business to rescue or restructure as a going concern
- that the business is sustainable for its purpose

- that it has current and future profitability, and
- has access to future capital requirements.

Any amendment to the objects of Part 5.3A, by removing the second limb – paragraph (b) – of section 435A requires a significant legal and cultural shift in Australia. As you would be aware, the object of paragraph (b) is to provide a better return for a company's creditors and members than would result from an immediate winding up of the company.

As noted in our Policy Position Paper dated February 2015 "the current Australian regime could be described as having a strong bias towards preserving creditors' rights. Other jurisdictions are more biased towards preserving the troubled company as a going concern. There are significant arguments around where the balance is appropriately set between these two approaches, and the balance point advocated may alter depending on where an economy's performance is trending."

Following a limited process of consultation with senior practitioners arising from the Commission's recommendations, at this time, ARITA has been unable to reach an agreed position as to whether it is appropriate to make such a fundamental change to the voluntary administration regime, but the issues raised by the Commission are prompting some useful debate in the profession on the restructuring process.

4.3 Draft Recommendation 15.2 – Safe harbour

Key point 4: ARITA has concerns with draft recommendation 15.2

ARITA has concerns with draft recommendation 15.2.

Although ARITA fully supports the implementation of "safe harbour" protection, we note that ARITA's Policies Position Paper recommends 'safe harbour' as a defence for, or protection against, insolvent trading actions; it is not a regime into which a financially distressed company is placed. Director protection under our safe harbour proposal assumes the director having pursued a course of financial conduct that is indicative of good corporate and financial governance of the company and its business.

As such, if a restructure is successful there is obviously no need for the director to rely upon the safe harbour defence. Safe harbour will only ever be considered in the event of the failure of the restructuring effort, liquidation of the company occurring, and pursuit of the directors for insolvent trading. It is at that time that the directors can rely on their compliance with the safe harbour requirements as a defence to the insolvent trading claim.

We also say that any law reform needs to offer protection from any inadvertent breach of directors' duties by virtue of the directors' attempts at restructuring. We refer to the submission of the Law Council of Australia to this inquiry which addresses the issues that

may arise from the court judgments in the Bell Group.[2] We agree with the Law Council that any safe harbour provision needs to be carefully drafted.

In addition, we note that any requirement to inform ASIC or the ASX (beyond the existing disclosure requirements) could undermine the ability of the director to explore the restructuring or turnaround of the company outside of a formal appointment. Any public disclosure of financial distress may lead to the same (or more) issues than are currently experienced when appointing a voluntary administrator. In particular, creditors would not have the same personal liability protection for ongoing debts incurred by the company that they have in a voluntary administration (where the appointee is personally liable for payment) and they may be reluctant to continue to deal with the company. They may also more forcefully attempt to recover any debts owed.

Existing independence requirements would prohibit any pre-appointment adviser from taking a subsequent formal appointment to the company.

The Commission has proposed the establishment of an approved list of safe harbour advisers. ARITA recognises that it is important to ensure that directors looking to take advantage of “safe harbour” protection, as envisaged by ARITA, obtain restructuring advice from an appropriately experienced and qualified professional. In this regard ARITA accepts the Commission’s view that directors must “receive independent advice from registered advisers” and believes that only professionals who have obtained the qualification of ARITA Professional Membership or are a Registered Liquidator should be able to oversee this process given their innate high level understanding of insolvency law that is required to ensure directors appropriately discharge their duties. Persons without this level of qualification may place creditors and other stakeholders in an otherwise worse position.

The Commission has sought information from ARITA regarding presumptions of insolvency. Attached at Appendix A is an overview of the presumption of insolvency provisions pursuant to section 588E of the Corporations Act, including its application where a company fails to keep sufficient books and records.

In addition, we note that failure to maintain adequate books and records in accordance with s 286 of the Corporations Act is an offence of strict liability. Under s 344, if the director is found not to have taken all reasonable steps to comply with, or to secure compliance with, that section (among others), they are subject to a civil penalty under section 1317E. A director commits an offence if their contravention is dishonest. We note that ASIC’s statistics, as detailed in the below Table 1, indicate that non-compliance with this statutory requirement is consistently in the top 3 alleged offences reported by external administrators.

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[2] *Westpac Banking Corp v Bell Group Ltd (in liq) No 3* (2012) 89 ACSR1; [2012] WASCA 157

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Table 1 – Extract of Summary of findings—Initial external administrators' reports (2011–12 to 2013–14)

	2013–14	2012–13	2011–12
Top 3 nominated causes of failure	• Inadequate cash flow or high cash use (4,031 or 43% of reports) • Poor strategic management of business (3,975 or 42% of reports) • Trading losses (3,078 or 33% of reports)	• Poor strategic management of business (3,908 or 42% of reports) • Inadequate cash flow or high cash use (3,829 or 41% of reports) • Trading losses (2,989 or 32% of reports)	• Poor strategic management of business (4,449 or 44% of reports) • Inadequate cash flow or high cash use (4,048 or 40% of reports) • Trading losses (3,326 or 33% of reports)
Top 3 alleged possible misconduct	• s588G(1)–(2) Insolvent trading (5,425 or 57% of reports) • s286 and 344(1) Obligation to keep financial records (3,486 or 37% of reports) • s180 Care and diligence—Directors' and officers' duties (2,542 or 27% of reports)	• s588G(1)–(2) Insolvent trading (4,872 or 53% of reports) • s286 and 344(1) Obligation to keep financial records (3,263 or 35% of reports) • s180 Care and diligence—Directors' and officers' duties (2,302 or 25% of reports)	• s588G(1)–(2) Insolvent trading (5,075 or 50% of reports) • s286 and 344(1) Obligation to keep financia records (3,361 or 33% of reports) • s180 Care and diligence—Directors' and officers' duties (2,376 or 24% of reports)
Dividends to unsecured creditors	In 97% of cases, the dividend estimate was less than 11 cents in the dollar	In 97% of cases, the dividend estimate was less than 11 cents in the dollar	In 98% of cases, the dividend estimate was less than 11 cents in the dollar

The term 'reports' in this table means 'initial external administrators' reports'.

Source: ASIC Report 412: Insolvency statistics: External administrators' reports (July 2013 to June 2014)

There are other presumptions available, as to insolvency for the purposes of winding up a company (s 459C) and as to the state of mind of a director in relation to a declaration of solvency (s 494). Under the Bankruptcy Act, trustees are also assisted by presumptions, as to insolvency in relation to s 120 and s 121 voidable transaction proceedings, and as to the intent in making superannuation payments to defeat creditors under s 128B and s 128C.

4.4 Draft Recommendation 15.3 – Law should be amended to allow for "pre-positioned" sales

Key point 5: ARITA generally supports draft recommendation 15.3

Subject to the following comments, ARITA generally supports draft recommendation 15.3 that provision should be made in the Corporations Act for 'pre-positioned' sales where a non-distressed sale is organised in the period immediately prior to a formal insolvency appointment.

ARITA notes that there are two possible scenarios for pre-positioned sales:

1. a sale negotiated by or on behalf of the company and effected prior to the appointment of an external administrator; and
2. a sale negotiated prior to the appointment of an external administrator but effected post appointment.

ARITA believes that there is no requirement for the law to specifically permit a company's ability to sell the whole or part of its business pre-appointment (scenario 1). The existing director duties under sections 180-184 of the Corporations Act govern any such sale. Also, existing Corporations Act provisions (such as s 588FDA) enable an external administrator to challenge any pre-appointment sales that are "uncommercial", whether to a related party or not. However we suggest that there is scope for the law to be improved to make it easier to pursue related party claims, possibly by way of presumptions in favour of the liquidator.

In scenario 2, if the sale involves an unrelated party we suggest that the law should be amended to specifically allow for reliance on the pre-appointment sale process (i.e. a specific carve out).

However, where a sale is made to a related party there is no waiver of the common law sale obligations/duties.

Section 439A should be amended to include a statutory obligation to review and report on a pre-positioned sale under either scenario when reporting to creditors.

It is likely that a pre-positioned sale that is to occur post-appointment (type 2) will occur via a voluntary administration if the moratorium on ipso–facto clauses that is proposed is introduced into the law. This protection may be required after the appointment until the sale is completed.

This is another reason why the framework for use of a voluntary administration needs to be changed to a viability test rather than a solvency test. It is likely in a pre-positioned sale process that the company will be insolvent, but that there is a viable business to sell. As mentioned, voluntary administration will be the preferred option given the moratorium on creditors' claims that it offers.

We again stress, that the success of many of these reforms is reliant on the implementation of other suggested reforms and that they cannot be introduced on a stand-alone basis.

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4.5 Draft Recommendation 15.4 – Moratorium on ipso facto clauses

Key point 6: ARITA generally supports draft recommendation 15.4

Subject to the following comments, ARITA generally supports draft recommendation 15.4 that the Corporations Act should be amended such that ipso facto clauses that allow termination of contracts solely due to an insolvency event are unenforceable where a company is subject to external administration.

Noting ARITA's previous comments about safe harbour being a defence rather than a regime, ARITA notes that the moratorium on ipso facto clauses should only be applicable to companies in voluntary administration or a scheme of arrangement, where an informed and independent insolvency practitioner can assess relevant contracts and determine whether they should be continued.

ARITA is concerned that limiting the enforceability of ipso facto clauses during the Productivity Commission's draft recommended safe harbour proposal, where the company is still under the control of the directors, rather than an insolvency practitioner, could be open to abuse.

ARITA supports the consideration of alternatives to court involvement for straightforward procedural matters in voluntary administrations and liquidations; for example for requests for extensions of time, approval of contracts over 3 months, compromises of debt and a panel arrangement for the scheme approval process. At the same time, we think that a review of the need for court approval needs to be undertaken; it may be that many decisions can properly be made by the insolvency practitioner, with court review available.

The Commission asks about 'work arounds' that could be used to undermine the intent of draft recommendation 15.4. The reality is that most ipso facto clauses rely on trigger events beyond formal insolvency and we would see this as continuing and perhaps made more stringent. Certain types of contracts should also not be the subject of this restriction, in particular types of financing contracts.

ARITA suggests including a statutory provision enabling an external administrator to apply to the court for an order restricting the termination of a contract where they believe a supplier is undermining the intent of draft recommendation 15.4 and the termination of the contract is not in the best interests of the creditors of the company as a whole.

As detailed in ARITA's Policies Position Paper, we support the introduction of a specific provision enabling a Scheme of Arrangement, subject to court approval, to have a stand-alone moratorium against creditor claims, including a restriction on the exercising of ipso facto clauses.

ARITA notes that schemes of arrangement are more likely to be used by the very large end of the market or where legislative requirements make the use of voluntary administrations unattractive and impractical. An example was the HIH Insurance scheme which was

required due to the long tail nature of insurance liabilities. Consideration could be given to determining whether the current level of court involvement is necessary and whether it could be rationalised.

ARITA believes that schemes of arrangement can be made more usable via a moratorium, the limitation of ipso facto clauses and the use of an insolvency panel to limit the involvement of the court. However, the implementation only of a moratorium and limitation of ipso facto clauses still provides significant improvement to the process and we note that any company using a Scheme is likely to be large enough to bear the cost of court involvement.

ARITA supports the consideration of alternates to court approval for straightforward procedural matters in administrations and liquidations, for example for extensions of time, the approval of contracts over 3 months, and compromises of debts over $100,000) and a panel arrangement for the scheme of arrangement approval process. We have had regard to issues of non-judicial alternatives raised by the Commission in its 2014 Access to Justice Arrangements Report. We note that any alternative should include the ability to escalate any matters to the courts where it is determined appropriate. ARITA also supports the Commission's position that use of a panel of court appointed experts should be an option available to judges to use in appropriate cases.

In relation to the courts, we mention that both the Supreme Court in NSW, and the Federal Court of Australia, provide specialised judges for the hearing and determination of corporations and insolvency matters. We refer you to the websites of the respective courts.[3]

5 Corporate Insolvency

5.1 Draft Recommendation 15.5 – Small liquidations

Key point 7: ARITA supports draft recommendation 15.5

ARITA supports the Commission's draft recommendation 15.5 for a simplified 'small liquidation' process.

We support the Commission's recommendation of the appointment of the liquidator by rotation and believe that this is fundamental to ensure the independence of the appointee, particularly where there is no mandatory investigation of the company's affairs and the appointment of a completely independent practitioner with no relationship to the directors or any referral source will ensure creditor confidence in the process.

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[3] NSW Supreme Court: http://www.supremecourt.justice.nsw.gov.au/Pages/sco2_courtlists/court_sittings.aspx as to its Corporations List. Federal Court of Australia http://www.fedcourt.gov.au/case-management-services/case-allocation/individual-docket-system as to its Commercial and Corporations Court National Practice Area.

We note that some basic level of reporting to ASIC should be required to ensure that the insolvency event is appropriately recorded against the relevant company directors and to their director identity number (DIN).

ARITA strongly believes that a 'streamlined liquidation' needs to be based on a debtors' petition process where directors lodge a petition with ASIC together with a completed RATA and declaration that the company's liabilities are below $250,000 (similar to that under a personal insolvency debt agreement under Part IX of the *Bankruptcy Act*). ARITA considers that the $250,000 should only be liabilities to unrelated entities.

An appropriate penalty should be imposed for false declaration by directors.

We believe that a streamlined liquidation process could not be used in an application to the court by a creditor because a liquidator would be unable to readily determine the SME liquidation qualification thresholds.

We believe that the implementation of a streamlined process may encourage SME directors to take pro-active action in relation to their financially distressed companies. The fact that the liquidator is proposed to be funded will also mean that directors of such companies will be able to secure the appointment of a registered liquidator. At present, many insolvent companies do not proceed to liquidation voluntarily because there are no funds in the company from which the liquidator may be paid.

As to compulsory liquidations, ordered by the court, research commissioned by ARITA in 2012 showed that the insolvency profession in fact conducted court ordered liquidations at a total annual loss of $40 million in unpaid time and expenses.

ARITA recommends an expedited dividend payment process set out in our Policies Position Paper, with further specific enhancements modelled, to some extent, on the recent changes in the UK. These changes, made under the *Small Business, Enterprise and Employment Act* 2015 and the *Deregulation Act* 2015, include the use of internet based communications with creditors, including virtual meetings, electronic voting, meetings by correspondence or by deemed consent where appropriate. Creditors will not be required to prove for any "small debt" but will be treated as having done so for the purposes relating to the distribution of the company's property. That amount is to be prescribed by the rules, although it is anticipated that a small debt will be one not exceeding £1000.

Other suggestions we make are:

- There be a requirement for only one notice to call for proofs of debt and declare a dividend, including by way of a notice to the creditor of the amount detailed in the director's Report as to Affairs (RATA). The creditor would only need to lodge a claim if they dispute the RATA amount.
- No timeframe limit for payment (dividend must currently be paid within 2 months or process must start again)

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- No separate requirement for notification of adjudication unless claim rejected in full or part
- Restriction on the ability to challenge the adjudication of a proof of debt through the Courts below a set threshold.

The general use of the internet for the purposes of retaining and administering files, and providing access to creditors, is one that we would support. This would extend to the monitoring and regulation of the conduct of insolvencies by the profession. Such developments are currently being pursued in personal insolvency by AFSA, for example in relation to its AER Online facility.

ARITA does not believe that any changes are required to the existing director duties.

5.2 Draft Recommendation 15.6 – Modifications to receiverships

Key point 8: ARITA sees significant practical implementation issues with draft recommendation 15.6

ARITA notes the recommendation but sees significant practical implementation issues with potential significant costs for both unsecured and secured creditors. The implementation issues include, but may not be limited to:

- Receiver may not know who creditors are or have a legal right to the books and records if only appointed to one asset
- Books and records may be of poor quality so creditors cannot be identified
- Significant cost of holding meeting, including calling for and verifying claims to determine the right to vote
- What about voting rights of employees – significant uncertainty over the value of claims (redundancy v ongoing employment)
- If receiver prevented from selling the secured asset – what happens? Company to sell, how long do they have to sell? Does the secured creditor have the right to appeal to the court and who bears the cost of this?

ARITA does not have access to the quantitative data requested in this area and is unable to comment on the information request, however anecdotally we understand that secured creditors are less likely to enforce security via the appointment of a receiver. This appears to

be supported by the decline in receiver and manager appointments in recent years (833 in 2010-11, 792 in 2011-12, 688 in 2012-13, 544 in 2013-14)[4].

When consideration is given to the quantum of secured company debt in Australia the enforcement level is extremely low.

5.3 Draft Recommendation 15.7 – Fair Entitlements Guarantee scheme

Key point 9: ARITA supports draft recommendation 15.7

ARITA fully supports the Commission's recommendation that the Commonwealth should play a more active role as a creditor under the FEG regime and we have been encouraging this directly with the Department of Employment for some time.

5.4 Draft Recommendation 15.8 – Director identification number

Key point 10: ARITA supports draft recommendation 15.8

ARITA supports the implementation of a director identification number (DIN) as detailed in our Policies Position Paper. In particular, we see such a number as facilitative and useful for directors in establishing and maintaining their particular identity in the millions of company records that exist.

In addition to enabling consistent identification of directors across various companies, the implementation of a DIN will protect against fictitious directors and protect legitimate directors from having their identities misappropriated.

ARITA refers the Commission to previous submissions made by us in relation to phoenix activity and to the current Senate inquiry into construction industry insolvency due to report by 11 November 2015.

Trusts

ARITA notes that the matters raised in this information request require a more focused examination than is possible in this response. The difficulties with insolvent trusts are explained in our submission based on recent academic and other commentary which we have referenced. The CAMAC Report of 2012 – *Managed Investment Schemes* – addressed some issues concerning the related issues of the insolvency of schemes (MISs). There has been no government response to that report of which we are aware. Forestry MISs are themselves the subject of a Senate inquiry due to report by 17 September 2015.

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[4] ASIC Australian Insolvency Statistics released June 2015 - http://download.asic.gov.au/media/3257816/asic-insolvency-stats-series-1-published-june-2015.pdf

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We also note that New Zealand is proceeding to reform its law of trusts. An expert Trusts Reference Group has recently been established to provide advice to the government following on from the NZ Law Commission's report *Review of the Law of Trusts: A New Trusts Act for New Zealand* of March 2014. ARITA recommends that a similar and separate inquiry proceed into this issue.

6 Other issues

Penalties

As to penalties in corporate insolvency, we refer you to ASIC's report, of 20 March 2014, which outlines the penalties available for a range of corporate wrongdoing under the Corporations Act and other legislation administered by ASIC. ASIC released this report to enable consideration of whether the penalties are proportionate and consistent with those for comparable wrongdoing in other jurisdictions, such as Canada and the United Kingdom, and within the Australian context, across other domestic regulators and legislation administered by ASIC.

We also refer the Commission to *Convictions for summary insolvency offences committed by company directors*, Research in practice no. 30, Peter Keenan, Australian Institute of Criminology, February 2013 which analyses trends in the prosecution of insolvency offences committed by directors of insolvent companies.

Other information will be available from ASIC.

A comparison is the number of offences pursued by AFSA in relation to offences under the Bankruptcy Act where largely the same process, of referral of offences by trustees in bankruptcy, applies. In the UK, detailed comparable statistics are available from the Insolvency service. Also, stricter laws are being introduced under the UK *Small Business, Enterprise and Employment Act* 2015 that broaden the range of matters a court must consider when disqualifying a director; these now include consideration of the nature and extent of the harm the director misconduct has caused and the director's track record in running failed companies.

We also note that trustees in bankruptcy have a duty to refer alleged offences under the Bankruptcy Act to AFSA. AFSA assists trustees in that referral process by its "alleged offences web page" which provides a pre-referral enquiry (PRE) process and information on the actual referral of offences. AFSA has also provided training and education on the offence referral processes and regularly reports its prosecution outcomes.

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Appendix A - Presumptions of insolvency s 588E of Corporations Act

In respect of preferences (s 588FA) and uncommercial transactions (s 588FB), in order to establish that a transaction is voidable, it must be an "insolvent transaction": s 588FC. Similarly, personal liability of directors under s 588M, or of holding companies under s 588V, voidable circulating security interests under s 588FJ and circulating security interests created within six months under s 588FJ, all require that the company be insolvent at the time of the transaction.

Section 9 defines "insolvent" as having the meaning given by subs 95A(2). That sub-section states that if the company is not solvent it is insolvent. Subs 95A(1) states that a company is solvent if, and only if, it is able to pay all its debts as and when they fall due. Proving actual insolvency in these terms is difficult. For the purpose of certain recovery proceedings, s 588E provides presumptions of insolvency. This effectively shifts the onus of establishing solvency to the defendant in a recovery proceeding brought by a liquidator (s 588E(9)).

The recovery proceedings to which the presumptions apply are:

1. Voidable transactions under s 588FF (Unfair preferences and uncommercial transactions);
2. Recovery under s 588FH from guarantors who have had a liability discharged because of a voidable transaction;
3. Proceedings under s 588FJ in respect of circulating security interests created within 6 months of the relation back day; and,
4. Insolvent trading recoveries from directors under s 588M and holding companies under s 588W.

There are three presumptions of insolvency for the purposes of these recovery proceedings.

Inadequate books and records

Where a company fails to keep books and records in compliance with s 286 throughout a period, it is presumed insolvent throughout that period (s 588E(4)). Importantly, this presumption cannot be used in a recovery of an unfair preference involving a non-related party (s 588E(7)). The presumption will also not apply where the contravention is minor or technical, or where it would prejudice an individual and the breach was not their fault (s 588E(5) and s 588E(6)).

Proof in other proceedings

If insolvency has been proved in one case, it may then be presumed in other cases (s 588E(8)).

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Continuing presumption

If it is proved or must be presumed that the company was insolvent at any time in the twelve months ending on the relation back day, it will be presumed that it was insolvent throughout the entire period up to the relation back day (s 588E(3)).