Reducing barriers to Business Dynamism Project Team
The Productivity Commission
Australian Government

3 July 2026

To Whom It May Concern

Productivity Commission Inquiry: Reducing barriers to business dynamism in Australia

I am an Associate Professor at the Adelaide Law School, specialising in Corporate Law and Insolvency Law. I recognise the critical importance of a regulatory framework that supports entrepreneurship and that allows business to thrive. This is particularly true in respect of small and medium enterprises (SMEs), who make a critical contribution to economies across the world,[1] and also in Australia.[2] I therefore appreciate the opportunity to support the valuable work being done by the Australian Government's Productivity Commission through its Inquiry: Reducing barriers to business dynamism in Australia, by way of this Submission.

My submission aims to address one part of the Barriers to business entry, expansion and exit, namely '**The design, operation and integrity of insolvency frameworks'**, focussing on:

- Principles and objectives underpinning Australia's insolvency frameworks;
- Further harmonisation of Australia's corporate and personal insolvency frameworks;
- Integrity of Australia's insolvency frameworks – Insolvent trading.

[1] Data indicates that SMEs 'account for about 90 percent of businesses and more than 50 percent of employment worldwide'; see [1] International Finance Corporation (2024), 'IFC and Small and Medium Enterprises', © World Bank, License se: CC BY-NC-ND 3.0 IGO, available at https://openknowledge.worldbank.org/handle/10986/42083.
[2] See Australian Government, Small Business and Family Enterprise Ombudsman, 'MSME small business facts', available at https://www.asbfeo.gov.au/msme-small-business-facts.

1. Principles and objectives underpinning Australia's insolvency frameworks

It is trite that insolvency frameworks aim to balance the interests of debtors who cannot pay their debts, the interests of creditors whose claims will not be satisfied, and the interests of society more broadly.[3] It is also well-known that it is an ongoing challenge to appropriately balance these competing interests. As part of this broader issue, it is important not to lose sight of economic relevance of effective insolvency law frameworks, both in terms of perceptions of the effectiveness of the frameworks and the reality, as expectations will shape behaviour.

Of relevance is the way in which insolvency law frameworks could support entrepreneurial risk-taking – higher rates of innovation, and market entry by SMEs in particular, could be encouraged through operation of an insolvency law framework that allows entrepreneurs the 'freedom to fail'. It could be argued that the separate legal entity of the corporation offers protection against business failure thus allowing for freedom to fail, and it is true that many SMEs may be operating as companies. However, the way in which personal finances of entrepreneurs, especially in the context of SMEs, are interwoven with the finance of the business could lead to this 'protection' being largely illusory. The personal assets of a director who personally guarantees repayment of company loans are vulnerable to creditor claims, with the director potentially being exposed to becoming bankrupt as a result. It is therefore important to not only consider the impact of the corporate insolvency framework in respect of entrepreneurial risk-taking, but also that of the personal insolvency framework.

Personal insolvency being a real risk for SME entrepreneurs, even where the business is conducted through the vehicle of a corporate entity,[4] could discourage entrepreneurial risk-taking. The lack of adequate alternatives to bankruptcy and the persistent stigma attached to bankruptcy[5] could be problematic in this context. It is thus important to provide viable

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[3] See, eg, The World Bank: Insolvency and Creditor/Debtor Regimes Taks Force, Working Group on the Treatment of Insolvency of Natural Persons, 'Report on the Treatment of the Insolvency of Natural Persons' (2014), 2 (World Bank Report), [57]-[69].

[4] AFSA reported an increase of 6.2% in personal insolvencies in the March quarter 2026, with just under one-third (29.2%) of these being 'business-related', i.e., a personal insolvency where a person has potentially operated a business as a sole trader, in partnership, or as a director in a company within the last 5 years. See AFSA reports increase in personal insolvencies in March quarter 2026 | Australian Financial Security Authority. During the previous financial year, most business-related insolvencies were bankruptcies (88.2%). During the 2024-25 financial year, 17.9% individuals furthermore identified business failure as their reason for entering insolvency. See State of the Personal Insolvency System 2024-25 | Australian Financial Security Authority. According to data provided by AFSA, the percentage of individuals attributing their entry into insolvency to business failure has been rising steadily since 2022-23. See State of the Personal Insolvency System 2024-25 | Australian Financial Security Authority, Figure 7.

[5] The bankruptcy stigma is well-documented. See, eg, Howell N and Mason R, 'Reinforcing Stigma or Delivering a Fresh Start: Bankruptcy and Future Engagement in the Workforce' (2015) 38(4) *UNSW LJ* 1529, 1530; Sullivan TA, Warren E and Westbrook JL, 'Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings' (2006) 59 *Stanford Law Review* 213, 214-215, 254. See also Ali P, O'Brien L and Ramsay I, 'Bankruptcy and Debtor Rehabilitation: An Australian Empirical Study' (2017) 40 *MULR* 688, 708 (Ali, O'Brien and Ramsay 'Debtor Rehabilitation'), for a report on the extent to which bankrupt debtors describe the experience of stigma associated with bankruptcy.

alternatives to bankruptcy and to address the aspects of personal insolvency that allow the stigma to endure.

1.1 Alternatives to bankruptcy

Current personal insolvency alternatives to bankruptcy include the personal insolvency agreement (PIA)[6] and the debt agreement.[7] For SME entrepreneurs operating as sole traders or partnerships, these options may not provide a viable alternative to bankruptcy – the debt agreement is not generally available to all debtors due to operating under strict thresholds,[8] while many debtors may be excluded from utilising he PIA due to the cost involved. For SME entrepreneurs who are directors of companies and face personal insolvency due to business failure, the same considerations apply. In addition to these considerations, the failure of the business could result in the debtor not having sufficient income to participate in any of these alternatives, with bankruptcy left as the only option to obtain debt relief. Addressing the bankruptcy stigma is therefore relevant and important.

1.2 Bankruptcy stigma

Elements of the bankruptcy framework that contribute to maintaining the bankruptcy stigma include, among other things, the indefinite and public availability of personal information of bankrupts on the National Personal Insolvency Index (NPII) and the length of the discharge period.

A 2023 Personal Insolvency Discussion paper proposed removing the NPII record seven years after discharge from the public record.[9] While it was announced in July 2024 that the government will introduce this reform,[10] it has not yet occurred.

Recognising the way in which the indefinite NPII record contributes to bankruptcy stigma, the proposal for removal of the NPII record from the public register after seven years is supported and it is submitted that it should form part of an insolvency law reform package.

The general discharge period in Australia is three years,[11] which could be extended to five or eight years under particular circumstances.[12] This is longer than the discharge in jurisdictions

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[6] Provided for in terms of the *Bankruptcy Act 1966* (Cth), Pt X.
[7] Provided or in terms of the *Bankruptcy Act 1966* (Cth), Pt IX.
[8] *Bankruptcy Act 1966* (Cth), s 185C. The latest indexed threshold amounts are available at https://www.afsa.gov.au/professionals/resource-hub/indexed-amounts.
[9] Australian Government, Attorney-General's Department *Personal insolvency discussion paper* (September 2023).
[10] Attorney-General's Department, The Hon Mark Dreyfus KC MP, Media Release – Bankruptcy law reforms (8 July 2024), available at https://webarchive.nla.gov.au/awa/20240804141555/https://ministers.ag.gov.au/media-centre/bankruptcy-law-reforms-08-07-2024.
[11] *Bankruptcy Act 1966* (Cth), s 149.
[12] *Bankruptcy Act 1966* (Cth), s 149A.

such as the UK and Canada. In the UK, the general discharge period is one year.[13] Canada provides for a more nuanced discharge scheme, with the length of the discharge period being dependent on whether it is a first or subsequent bankruptcy, and also on whether the bankrupt is liable for income contributions.[14] While the option of a shorter discharged period of one-year has been mooted previously,[15] concerns were raised about this leaving insufficient time to administer complex estates or non-compliant bankrupts. These concerns could be accommodated by 'exceptions' to a shorter discharge period, similar to the Canadian model.

It is submitted that the general discharge period be reduced to no more than one year, allowing for a longer discharge period by way of exception.

2. Further harmonisation of Australia's corporate and personal insolvency frameworks

In a recent article published in the *Insolvency Law Journal* (copy of the article available on request), I argued that the

> current fragmentation of insolvency law principles across various pieces of legislation leaves ample room for confusion and uncertainty, especially in instances where multiple statutes potentially apply to the same insolvency, or where it is unclear which legislation applies. This issue is nowhere more apparent than in the case of insolvency of companies that operate in partnership.[16]

For the reasons mentioned in the article, as well as a similar view expressed in a Submission to the Parliamentary Joint Committee Inquiry into Corporate Insolvency in Australia,[17] this view still holds true and I submit that

> legislative review and law reform are required to ensure coherent, comprehensive insolvency legislation that sufficiently recognises the intrinsic differences between various business structures, and distinctive policy principles and theories that apply in case of the insolvency of these different structures. At the same time, it would be worthwhile to revisit partnership legislation that has been in operation for more than a century in most of the Australian jurisdictions, in order to remove inconsistency in use of terminology and consider the fact that the ability to be a partner is not restricted to natural persons and extends to corporations.

[13] *Insolvency Act 1986* (UK), s 279(1).
[14] *Bankruptcy and Insolvency Act* (R.S.C., 1985, c.B-3), s 168.
[15] Australian Government Attorney-General's Department, Ministerial Roundtable on Personal Insolvency: summary (March 2023), available at [Ministerial Roundtable on Personal Insolvency: summary | Treasury.gov.au].
[16] Sulette Lombard, 'What happens when companies in partnership become insolvent?' (2025) 33 *Insolvency Law Journal* 198, 198-199.
[17] Sulette Lombard, Submission n0 46, par [2] to Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into Corporate Insolvency in Australia (30 November 2023).

Legislative review also presents an opportunity to consider restructuring options for partnerships in financial distress – an aspect that has largely been neglected.[18]

It is submitted that further harmonisation of Australia's corporate and personal insolvency frameworks is required, also taking into consideration the role that the partnership business structure has in this context.

3. Integrity of Australia's insolvency frameworks – Insolvent trading

The insolvent trading duty has been the subject of extensive academic analysis,[19] as well as judicial interpretation.[20] This duty also featured prominently in the Parliamentary Joint Committee on Corporations and Financial Services inquiry into corporate insolvency in Australia, with many submissions being critical of the current regime to varying degrees and for different reasons.[21]

Many have criticised the insolvent trading duty and have done so for various reasons – criticism against the duty can broadly be categorised under three points, namely the content or framing of the insolvent trading duty, the fact that the insolvent trading regime does not strike an appropriate balance between competing policy objectives, and poor enforcement of the duty. The third point of criticism is likely due to broader systemic issues, rather than the content of relevant statutory provisions.

At first glance the duty to prevent insolvent trading appears deceptively clear and certain as it deals with specific terms rather than broad concepts. However, these specific terms have proven to be very problematic in practice, leading to the conclusion that any clarity and certainty

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[18] Lombard, above n 16, at 211.

[19] See, eg, Colin Anderson and David Morrison, 'Should Directors be Pursued for Insolvent Trading where a Company has Entered into a Deed of Company Arrangement?' (2005) 13 *Insolvency Law Journal* 163; Jason Harris, 'Director Liability for Insolvent Trading: Is the Cure Worse than the Disease?' (2009) 23(3) *Australian Journal of Corporate Law* 1; Patrick J Lewis, 'Insolvent trading defences after Hall v Poolman' (2010) 28(6) *Company and Securities Law Journal* 396; Stacey Steel and Ian Ramsay, 'Insolvent Trading in Australia: A Study of Court Judgments from 2004 to 2017' (2019) 27(3) *Insolvency Law Journal* 156; Michael D Wells, 'Insolvent Trading Claims against Creditors: Liability in Post-Buzzle Australia' (2023) 31(3) *Insolvency Law Journal* 158, 159; L Taylor and S Lombard, 'Statutory Principles Governing Director Conduct When a Company Is in Financial Distress – A Trans-Tasman Comparison' (2024) *Journal of Corporate Law Studies* 515, https://doi.org/10.1080/14735970.2024.2403225; etc.

[20] See, eg, *ASIC v Plymin (No 1)* (2003) 175 FLR 124; *Elliott v ASIC* (2004) 10 VR 369; *Hall v Poolman* (2007) 215 FLR 243; *Quin v Vlahos* (2021) 64 VR 319; *Taylor (as liquidator of Heading Contractors Pty Ltd (in liq)(ACN 067 151 688) v Heading* (2021) 154 ACSR 456; *Newman v Hartwig* (2024) 73 VR 326; *Re Shire Lind Developments (NSW) Pty Ltd (in liq)* [2024] NSWSC 1454; *Copeland v Murace (No 2)* [2024] FCA 957; *Hayes v Sinadinos* [2024] FCA 885; etc.

[21] See, eg, Australian Institute of Credit Management, Submission 9, 2 to Parliamentary Joint Committee on Corporations and Financial Services, Corporate Insolvency in Australia (29 November 2022); Michael Brennan, Submission 73, 7 to Parliamentary Joint Committee on Corporations and Financial Services, Corporate Insolvency in Australia (30 January 2023); King & Wood Mallesons, Submission 45, 8-9 to Parliamentary Joint Committee on Corporations and Financial Services, Corporate Insolvency in Australia (30 November 2022); Mark Wellard, Submission 51, 4-5 to Parliamentary Joint Committee on Corporations and Financial Services, Corporate Insolvency in Australia (30 November 2022).

are illusory. The duty in its current form is also likely to be obscure to particularly directors of SME companies – a significant point of criticism as this type of company represents the vast majority of companies in Australia and other jurisdictions, and a point of particular relevance to this Submission.

Of particular relevance for the purposes of this contribution is the criticism regarding balancing competing policy objectives, and the way in which the duty impedes entrepreneurialism. On the one hand, it is important to ensure director accountability and to protect interests of corporate creditors. On the other hand, it is critical to allow directors sufficient freedom to take appropriate business risks. This policy imperative is emphasised in law reform recommendations in respect of the insolvent trading type duty in Australia, the UK and New Zealand.[22] Detractors of the insolvent trading (type) duty express concerns that the fear of personal liability could cause directors to become too risk averse, enter external administration processes prematurely, or even lead to a reluctance to take up board positions.[23]

3.1. Protection against insolvent trading liability

The tension between the policy objectives of creditor protection and entrepreneurial freedom to take appropriate business risks is clear, and it is critical that the relevant statutory framework strikes an appropriate balance between these objectives. In Australia, targeted measures aimed at balancing these competing policy objectives include statutory defences against insolvent trading liability, as well as access to a safe harbour, as mentioned previously. Whether these measures are successful in achieving that balance is an open question. The protection afforded by statutory defences is questionable – directors rarely appear to be successful when attempting to rely on the targeted statutory defences, with an empirical study conducted approximately 20 years ago showing that 75 per cent of defences argued in insolvent trading cases were unsuccessful.[24] It is likely that directors are still finding it challenging to avoid personal liability through reliance on one or more of these defences – commentators note that '[a]lthough the defences appear to be fairly broad, the courts have interpreted them quite restrictively'.[25] The limited protection offered by the statutory defences raised concerns about the insolvent trading duty not achieving an appropriate balance between the competing policy

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[22] See Australian Law Reform Commission, *General Insolvency Inquiry* (ALRC R 45, 1988), [277] referring to the importance of 'the inception and growth of business'; Cork Review Committee Report (UK), *Report on Insolvency Law and Practice* (Final Report, Cmnd 8558, 1982), [1805], citing the importance of 'the inception and growth of business'; Law Commission (NZ), *Company Law: Reform and Restatement* (Report, NZLC R 9, 1989), [22]-[23] recognising 'the benefits for investors and society arising from the use of the corporate form as a vehicle for taking business risks'.

[23] Thomas Telfer, 'Risk and Insolvent Trading' in Ross Grantham and Charles Rickett (eds), *Corporate Personality in the 20th Century* (Hart Publishing, Oxford, 1998), 127, 135-136. See also *Mainzeal,* [195].

[24] Paul James, Ian Ramsay and Polat Siva, *Insolvent Trading – An Empirical Study' Clayton Utz and Centre for Corporate Law and Securities Regulation, the University of Melbourne – Research Report* (Report, 2004), 34.

[25] Michael Murray and Jason Harris *Keay's Insolvency* (11th ed, Thomson Reuters 2022), 695. See also Timothy Bost, 'Smooth Sailing for Directors: Using the Safe Harbour to Restructure Insolvent Companies in Australia' (2020) 28(2) *Insolvency Law Journal* 69, 80; Anil Hargovan, 'Governance in Financially Troubled Companies: Australian Law Reform Proposals' (2016) 34 *Company and Securities Law Journal* 483, 487; Patrick J Lewis, 'Insolvent trading defences after Hall v Poolman' (2010) 28 *Company and Securities Law Journal* 396, 403.

objectives mentioned above, and also about limiting the ability of directors to implement informal restructuring actions.

Although the subsequent introduction of a safe harbour regime[26] has no doubt improved the balance between various policy objectives, the framework is far from perfect. Some express doubt about its utility due to the fact that it would be difficult for directors to rely on.[27] The PJC Report also notes a number of issues in relation to the safe harbour protection, including eligibility criteria, and the cost of the scheme which may render it inaccessible to SMEs in particular.[28] The government response to the review to the safe harbour has not necessarily addressed all issues, and potentially created novel ones, such as use of terminology such as 'financial distress' which is not defined.[29]

The appropriate balancing of competing policy objectives is also problematic in the UK and New Zealand in respect of this type of duty. The New Zealand Law Commission announced a Review of 'Directors' duties and liabilities' in 2025, particularly due to concerns having been raised by the New Zealand Supreme Court about some of the directors' duties when a company is at risk of insolvency.[30]

3.2. An alternative option

A suggestion that is worth exploring is whether the duty of care and diligence may not be better able to achieve the required balance between protecting the interests of creditors and allowing sufficient freedom for entrepreneurial risk-taking.[31] The duty of care and diligence is well-developed and supported by an extensive body of jurisprudence and it would be advantageous to retain terminology and concepts that are familiar to the legal profession and judiciary, rather than introducing a new duty. Statements by the New Zealand Supreme Court in *Mainzeal*[32] may already point to first steps in incremental progression towards blurring of the boundaries between typical 'insolvent trading' type duties, and the duty of care and diligence. These statements include the court's stance that a standard of 'reasonableness' may be applied in assessing directors' decisions in relation to compliance with the reckless trading duty[33] and duty in relation to obligations;[34] recognition of the fact that such decisions will involve a 'business

[26] In terms of the *Treasury Laws Amendment (2017 Enterprise Incentives No 2) Act 2017* (Cth).
[27] See, eg, Corey Byrne, 'Rescuing the Rescue Culture? Australian Corporate Restructuring After the Safe Harbour and Ipso Facto Reforms' (2019) 27(3) *Insolvency Law Journal* 122, 137-143.
[28] Parliamentary Joint Committee on Corporations and Financial Services, *Report on Corporate Insolvency in Australia* (Report, July 2023), [7.30]-[7.31].
[29] CPA Australia Ltd, Submission no 11, 3 to Parliamentary Joint Committee on Corporations and Financial Services, Corporate Insolvency in Australia (29 November 2022).
[30] https://www.lawcom.govt.nz/our-work/directors-review.
[31] See, eg, L Taylor and S Lombard, 'Directors' Duties in Sections 135 and 136 of the Companies Act 1993 after *Mainzeal*' (2025) 28(2) *New Zealand Business Law Quarterly* 77.
[32] *Yan v Mainzeal Property & Construction Ltd (in liq)* [2023] NZSC 113
[33] *Companies Act 1993* (NZ) s 135.
[34] Ibid s 136.

judgment'; and that 'in their decision-making as to whether to allow continued trading, the directors applied reasonable *care, skill and diligence*'.[35]

There are existing protections available to directors in so far as compliance with the duty of care and diligence is concerned, and these could be equally appropriate in respect of director conduct in the context of a company in financial distress. Australian directors are provided with statutory protection under the business judgment rule in relation to compliance with the duty of care and diligence. In terms of the relevant provision of the *Corporations Act 2001* (Cth), directors who make a business judgment are deemed to have met their obligations under both the statutory and general law duty of care and diligence, provided that they made the judgment in good faith and for a proper purpose; do not have a material personal interest in the subject matter of the judgment; are informed about the subject matter of the judgment to the extent that they reasonably believe to be appropriate; and rationally believe that the judgment is in the best interests of the corporation.[36] The term 'business judgment' is defined as 'any decision to take or not take action in respect of a matter relevant to the business operations of the corporation'.[37] The business judgment rule has been the subject of extensive academic commentary,[38] and has also been considered in a number cases.[39]

The Explanatory Memorandum to the Corporate Law Economic Reform Bill 1998 (Cth) provides clear indication of the intention achieve a balance between competing policy objectives of entrepreneurial freedom and risk-taking on the one hand, and accountability on the other, through the business judgment rule:

> The fundamental purpose of the business judgement rule is to protect the authority of directors in the exercise of their duties, not to insulate directors from liability. While it is accepted that directors should be subject to a high level of accountability, a failure to expressly acknowledge that directors should not be liable for decisions made in good faith and with due care, may lead to failure by the company and its directors to take advantage of opportunities that involve responsible risk taking.[40]

[35] *Mainzeal* [273] (emphasis added).
[36] *Corporations Act 2001* (Cth) s 180(2); see generally *ASIC v Rich* (2009) 75 ACSR 1; *ASIC v Adler* (2002) 41 ACSR 72.
[37] *Corporations Act 2001* (Cth) s 180(3).
[38] See, eg, Andrew Clarke, 'The Business Judgment Rule – Good Corporate Governance or Not' (2000) 12(2) *Australian Journal of Corporate Law* 85; J Varzaly, 'Protecting the Authority of Directors: An Empirical Analysis of the Statutory Business Judgment Rule' (2012) 12(2) *Journal of Corporate Law Studies* 429; J du Plessis and J Mathiopoulos, 'Defences and Relief from Liability for Company Directors: Widening Protection to Stimulate Innovation' (2016) 31 *Australian Journal of Corporate Law* 287; J Harris and H Hargovan, 'Still a Sleepy Hollow" Directors' Liability and the Business Judgment Rule' (2016) 31 *Australian Journal of Corporate Law* 319; Nicholas Todd, 'The Future of the Statutory Business Judgment Rule: Balancing Accountability and Protection' (2021) 38(7) *Company and Securities Law Journal* 513.
[39] See, eg, *ASIC v Rich* (2009) 236 FLR 1; *ASIC v Macdonald (No 11)* (2009) 256 ALR 199; *ASIC v Mariner Corp* (2015) 327 ALR 95; *Pacific Current Group Ltd v Fitzpatrick* [2024] FCA 1480.
[40] Explanatory Memorandum to the Corporate Law Economic Reform Bill 1998 (Cth), [6.3].

The business judgment rule acts as a rebuttable presumption in favour of directors, and in that way provides broader protection against director liability compared to the defences available in respect of an alleged breach of the insolvent trading duty.

For completeness sake, it should also be mentioned that directors are protected in respect of reasonable reliance on information or expert advice given by, for example, competent employee or professional advisers, by way of a rebuttable presumption that the reliance was reasonable if made in good faith and after having made an independent assessment of the information.[41] This defence is somewhat similar to the defence against insolvent trading liability in relation to reasonable reliance on information regarding the company's solvency.[42]

It thus appears as if there are sufficient protections in place with respect to the duty of care and diligence to balance responsible risk taking with accountability. Although the same may be said in respect of the current insolvent trading legislative framework, a key distinction between the two duties and relevant defences remains the fact that the defences available in respect of insolvent trading liability are narrow and complicated, similar to the duty itself, which may cause difficulty with respect to the opportunity to adequately consider contextual factors when assessing director conduct.

Ultimately, I agree that

> [i]f a corporate entity is viewed, as it should be, as an amalgam of a wide array of stakeholders (shareholders, directors, employees, suppliers, lenders, customers…even the community at large), rather than just creditors, then it can be readily be seen that the burden on directors should be governed by the very flexible, yet comprehensive, general statutory and common law duties.[43]

It is submitted that the insolvent trading legislative framework is not fit for purpose, does not succeed in achieving an appropriate balance between competing policy objectives, ultimately inhibiting entrepreneurialism, and that consideration should be given to abolishing this duty, given that the modern duty of care and diligence may well serve a similar function, but with more success in balancing competing policy objectives.

I would be happy to discuss or elaborate any of the comments in this Submission.

Yours sincerely,

[41] *Corporations Act 2001* (Cth) s 189.
[42] Ibid s 588H(3).
[43] King & Wood Mallesons, Submission 45, 8-9 to Parliamentary Joint Committee on Corporations and Financial Services, Corporate Insolvency in Australia (30 November 2022).

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APPENDIX A

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 Secretary

Inquiry into Corporate Insolvency in Australia

I am an experienced academic with a keen research interest in insolvency law. Aspects of my research will be relevant to Terms of Reference (1) recent and emerging trends in the use of corporate insolvency and related practices in Australia; (3) other potential areas for reform; and (7) any related corporate insolvency matters.

In relation to the above Terms of Reference, I would like to comment on the use and regulation of litigation funding in insolvency; the intersection of insolvency law principles and legal frameworks when different types of business structures are being wound up, specifically in relation to companies operating in partnerships; as well as the insolvency law framework in general.

(1) Use and regulation of commercial litigation funding in insolvency

I have been involved in numerous research projects;[44] publications;[45] presentations;[46] and Parliamentary Inquiries[47] in respect of the use of commercial litigation funding in insolvency and have closely followed law reform in this area. My position, based on my research, is that commercial litigation funding in insolvency is a very useful mechanism that enables insolvency practitioners to pursue proceedings that may not have been possible otherwise, ultimately for the benefit of unsecured creditors and/or to achieve broader policy objectives.[48] I consequently expressed my concerns about the appropriateness of regulations and proposed regulations in respect of litigation funders and litigation funding agreements, particularly regarding the extent to which these measures could potentially restrict use of litigation funding in insolvency.[49] I therefore welcome the dismantling and current attempts to unwind most of these regulatory measures. However, this does mean that the previous regulatory gap in respect of insolvent litigation funding will remain.

The regulatory gap in respect of insolvent litigation funding could, to some extent, be addressed by court approval of insolvent litigation funding agreements. Due to the operation of provisions such as s 477(2B) of the *Corporations Act 2001* (Cth), which indicates that Court or creditor approval is required for agreements that will continue for more than three months, as well as ss 90-20 and 90-15 of the *Insolvency Practice Schedule (Corporations)*(IPSC), which enables insolvency practitioners to seek directions from Court,[50] a practice has developed where insolvency practitioners often seek judicial approval for entering into funding agreements with commercial funders. As a result, a set of 'judicial guidelines' appears to have developed over the years in respect of insolvent litigation funding

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[44] Co-lead on INSOL International funded research project: 'A Cross-Jurisdictional Comparison of the Use of Commercial Litigation Funding in Insolvency in Selected Jurisdictions' (INSOL International ©, November 2022).
[45] S Lombard and C Symes, 'Insolvent litigation funding and new regulatory measures: A missed opportunity or blessing in disguise?' (2022) 37 *Australian Journal of Corporate Law* 185; S Lombard and C Symes, 'Judicial Guidelines for Insolvent Litigation Funding Agreements' (2020) 28 *Insolvency Law Journal* 165.
[46] S Lombard, 'Litigation Funding in Insolvency Proceedings Around the World: Theory, Evidence and Policy' – Invited presentation at the Singapore Global Restructuring Initiative (SGRI) Inaugural Conference (Singapore, November 2022); S Lombard, 'Litigation Funding in Liquidation: South Africa and Australia' – Invited presentation at the Insolvency and Business Rescue Colloquium (University of Pretoria, South Africa, October 2022); S Lombard (invited as panel member) 'Recent Developments in Litigation Funding' Australian Law Council National Insolvency Workshop (Sydney, October 2022); S Lombard, 'A Cross-Jurisdictional Comparison of the Use of Commercial Litigation Funding in Insolvency', INSOL International Conference (Academics' Colloquium)(London, June 2022); S Lombard, 'Litigation Funding in the Insolvency Context: An Australian Perspective', INSOL International Conference (Academics' Colloquium)(Singapore, 2019)
[47] S Lombard and C Symes, Invited submission to the Senate Inquiry into Corporations Amendment (Improving Outcomes for Litigation Funding Participants) Bill 2021 (2021, submission no 6); S Lombard and C Symes, Response to Questions on Notice from Senate Inquiry into Litigation Funding and the Regulation of the Class Action Industry (2020); S Lombard and C Symes, Submission to the Senate Inquiry into Litigation Funding and the Regulation of the Class Action Industry (2020, submission no 4).
[48] The judiciary noted the relevance of the 'public interest' element in enabling insolvency practitioners to pursue actions against directors and for the purpose of antecedent transactions in, for example, *Hall v Poolman* (2009) 71 ACSR 139, at [187] and *Marsden v Screenmasters Australia Pty Ltd, Re Cardinal Group Pty Ltd (in liq)* (2015) 110 ACSR 175, at [63].
[49] See sources cited in notes 2 – 4.
[50] Previously provided for in terms of the *Corporations Act 2001* (Cth), s 479(3), which has now been repealed.

agreements.[51] These 'guidelines' have been useful to clarify some of the parameters within which insolvent litigation funding agreements operate. Court approval of litigation funding agreements therefore fulfils an important quasi-regulatory function and enables continued development of judicial guidelines in respect of these types of agreements.

However, this system, useful as it is, is far from ideal as Court approval for litigation funding agreements is not mandated. For example, Court approval for a litigation funding agreement may not necessarily be sought where the insolvency practitioner is able to obtain creditor approval for the agreement,[52] or where the insolvency practitioner assigns the bare cause of action to a funder instead of entering into a typical funding arrangement (where litigation will be funded in return for a portion of the proceeds of a successful outcome).[53]

I submit that an obvious solution to this issue is statutory reform to the effect that Court approval for insolvent litigation funding agreements be mandated. Any statutory reform in this area should carefully consider –

- the need for Court approval for typical funding arrangements, compared to funding arrangements that involve the assignment of the bare cause of action;
- the nuance difference between the approach taken by the Court when approval is sought under s 477(2B), compared to directions being sought under ss 90-15 of the IPSC - the Court recognises that a different approach is required when requested to approve a litigation funding agreement on the basis of s 90-15, due to the fact that 'the granting of a direction under s 90-15 of the Schedule requires a *wider inquiry*',[54] because of the fact that 'a direction – unlike an approval under s 477(2A) or s 477(2B) – exonerates the liquidator from personal liability'[55];
- alignment of principles in respect of funding provided by commercial funders, and funding provided by unsecured creditors for the purpose of obtaining the statutory priority provided for in terms of s 564 of the *Corporations Act 2001* (Cth).

(2) Winding-up of different types of business structures – companies operating in partnerships

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[51] See S Lombard and C Symes, 'Judicial Guidelines for Insolvent Litigation Funding Agreements' (2020) 28 *Insolvency Law Journal* 165 for more detail.
[52] *Corporations Act 2001* (Cth), s 477(2B).
[53] ISPC, s 100-5.
[54] *Re Macro Realty Developments Pty Ltd (No 2)* [2020] FCA 649, [11] (emphasis added). Also see *Re City Pacific Ltd* [2017] NSWSC 784, where the Court expressed similar sentiments in respect of the the distinction between s 477(2B) and the predecessor provision to s 90-15 – s 479(3).
[55] *Re Macro Realty Developments Pty Ltd (No 2)* [2020] FCA 649, [11], with reference to *Re Minken Pty Ltd (in liq); Minken Pty Ltd (in liq) v Entwisle* [2019] VSC 288, [23] – [24]. See also *Re Gerard Cassegrain & Co Pty Ltd (in liq)* [2013] NSWSC 257, in which case the liquidator sought approval for entering into the litigation funding agreement on the basis of s 477(2B), as well as directions under s 479(3) that entering into the agreements would be justified, in order to obtain the protection of the latter provision.

A significant amount of interest has been generated regarding the insolvent liquidation of corporate trustees, both in terms of academic commentary[56] and public consultation by Government.[57] Although the Australian High Court provided clarity around some of the uncertainties in this context in *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth*,[58] there are questions that remain unanswered and these, as well as ways in which to address them, will no doubt feature in some of the Submissions to this Inquiry. This issue has highlighted the challenges that exist where distinct legal frameworks intersect when winding up different types of business structures – challenges that also exist in respect of insolvent winding-up of companies operating in partnership. This is due to the fact that the Australian insolvency law framework provides for separate legislation in respect of insolvent corporations (*Corporations Act 2001* (Cth)), and insolvent partnerships (*Bankruptcy Act 1966* (Cth) and the partnership legislation for the specific jurisdiction).

A particular question that arises in this context is whether assets realised by the insolvency practitioner/s should be applied in accordance with the provisions of the *Corporations Act 2001* (Cth), or in accordance with the provisions of the *Bankruptcy Act 1966* (Cth) and relevant state partnership legislation. Priority of distribution will not only affect the position of claims by unsecured creditors, but also of secured creditors holding circulating security interests and of employee claims, due to the operation of s 561 of the *Corporations Act 2001* (Cth). In terms of this provision, certain employee claims will enjoy a statutory priority over any claims of the secured creditor holding the circulating security interest. The way in which the protection of employee claims is dealt with will also have implications in respect of any payments made under the Fair Entitlement Guarantee scheme. When a payment is made to an employee under this government-funded scheme, the Commonwealth becomes a priority creditor of the company in terms of s 560 of the *Corporations Act 2001* (Cth). However, this 'super-priority' in respect of employee claims (and consequently, any payments made under the FEG scheme) only exists in terms of corporations law principles, and will not be available when distribution principles under bankruptcy/partnership law legislation are applied.

There are conflicting Australian judgments in relation to this issue. In some instances, the Court held that distribution should take place on the basis of corporate law principles,[59]

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[56] See eg Nuncio d'Angelo, 'When is a trustee or responsible entity insolvent? Can a trust or managed investment scheme be "insolvent"?' (2011) *Australian Business Law Review* 95; Nuncio d'Angelo 'The trust as a surrogate company: The challenge of insolvency' (2014) 8 *Journal of Equity* 299; Garry Hamilton, 'Amerind – The Aftermath: Questions and Practical Difficulties Remaining' (2019) 27 *Insolvency Law Journal* 185; Garry Hamilton and David Morrison, 'Resolving Problems with Insolvent Corporate Trustees – Some Suggestions for Consideration' (2022) 30 *Insolvency Law Journal* 43; Mark Leeming, 'Trustees rights of Indemnity, Insolvency and Statutory Distributions to Preferred Creditors' (2018) 92 *Australian Law Journal* 503; Allison Silink, 'Trustee exoneration from trust assets – Out on a limb? The tension between creditor expectations and the "clear accounts"' (2018) 12 *Journal of Equity* 58; Allison Silink, 'The Trustee's Indemnity as "Property of the Company" under the Corporations Act 2001 (Cth): Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth' (2019) 30 *Journal of Banking and Finance Law and Practice* 272; etc.

[57] Commonwealth Treasury, 'Clarifying the treatment of trusts under insolvency law' (Consultation Paper, 15 October 2021).

[58] (2019) 268 CLR 254.

[59] See eg *Anmi Pty Ltd v Williams* [1981] 2 NSWLR 138.

whereas others determined that distribution should occur on the basis of bankruptcy/partnership law principles.[60] The issue becomes even more complicated when the companies operating in partnership are corporate trustees, which raises the question of whether corporate law principles of distribution should apply on the basis that equity follows the law.[61]

A further layer of complexity is added by the fact that certain partnerships may potentially become subject to corporate insolvency law distribution principles on the basis of being a 'Part 5.7 body' under the *Corporations Act 2001* (Cth), where the partnership has more than five members.[62] It seems like an arbitrary outcome where the determination of legal principles with far-reaching implications could hinge on whether a partnership had four or six members.

In this regard, one is inclined to agree with Hill J in *Woodhouse v Francis [No 2]* that

> [t]he complexity that arises in this case and the other cases that have previously addressed this issue, primarily arises because the liquidator has tried to subject the activities of companies trading as partnership to insolvency laws which are principally, if not almost entirely, directed to the companies that trade or hold assets in their own right [and that this] complexity can only be resolved if and when the legislature consider that a different result should apply to that which arises on what I consider to be the proper construction of the legislation.[63]

It is therefore submitted that statutory reform to provide clarity and consistency around issues like those described above, would be useful.

(3) The insolvency law framework in general

It is not certain that the time frames of the current Inquiry into Corporate Insolvency in Australia allow for a broad, comprehensive overview and legislative reform in respect of the current insolvency law framework. The previous comprehensive insolvency law reform took place nearly 35 years ago,[64] and it is suggested that a project of similar scope would be useful in the near future, if the current Inquiry does not allow for that.

As indicated above, principles of corporate insolvency law are 'directed to companies trade trade and hold assets in their own right'.[65] It is clear that many companies do not operate in this way, and that insolvent winding-up of complex business structures pose significant legal challenges. The appropriateness of the approach as described above and desirability of separate pieces of legislation dealing with insolvency, become questionable in that context.

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[60] See eg *Woods & White v Hopkins* [2016] WASC 16; *Woodhouse v Francis [No 2]* [2022] WASC 318.
[61] See eg *Re O'Keeffe Heneghan Pty Ltd (in liq)* [2018] NSWSC 1885.
[62] *Corporations Act 2001* (Cth), s 9(c) definition of 'Part 5.7 body', read with s 583.
[63] [2022] WASC 318, at [100].
[64] The Australian Law Reform Commission General Insolvency Inquiry, which resulted in the 'Harmer Report' (Report No 45, 1988).
[65] *Woodhouse v Francis [No 2]* [2022] WASC 318, at [100].

I would be happy to answer any questions you may have in relation to my submission.

Yours sincerely,

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