Submission to Productivity Commission inquiry: Reducing barriers to business dynamism in Australia

3 July 2026

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We note the call for submissions and the terms of reference and make the following comments on matters within our expertise. Our submission initially addresses the first term of reference ('Identify and evaluate key processes and barriers to business entry, expansion and exit').

Australia's innovation ecosystem and stigma

With respect to priority area two ('Australia's innovation ecosystem'), we note that the call for submissions specifically mentions the stigma regarding business failure. There is extensive literature that demonstrates that there is a negative stigma that attaches to persons who have managed businesses that have gone through an insolvency process, such as voluntary administration or personal bankruptcy.[1] While some jurisdictions have social attitudes that do not penalise business failure and encourage entrepreneurs to start again after business failure,[2] it does not seem that Australia wholly embraces such social attitudes.

It's common for media reports to highlight connections with prior business failures, for example stating that a director is a 'former bankrupt' or 'former failed company director'.

We also note that personal insolvency law imposes extensive penalties and restrictions on employment for persons who are bankrupt, and indeed the Commonwealth Constitution bars bankrupts from serving in federal parliament.[3]

Changing social attitudes to business failure involves recognising that not every case of failure should be attributed to the fault or blame of the entrepreneur or the directors of the failed company. Indeed the assumption of risk is a necessary element of entrepreneurial endeavour.

Businesses can fail for many reasons, some of which can arise from the fault of the manager of the business, such as:

- poor management skills
- poor financial management
- poor record keeping
- poor business strategy

Of course, there will always be some businesses that fail because of the improper or even illegal conduct of the entrepreneur. However, that is not the primary focus of insolvency law or corporate restructuring processes. The goal of insolvency law should be to provide the best commercial outcome in all the circumstances. Where there is misconduct or breaches of the law, that should be a matter that comes within the scope of the corporate regulator and/or state or federal police. The link between insolvency and breaches of the law exacerbates the stigma that attaches to all insolvencies and those previously involved with insolvency processes. To address these concerns, many jurisdictions eschew using the term 'bankrupt'

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[1] M Sousa, 'Bankruptcy Stigma: A Socio-Legal Study' (2013) 87 American Bankruptcy Law Journal 435; E Ghio and D Thomson, 'Is insolvency stigmatised?' (2023) 32 International Insolvency Review 397.
[2] The United States is the most often cited example.
[3] M Murray, 'Bankruptcy, Treason and Other Crimes' [2001] 1 INSLB 138.

and instead refer to the 'debtor'. The issue of stigma is particularly important when we consider that a person who is made bankrupt will have that recorded on the NPII forever.[4] A director who puts their company into a 'small business restructuring' under Part 5.3B of the Corporations Act will have that recorded as an 'external administration' by ASIC and therefore also by credit reporting agencies, which indicates an insolvency addressed by an insolvency practitioner when the small business restructuring is, in fact, a 'debtor-in-possession' model.

Put simply, we need to re-frame the narrative about business failure and insolvency and make it clear that attempts to rescue and restructure businesses are not necessarily indicative of the personal failings of those who are running those businesses. To reframe that narrative, we need to reconsider the role of investigations of criminal behaviour and breaches of the law that occur in insolvency, for example under s 533 Corporations Act. While these are important functions of practitioner that need to occur in *some* matters, the framing of insolvency processes as being directed towards uncovering illegality and wrong-doing paints the picture of insolvency and restructuring as going hand-in-hand with criminality and wrong-doing, which in the vast majority of cases is not correct. The same comments are made about personal insolvency.

For example, both ASIC and AFSA suggesting that insolvency practitioners are 'gatekeepers' responsible for uncovering wrongdoing suggests that large numbers of insolvencies involve wrongdoing.

Human capital and management capability

With respect to priority area three ('human capital and management capability'), we make the brief comment that management capability around financial management and strategic business capabilities, record keeping and compliance processes for many small businesses is poor. Large numbers of reports from liquidators reveal that company directors of many insolvent businesses have not properly maintained books and records. ASIC has identified the financial reporting as a strategic enforcement priority for this year, across all companies,[5] but we note that even some larger companies are routinely not submitting their financial reports on time or at all, suggesting that their internal financial records are inadequate. It's difficult to anticipate and avoid financial distress if a manager can't identify the company's cash flows and costs. While it is relatively easy to start up a business, it's much harder to obtain the right training in a cost-effective manner and in a way that is suited to the diverse learning needs of managers and owners of businesses.

Improving financial literacy and management capabilities is an essential part of improving the resiliency of businesses, both large and small, and reducing the risks that those businesses will become financially distressed. We accept that is a large task.

Taking action earlier in the decline curve improves the range of viable outcomes for distressed businesses. Leaving it too long, often until creditors are taking enforcement action, often means that businesses are run into the ground with little left to distribute to creditors and insolvency. It's no surprise then that the vast majority of company liquidations and bankruptcies produce no return for creditors.

An ounce of prevention is worth a pound of cure.

Capital markets

With respect to priority area four ('capital markets'), we note that providing personal guarantees through shareholders, directors, and family members to cover company business debts is a common practice. This creates problems when the insolvency and restructuring

[4] This is proposed for review, to be reduced to 7 years.

[5] ASIC 26-098MR.

laws are focused on the specific legal entity that owns the business, usually either a company (which is a separate legal entity), a partnership, a trust, or a sole trader (which are not separate legal entities). The widespread use of personal guarantees and the common intermingling of personal and business finances that is frequently seen with small businesses complicates insolvency and restructuring efforts.

While insolvency law provides restructuring tools for insolvent companies, such as small business restructuring or Part 5.3B voluntary administration, the only comparable regime in personal insolvency is under Part X of the Bankruptcy Act, which is not particularly directed at business failures. With unincorporated businesses making up in excess of 40% of all businesses in Australia, options for directors to resolve their own liabilities are limited.

The limitations of the law in resolving all liabilities of a small corporate business might be a disincentive for some business owners to use restructuring tools if they believe that they will then be made personally bankrupt as a result. We recommend including personal guarantees within the Part 5.3B restructuring plan or Part 5.3A deed of company arrangement under the Corporations Act.

Transfer of businesses

With respect to the transfer of businesses, we note that Priority Area 5 speaks of transferring successful businesses. However, we offer some comments on the transfer of insolvent businesses as part of a Corporate Rescue or Business Restructuring exercise. Many businesses that are in financial distress could be saved by using a formal restructuring process. However, they lack the awareness of the financial problems at an early enough stage to seek advice from appropriately qualified advisors at a time when the business can still be saved. Many business owners bury their head in the sand, focus on their work rather than on the management of their business or saving their business. It's only when an external shock, such as enforcement action by a creditor such as the ATO, forces the business owner to seek advice. At that stage, it is often too late. It is hard for doctors to save a patient who is dead on arrival at the hospital. Again, having better information systems, better corporate governance and better strategic management skills could reduce some of these business failures. Acting earlier in the decline curve could reduce some of these business failures.

We should note we're not advocating that no business should fail. In a capitalist economy, capital recycling serves a valuable function in promoting new businesses and entrepreneurial dynamism. As the PJC Report records, the comments of the then Productivity Commissioner [at 3.22] that we should not be "so naïve as to think that it's the goal of the regime to minimise insolvency. Insolvency and business exit play a very important part in maintaining the dynamism of the economy. They ensure that it's an innovative and constantly changing economy. Whilst there's an element of pain associated with financial distress, sometimes business exit is an important way for us [to] get economic growth through innovation and different business models, and in some industries in particular that is a mechanism by which innovation and productivity growth occur".[6]

The difficulty is identifying which businesses can and should be saved, as opposed to those businesses that are fundamentally uncompetitive and uneconomic. Having better information, tools, and improving management and financial literacy would assist in an assessment of whether the business can be saved or not. In short, improving standards of management capability and financial literacy is an urgent need to promote business dynamism in the Australian economy.

The cost of the process

At present, businesses that are uneconomic, often outright insolvent, can be transferred through an asset sale. The company can be transferred through a share sale. For insolvent

[6] Mr Michael Brennan, Chair, Productivity Commission, *Committee Hansard*, 13 December 2022, p. 16.

companies, they should go through an insolvency process such as liquidation, administration, or restructuring, but for many small businesses the cost of obtaining appropriate advice is too high. While some insolvency practitioners might quote $10,000 or $15,000 to undertake a liquidation and sell the assets, many insolvency appointments involve much higher costs. Insolvency practitioners do not have to take insolvency appointments, and so it's common for them to require upfront payment of minimum costs. For micro and small businesses, this might mean that insolvency processes are simply unaffordable. In short, these businesses are too poor to go broke.

What can the business owners do? They can try and do deals with particular creditors, enter into payment arrangements with the ATO, put off paying certain creditors, under-pay employee entitlements and stop paying rent and utility bills.

Default disappearance

It's common for these businesses to avoid formal insolvency altogether and to simply be deregistered after shutting down their business operations. This default process occurs under ss 601AB of the CA.

While much of the debate about law reform concerns formal insolvency procedures, the numbers of formal corporate insolvencies each year are relatively low (<15,000) compared to the total number of registered companies (>3 million). On the other hand, more than a hundred thousand companies are deregistered every year,[7] some of which have been effectively put into de-registration as zombie companies that should have gone through an insolvency process (because they owed outstanding debts) but didn't. Allowing a company that has outstanding debts, particularly tax debts, to go into deregistration can leave the directors of the company (or rather, former directors of the company) at risk of future tax liabilities by way of Director Penalty Notices.

Professor Helen Anderson has explained the circumstances of the losses to creditors from these 'abandoned' companies:[8]

> " …both employees and general unsecured creditors of insolvent companies, where the directors have not sought liquidation or VA, are in a difficult position. They will need to fund the company's liquidation themselves if they hope to recover anything of what they are owed, and risk further losses if it eventuates that company has no assets. As a result, many of these creditors do nothing, and the abandoned companies are eventually deregistered by ASIC for failure to return documents or pay annual fees. It is estimated that there are five times as many abandoned companies as there are companies in liquidation each year, but the amounts lost to their creditors are unquantified."

Having a low-cost, simplified insolvency process could assist these directors to better manage personal liabilities, but even then, a publicly funded Official Receiver role would be necessary.[9]

We now address the specific terms of reference.

The design, operation and integrity of insolvency frameworks

We make an initial observation that much of the information and views that you seek comes from an economics perspective, which we welcome. We have expressed the view in the past that insolvency system suffers from a lack of input from economics: see *Keay's Insolvency*, 11th ed, 2022, p 39. We are critical of the failure of policy makers to include robust economic

[7] See Corporations Act 2001 (Cth) ss 601AA, 601AB.
[8] H Anderson, 'Insolvency - It's all About the Money' [2018] UMelb LRS 6, footnotes omitted.
[9] M Murray & J Harris, 'Rebuilding the structure of the Australian insolvency system' (2022) 22(1&2) INSLB 14.

analysis into the insolvency system, which in part is driven by a lack of robust data about failure and insolvency.

We also welcome the apparent intent of your inquiry from a high-level macro perspective. There is much to be said for the view that the framework in which the insolvency system operates is as important as the detail; to the extent that 'a reform that leaves the substantive insolvency law unchanged but improves its effective implementation could yield significant benefits'.[10]

This was an approach we recommended to the PJC and its recommendations reflect that. In that respect we make two high level comments which we made in submissions to the PJC, which to some extent we have mentioned already.

One is that in so far as the insolvency system relies largely for its funding on the remaining funds in administrations, the reality seems to be that there is just not enough money remaining in insolvent estates for that to be realistic. The reason for this is not necessarily a fault or criticism of the insolvency system but rather a reality of the market. Three reasons are suggested. The value of business assets is increasingly based more on intangibles, and services, and less so on 'bricks and mortar'; there has often been trading of the business at a loss, and probably while insolvent, thereby depleting remaining assets; and assets of the directors, to the extent they have significant assets, are increasingly protected by trusts, or subject to family or other such claims.

While corporate failures might tend to have larger reserves of assets, the vast majority of corporate trading businesses in Australia are small to medium enterprises with limited asset bases. It is for that reason that we have suggested that the state should have a larger role in supporting the insolvency system. That is the case in relation to personal insolvency with its Official Receiver role, and we say there is a similar need in respect of corporate insolvency.[11]

Our second threshold view, again already mentioned, is that an alternative approach to a public role might be to reduce the cost in the administration of insolvencies. In that respect, given that creditors receive so little in insolvencies, we query the high level of attention given to them under the law in particular since the Insolvency Law Reform Act 2016, and the consequent cost. While lessening a focus on unsecured creditors may seem contrary to the fundamentals of insolvency, it accords with the reality of their position.

An option would necessarily remain that information can be provided to creditors if they wish to access it, and they can provide information themselves, but this would not necessarily be at the level of reporting presently required.

The other potential area for reduced IP responsibility is in respect of investigations being required by practitioners. Many reports are given to the regulators about the conduct of the insolvent entity – very, very few of those are actioned. We contrast that attention with the virtual lack of attention to small trading enterprises in the market many of which might well be non-compliant and may well be trading while insolvent.

The design of Australia's insolvency frameworks

Australia's insolvency system maintains a strict divergence between personal and corporate insolvency, with separate legislation, separate regulators and different processes. This is largely a result of history, with personal insolvency developed first in England (in the Bankruptcy Act) and then corporate insolvency came much later (in the Companies Act). While England subsequently created a unitary insolvency system, with primarily a single statute (Insolvency Act 1986, although some rules continue in the Companies Act) and a mix

[10] Menezes and Gropper, *The Economic Impacts of Insolvency Regimes*, World Bank, 2025, p 19.
[11] See also P Heath, 'Insolvency Law Reform: The Role of the State' (1999) NZL Rev 569. The 2023 PJC Report comments on this at Chapter 9.

of government and private insolvency officeholders (in the form of the Official Receiver and licensed insolvency practitioners), Australia adopted only parts of the English law and maintained only a government bankruptcy trustee (the Official Trustee) with private registered trustees and private liquidators (but no government liquidator). Most common law jurisdictions have unitary insolvency legislation covering both personal and corporate insolvency, including Canada, England, India, Singapore and the United States. In fact, unitary systems with insolvency statutes that cover both personal and corporate insolvency are the norm in the OECD, including in Germany, Italy, Japan, South Korea and Spain.[12]

We recommend a unitary legislative framework be adopted with a single regulator, a single set of forms, fees and practice rules and a single insolvency profession who can take either personal or corporate insolvency appointments. At present, small business owners needing insolvency assistance need to see a registered liquidator to enter into corporate insolvency or restructuring and speak to a bankruptcy trustee (or the Official Trustee) for personal insolvency. Restructuring a business under the small business restructuring or voluntary administration will not protect the business owner if they've given personal guarantees over the company's debts and they may face bankruptcy as a result.

The operation of Australia's insolvency frameworks

The call for submissions asks about how the insolvency pathways can be improved and how different types of creditors are prioritised. The improvement of insolvency pathways was addressed in submissions to the PJC's Corporate Insolvency in Australia review in 2023. We re-iterate our submission to that inquiry (attached as an appendix).

As for the prioritisation of creditors, we note that the design of insolvency law is primarily a creditor-centric model. The law reform debate is framed as being concerned with improving outcomes (i.e. economic returns) to creditors. However, reports to ASIC by liquidators show that estimated dividends to unsecured creditors are mostly non-existent (in over 90% of cases). Indeed, anecdotally we have regularly had liquidators and bankruptcy trustees note that they have not paid a dividend to creditors in years, some have never paid a dividend. This is not a criticism of the insolvency system, nor of insolvency practitioner fees and expenses. Rather, it is suggestion that the supposed goals of insolvency law to produce creditor returns are mostly not achieved for unsecured creditors. Put simply, insolvency is not about unsecured creditors, who are rationally apathetic and mostly disengaged because they know there is usually no chance of repayment. The work that insolvency practitioner does not regularly result in payment to unsecured creditors, but rather is administrative and regulatory in nature and asset realisations or litigation serves to pay for that administrative and regulatory work.

The PJC report, which had over 70 submissions and 5 days of public hearings, noted that almost no stakeholder category was happy with the operation of the insolvency framework. It is a system that requires extensive work by private professionals that results in little or no financial benefit to unsecured creditors but neither results in significant regulatory outcomes with both ASIC and AFSA taking only a small number of significant enforcement actions in respect of alleged breaches of the law. The only beneficiaries of the insolvency system seem to be secured creditors, who have bargained for priority property rights in secured assets and largely stand outside of most insolvency processes, and the professionals involved in managing insolvency matters. However, we note that many insolvency practitioners and lawyers also go underpaid or even unpaid - because insolvency matters usually involve little or no assets.

The Australian insolvency framework is simply not fit for purposes. It promises full transparency, accountability and meaningful creditor outcomes and achieves none of those

[12] France and Mexico are the only other countries (with Australia) with separate personal and corporate insolvency laws in the top 10 largest OECD countries.

aims in most cases. It should be noted that these comments mostly apply to liquidation and formal bankruptcy, with restructuring under small business restructuring, voluntary administration and receivership involving debtors with assets and so there are more likely to pay dividends to unsecured creditors. This reality is not the direct result of the insolvency framework, but a result of most debtors having little or no assets when they enter formal insolvency. Most debtors don't file for insolvency when they have assets. Informal restructuring is common and can produce good outcomes for stakeholders in terms of high payment ratios and continuing businesses, but formal liquidations and bankruptcies produce little of value for unsecured creditors.

We do not recommend reducing the priority of secured creditors, which has been bargained for with the debtor (pre-insolvency) presumably for a lower rate of interest commensurate with the lower level of risk involved (compared with unsecured credit or equity). However, we note that in corporate insolvency, Australia provides extensive priority for secured creditors to overtake a restructuring effort by appointing a receiver (who acts in the secure creditor's best interests). This is another relic of historical English law, but does not exist in many other jurisdictions (including Canada, the United States) and in fact even in England the ability of secured creditors to appoint private receivers was virtually abolished over 20 years ago. In England, removing the right to appoint private receivers was balanced by giving secured creditors the right to replace an administrator (who must act in the best interests of creditors overall). We recommend consideration be given to restricting the ability of secured creditors to appoint receivers during administration or small business restructuring in Australia.

The integrity of Australia's insolvency frameworks

We note that the scope and efficacy of anti-phoenixing and insolvent trading provisions were addressed by the PJC inquiry and we re-iterate our submission to the PJC. The central problem with phoenixing and insolvent trading is not a lack of adequate laws, but a lack of enforcement based on a chronic lack of funding. The phoenixing laws was unnecessary because the existing voidable transaction laws already covered the relevant conduct, but a lack of funding for liquidators and a lack of enforcement action by ASIC for insolvent trading and breaches of directors duties involving the insolvency of companies, has led to an environment where deliberate misconduct goes under-investigated and under-enforced, because there is simply not enough money to allow liquidators to investigate and take action. ASIC's low levels of annual enforcement action for breaches of directors' duties connected with insolvency, usually measured in single digits each year, sends a message to wrongdoers that running a business into the ground and leaving nothing for liquidators will minimise the prospects of being held accountable. In addition to increasing the assetless administration fund (AAF) and broadening access to the AAF, we recommend measures such as automatic director disqualification for being a director of companies that enter insolvency without paying a reasonable dividend to creditors.

Conclusion

By way of summation, we necessarily acknowledge the importance of the insolvency system in the economy, hence all the more reason for it to be operating efficiently and effectively. In that respect, the system satisfactorily addresses a number of important roles. It finalises the debtor's financial distress by immediately closing off claims from creditors and protecting individuals in bankruptcy from on-going creditor claims, a responsibility taken on by the trustee or liquidator. Their role is also to secure and protect any assets or funds of the insolvent.

That also serves a purpose for creditors, to cause them to cease recovery or other legal action and allay associated costs.

The insolvent having entered the protection of insolvency, they are then subject to statutory obligations to provide details of their assets and liabilities and otherwise assist the IP. This provides at least some explanation and accountability to creditors in respect of their financial losses. And while we say that financial returns are limited, payments to priority creditors such as employees and secured creditors are made, and substantial payments can be made to unsecured creditors.

The sale of remaining assets, or of the business itself, serves the important aim of re-distributing the remaining elements of the enterprise to enable their more productive use. The extent to which that occurs and is productive is perhaps more an issue for economics to assess.

The relatively prompt resolution of a business failure, allowing the business owner to start again, released from any financial liability is said to encourage entrepreneurial pursuit. We do note various commentaries and articles saying that that is the case, and on its face it appears a reasonable claim.

Overall, while we defer much to economic analysis, and its focus on the efficient allocation of resources, insolvency involves a substantial alteration of rights and allows recovery of assets from third parties and imposition of liabilities on directors and others. Determination of claims and rights involves legal processes which can impede, justifiably, a business exit. There needs to be a proper balance maintained.

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Appendix: Submission by Murray and Harris to the PJC (2022)

30 November 2022

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Parliament House
Canberra ACT

By email corporations.joint@aph.gov.au

Submission for the inquiry into Corporate Insolvency in Australia

We welcome the opportunity to make a submission to the Committee's Corporate Insolvency in Australia inquiry.

Executive summary

In Part 1, we explain that it is difficult to assess the corporate insolvency regime without relevant data. What data is available reveals a system that is underfunded, with its insolvency practitioners (IPs) attending to tasks better performed or funded by the state. It also suffers from barriers to entry given the costs of its processes.

We recommend a financial and legal analysis of the regime in order to re-assess the law's expectations against available resources. This may lead to a re-assessment of the tasks of the IP in relation to offence investigations and reporting, and other public interest tasks; and the need for a greater role of the state in insolvency. While these matters may be outside the remit of the PJC, a road map or other guidance on how such an analysis, if accepted as necessary, might proceed, would be useful.

In Part 2 we address each of the Terms of Reference with recommendations as relevant.

In Part 3, we conclude with an offer to assist further as may be required.

Our submission has two attachments, A and B.

Part 1

We note that the terms of reference are broad in scope, but also refer to specific rules within corporate insolvency, such as unfair preferences, insolvent trading safe harbours and small business restructuring. Any review of the operation of the corporate insolvency system should consider both how the insolvency system operates within itself and how the insolvency system operates within the broader economy. While there have been several parliamentary and government sponsored reviews of insolvency law over the past 30 years,[1] these have tended to focus on particular issues and have given rise to specific reform proposals.[2] This has led to the expansion in volume and complexity of insolvency law. As noted in the announcement of the inquiry, the last broad-based review of insolvency law was the ALRC's Harmer Report in the mid-1980s.[3] The economy has changed significantly since the Harmer Report was released in 1988, with a digital/online industrial revolution, diversification of the credit markets and a move from fixed asset bases to intangibles for most businesses.

While we welcome the Committee's inquiry as an opportunity to consider the state of corporate insolvency law in Australia, the need for a detailed examination of insolvency law (both personal and corporate) can't be satisfied by a parliamentary committee reporting back in several months. Insolvency reform that is fit for purpose takes some

[1] See for example, Commonwealth Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Law: A Stocktake* (June 2004); Productivity Commission, *Business Set-up, Transfer and Closure: Inquiry Report* (September 2015).
[2] Most notably, the *Insolvency Law Reform Act 2016* (Cth).
[3] Australian Law Reform Commission, *General Insolvency Inquiry*, Report No 45 (AGPS, 1988).

considerable time and requires consultation across the economy. We strongly recommend that one outcome of this inquiry is a referral to the ALRC or similar body equipped with the expertise for the sort of threshold inquiry we suggest. Many other countries have undertaken broad scale reforms of their insolvency law in the past 30 years, including notably India and Singapore in our own region. Many aspects of our insolvency law date back to the 16th century. Many of the goals of insolvency law have not been reviewed in decades. Now is the time to rethink insolvency law to ensure that it is meeting community expectations and delivering outcomes that are commercially and economically appropriate.

Initial threshold issues

Before addressing the specific terms of reference, we offer the following comments on what we believe are important threshold issues for the inquiry to consider beyond any technical reforms that may be evaluated. We are in the midst of a book project that will recommend a review of Australia's insolvency laws from a systemic perspective. We say that this is necessary first step before examining the operation of effectiveness of insolvency provisions. Our broad thesis is that a large portion of the work that insolvency practitioners engage in is in the public interest but must be paid for out of assets otherwise available to creditors. Also, in a large proportion of corporate insolvency matters there are insufficient funds to pay for the liquidator's work, let alone to provide a meaningful return to creditors.[4] The role of government, "the state", in the administration and conduct of insolvency matters needs to be increased in corporate insolvency. Furthermore, we argue for a realignment of the purposes of insolvency to recognise the role of the public interest and a re-allocation of the responsibility and funding of work undertaken in corporate insolvencies to recognise that public interest work should be undertaken and/or funded from public sources. [5]

Any consideration of the detail of insolvency law should be considered in that realigned context. To some extent, the terms of reference raise issues relevant to that.

This submission raises these as "threshold issues". At the same time, we appreciate that the detail of insolvency law as outlined in the bulk of the terms of reference (TOR) require consideration. We give those appropriate response through the lens of this threshold issue.

In our view, by standards of effectiveness (in achieving purposes, aims) and efficiency (in being cost/time effective),[6] the Australian insolvency regime has shortcomings that need attention, in particular in the MSME sector. In that sector, its effectiveness is qualified by the financial limits on those insolvents[7] who cannot access it and qualified overall by the lack of data showing desired outcomes, or indeed a lack of data showing any final outcomes of insolvency (desired or otherwise).

The effectiveness and efficiency of the insolvency system in Australia is also qualified by the dual system of laws and regulation that exists between ASIC and AFSA. Its efficiency is qualified by the unfunded cost of administrations, the unrecognised public interest work performed by insolvency practitioners (IPs), and the unnecessary complexity of the system, including in relation to the disconnection between the operation and regulation of

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[4] This also seems to be the case in personal insolvency; see *Rebuilding the structure of the Australian insolvency system* (2022) 22 (1&2) INSLB 14, M Murray and J Harris (Rebuilding the structure, Murray & Harris), which is Attachment A to this submission.

[5] Discussed further in Rebuilding the structure, Murray & Harris.

[6] As to the distinction between effectiveness and efficiency in the insolvency context, see IMF Report The Use of Data in Assessing and Designing Insolvency Systems (imf.org), WP/19/27, prepared by José Garrido (dir.), Wolfgang Bergthaler, Chanda DeLong, Juliet Johnson, Amira Rasekh, Anjum Rosha, and Natalia Stetsenko, February 2019.

[7] Companies and individuals

the personal and corporate insolvency law systems. In the large company sector, it appears (anecdotally at least) to operate much better, although refinements are required, and collection and analysis of data is also required.

Detail of the threshold issue

Insolvency needs to deal with both public and private interests. The nature of those interests and who attends to them and who should bear responsibility for them must first be examined and balanced appropriately. The approach to clarifying those respective responsibilities in insolvency has been explained as being that

> "private functions should be performed by the private sector and paid out of funds otherwise available for distribution among creditors, while public functions should be performed by public officials and paid for out of public funds …".[8]

At present in corporate insolvency in Australia, there is no significant government role and we consider that this creates problems and distortions in that sphere in which the inquiry is proceeding. This is caused by the fundamental and pervasive lack of sufficient funding to pay for the work that the law requires corporate insolvency practitioners to undertake. In short, we have a corporate insolvency system that cannot pay for itself and certainly produces little or nothing to creditors *in most cases*.

ASIC reports based on insolvency practitioner filings[9] show that in 92% of companies that enter external administration (i.e. formal insolvency) the estimated returns to unsecured creditors are 0c in the dollar (no return). In 96.4% of cases the estimated return is 11c in the dollar or less. In only 2.3% of cases is the return estimated at more than 21c in the dollar.

These figures show that in almost every corporate insolvency where the insolvency practitioner filed a return with ASIC at the commencement of the case, there was virtually no prospect of a meaningful financial return to creditors. Furthermore, in 18% of liquidations, the liquidator estimated there would be no remuneration, meaning the liquidator is effectively working for free. In Australia (and unlike in many other common law countries) liquidators consist solely of a private profession, there is no government liquidator (often called an Official Receiver, Official Liquidator or Official Assignee).

Three broad concerns arising from lack of state involvement

We identify three issues in relation to that lack of government involvement

First, the need to pay a liquidator to take the appointment (which can cost $10,000 or more) presents a barrier to entry for no or low asset insolvent companies. While there may be a desire by the directors to liquidate their insolvent company, they have no funds to pay a liquidator, which is generally required. Their easiest option, absent any action by a creditor, or direct claim on the directors by the ATO, is to simply "walk away" and let the company be deregistered. This was an expected outcome given changes and statements made by the government in 2016.[10] Latest figures from ASIC show that for every company dealt with under Ch 5, 13 more simply are deregistered.[11] However, these figures do not show the full picture. A review of deregistration notices on https://publishednotices.asic.gov.au/ shows that each year since 2012 (when records on

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[8] P Heath, *Insolvency Law Reform: The Role of the State* (1999) NZLRev 569 ["Heath, the Role of the State"].

[9] ASIC Insolvency Statistics, Series 3.3 (FY18-19). This report stopped in 2019 and is currently being reviewed by ASIC for release in a new form in 2023.

[10] See *Rebuilding the structure*, Murray & Harris

[11] *Is ASIC deregistering more 'abandoned companies'? What the data shows*, (2022) ARITA J 40, Thea Eszenyi, ASIC. It shows in 2020-2021, 52,365 companies "ASIC initiated" (ie, s 601AB) deregistered.

that website began) there have been more than 82,000 voluntary company deregistrations and more than 65,000 involuntary (ASIC-initiated) deregistrations. Some proportion of these may be defunct companies; another proportion may be 'spent' phoenix companies, or by-products of other corporate law abuse. The important point to note is that *none* of these companies are investigated by ASIC, they are simply deregistered. A government liquidator's office could have a role in conducting basic investigations into corporate misconduct, as the Official Receiver's office does in the UK.[12] It is quite clear that the numbers of formal insolvency cases are merely the tip of the iceberg and that many more are being abandoned each year.

Second, there is much public interest work done by private sector IPs on behalf of the state[13] which is charged to creditors. This is apart from the fact that much of insolvency is inherently in the public interest, as is apparent from its history. Some particular public tasks are the investigations of misconduct under s 533 Corporations Act and related sections and the referral of offences to ASIC. Although almost 20,000 offence referrals are made to ASIC each year, only a tiny fraction of cases are actually brought by the regulator.[14] There are a variety of reasons for this, including a lack of evidence where books and records have been destroyed by the directors of the company (or indeed, perhaps were never kept in the first place) and a lack of resources to undertake full proceedings.

Third, overall, there is a limited amount of remaining funds in insolvent estates. The system relies upon those funds to operate. A 2013 study quantified the annual contribution of liquidators at over $47million by way of unfunded work.[15] From this we conclude that the system is seriously underfunded. The remuneration of liquidators, who are central to the system, is extracted instead as best they can from the largest estates, by high charge out rates, creating distortions in the system. A system of 'swings and roundabouts' is in place where large asset matters fund the work done on unfunded matters.[16]

We consider a government role, an Official Receiver, would address in part or ameliorate these issues.

In contrast with New Zealand, the United Kingdom, and Singapore, Australia does not have an Official Receiver in corporate insolvency. It relies entirely on the private liquidator profession. The reasons for that are based more on default than design. An Official Receiver role was contemplated at Federation, in the draft Companies Bill 1908, being one and the same as the Official Receiver role created by what became the Bankruptcy Acy 1924. However, concerns were raised about the limit of the Constitution's corporations power generally, since discounted. While the idea of an Official Receiver was raised in 2018 in the context of anti-phoenix reforms, it was not pursued further.[17]

An Official Receiver may also be needed for what might be seen as national or public interest insolvencies, where there is undue risk and responsibility involved in the IP role as liquidator. For example, in the UK, the Official Receiver is the liquidator of British Steel,[18] with its extreme environmental and health risks; of Thomas Cook, the failure of which

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[12] The Official Receiver is appointed the default liquidator in every court liquidation and may subsequently be replaced by a private liquidator by a vote of the creditors.
[13] See *Rebuilding the structure*, Murray & Harris
[14] Compare ASIC 6-monthly enforcement reports with the offence referrals listed in ASIC Insolvency Statistics Series 3.3, Table 3.3.16.1.
[15] A report by A Phillips (2013), referred to in *Rebuilding the structure,* Murray & Harris.
[16] As to issues in relation to IP remuneration, see *Rethinking Insolvency Practitioner Remuneration*, (2022) Insolvency Law Bulletin, Murray, M (forthcoming).
[17] See Rebuilding the structure, Murray & Harris.
[18] See *British Steel – is it a wind up?* Corporate Rescue and Insolvency August 2019, A Keay and P Walton.

called for the largest peace time repatriation of British citizens; of Carillion Constructions, which had extensive government contracts for the construction of schools and hospitals; and most recently a failed electricity supply company on whose electricity supplies local authorities depended.[19] In each case, the Official Receiver was appointed by the Court with large private firms appointed as special managers to handle the work under the supervision of the Official Receiver. That default option is not available in Australia.

We note that there is limited data upon which we or the Committee might come to conclusions about the efficiency and effectiveness of Australia's insolvency laws, indeed as to how they work in practice. This lack of data has been the subject of critical comment from earlier inquiries.[20] We refer to some progress in that area and to some data which we ourselves have extracted in order to support our threshold arguments for reform, and which go to some of the points in the TOR.

In particular reference to small business, we need to know more about how small business operates – are personal guarantees common? How often is the family home "on the line"? How often do corporate liabilities lead to personal insolvency? How common are personal tax liabilities? Is the ABS division of 50-50 between corporate and personal businesses accurate?

Surveys of small business would be one way of finding this information. The information being/to be collected by the ABR will help. A centralised portal for all insolvency administrations is another, future, option.[21] Apart from these more formal mechanisms, the recent figures about those still to obtain a "director identity number" suggest many in small business do not know of have forgotten that they operate, or purport to operate, through a company. The Senate Economics References Committee Report of 2010 - *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework,* of September 2010 – recommended - recommendation 17, that there be a unit established that was to be responsible for gathering, collating and analysing data on a range of corporate and personal insolvency matters. The data was to be made publicly available with no charge.

We suggest a further recommendation be made to this effect by an independent body comprising representatives of AFSA, ASIC, the ASBFEO and other relevant agencies. A further point is that while there are certain settled aims of insolvency law, in our view these should be reconsidered in light of the reality that some are not or are rarely met, or do not seem to be met based on available data. We respectfully suggest that the Committee itself might usefully take submissions on what the aims of the system are in parallel with its consideration of the detail in our threshold issue.

In our view, an option for the Committee could be to recommend that a threshold financial and systems analysis of the regime, personal and corporate, be conducted, with a view to determining available funds and resources for necessary tasks. Depending on those findings, to then conduct a legal review to ascertain the private law and public law responsibilities in an insolvency and separate those that could be considered for a government role in the nature of an Official Receiver/Inspector-General role, funded by means to be devised.

That may then lead to a need to reconsider the aims of the Australian insolvency system, in particular in relation to the rights of unsecured creditors, of secured creditors, and in relation to investigation and enforcement of misconduct, with a view to redrafting aspects

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[19] *Counsel General for Wales v Allen* [2022] EWHC 647 (Ch) (21 March 2022).
[20] Harmer Report at [43].
[21] See further, https://murrayslegal.com.au/blog/2022/11/27/tip-the-insolvency-portal-or-big-data-room/

of the law accordingly. There is also a need to provide for on-going data collection as to the performance of the system.

At the same time, we acknowledge the terms of reference and we respond to those accordingly, although with reference back to the issues just raised.

Part 2: The Terms of Reference ('TOR')

TOR 1

Recent and emerging trends

As to the measures taken to address the Coronavirus in 2020-2022, our view is that they were appropriate as to content and length and consistent with steps taken in comparable overseas jurisdictions. Their impact was as intended, with a significant drop in companies being wound up by the court at the instigation of a creditor. Insolvent trading liability was put on hold. These led to not necessarily positive outcomes, as it may have meant that non-profitable companies traded on, relying on government payments, incurring debts they could not pay, with that full outcome yet to be seen in the market. Details of that outcome calls for an economic assessment that we are unable to give.

However, the effect of that continues, with numbers of liquidations remaining low. That may soon change but there are reasons why it may not. We have explained that assetless companies may not be able to afford the services of a liquidator. Nor may a creditor wish to apply to wind up a company when, apart from its own debt, it must incur the costs of funding a liquidator as well. This may be evident in current ASIC figures. As explained earlier, this was contemplated by law changes made in 2016 removing the role of "official liquidator".[22]

Beyond that, we speculate that the hiatus in insolvencies may have had a permanent effect on creditor behaviour, in at least causing some creditors to rethink the use of liquidation, and debtors and creditors also may have come to realise that, in a post COVID-19 environment, some compromises short of insolvency are worthwhile. In addition, creditors have increased access to their debtors' financial and trading affairs, through credit reference services, the internet and social media, directors' identity numbers [pending], as well as greater ability to take security over personal property using the PPSR. Such "self-help" remedies by creditors secure any recoveries for themselves alone; insolvency is necessarily a collective process with recoveries shared between all. Recovery proceedings are often complex and expensive, and creditors can often be asked to contribute. Ultimately, given the limited recoveries in insolvency, and time taken, banks and credit managers with unsecured loans may well decide that insolvency is of limited use, or at least that its use should be more directed and strategic.

We also note that there remains the regulatory "blind spot" of 'pre-insolvency' advisors whose business involves reaching out to distressed company directors and advising them how to hide assets and avoid their tax liabilities. We have even heard of struck-off liquidators operating in this market. Lawyers, accountants, financial advisors, tax agents etc are all heavily regulated professional advisors but pre-insolvency advisors seem to flourish in a lax regulatory environment where regulators focus on one-off prosecutions rather than a system-wide regulatory approach. Anecdotally we have heard of very different approaches being taken between ASIC, ATO, AFSA and the Fair Work Ombudsman to these matters.

We recognise that many (perhaps most) advisors of insolvent or financially distressed companies are highly qualified and ethical professionals. Indeed, multiple professional

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[22] See *Rebuilding the structure*, Murray & Harris.

industry bodies such as ARITA, TMA, ABRT and the AIIP have professional codes of conduct and ethics and training requirements for members. However, there does appear to be a segment of the market that is operating without professional standards and is regularly giving unlawful advice about circumventing and frustrating insolvency laws and preying on directors who are under significant financial pressure.

Clear rules around what advice needs to be given by a registered advisor and what those registration requirements are is needed. We recommend below that the recent Safe Harbour report recommendations be implemented, and one of those recommendations concerns clarifying who can provide safe harbour advice. This is needed beyond just safe harbour engagements, with regulation needed for pre-insolvency advisors to promote access to quality information and advice for directors of distressed and insolvent companies.

TOR 2

Small business insolvency generally

Small businesses comprise over 95% of all businesses in Australia and are central to nearly all the various questions raised in the terms of reference. An initial difficulty is that "small business" is variously classified in the law – by industry type or financial turnover[23] or revenue or employee number[24] – but not in terms that the law of insolvency recognises, that is, whether the business operates through a sole trader or a company. For better or worse, insolvency law only looks at small business in terms of those legal structures, through which debts are incurred and assets held.[25] As to corporate structures, the ABS reports that 1.05m companies and 1.03m sole traders/partners comprise the bulk of businesses in Australia.[26]

Corporate insolvency law should start to look at small business insolvency from the debtor's operational perspective and not only at the form of legal structure used to run the business. Seeking to address the financial problems of an insolvent company is addressing only half of the problem if the financial problems of the directors (who are often owner-managers) are ignored. A solution that 'saves' the company but bankrupts the directors is unlikely to be attractive to directors who are responsible for most insolvency appointments. Furthermore, ignoring the overlap between personal and corporate finances in MSMEs means that unnecessary costs and complexities remain in requiring separate corporate insolvency practitioners and separate personal insolvency practitioners. Jurisdictions around the world are investigating combined proceedings for MSMEs that address the problems of the business and the family owners.[27]

In Australia, the insolvency of sole traders arising from their personal liabilities is dealt with under the *Bankruptcy Act*, and the insolvency of companies is dealt with under the *Corporations Act*. But even in relation to the insolvency of companies, there will be a significant proportion where the owner [shareholder] has incurred personal liabilities by

[23] The ASBFEO Act 2015 s 5 refers to under 100 employees or revenue under $5m. Section 6D of the Privacy Act 1988 refers to annual turnover of under $3m. The ITAA 1997 at s 328.10 refers to aggregated turnover of under $10m.
[24] And internationally, see for example *Guide on the Treatment of Insolvent Micro and Small Enterprises in Asia* 2022, p 13.
[25] Bankruptcy Act s 7; Corporations Act s 459A
[26] In 2021-22 sole traders increased by 90,239 businesses, or 12.7% to 798,209 in total. [see Counts of Australian Businesses, including Entries and Exits, July 2018 - June 2022 | Australian Bureau of Statistics (abs.gov.au)].
[27] See Riz Mokal et al, *Micro, Small and Medium Enterprise Insolvency: A Modular Approach* (Oxford University Press, 2018); Aurelio Gurrea-Martinez, 'Implementing an insolvency framework for micro and small firms' (2021) 30 *International Insolvency Review* S46.

way of giving personal guarantees, or otherwise incurring liabilities in their own name in support of the business. Tax liabilities or indemnities may also have been imposed on the owner personally. Some such liabilities may be owed by the owner to the company itself. Small corporate businesses therefore will not always be neatly packaged within their corporate structure.

While corporate insolvency law can deal with significant corporate liabilities, and that is what the terms of reference focus on, corporate insolvency does not resolve those personal liabilities, whether it be liquidation, Part 5.3A; or the new Part 5.3B.

The practical difficulty for a small business owner is that if there is some current financial slide in its operations, there is no one-stop-shop in insolvency law to try to remedy that. Insolvency law requires a two or more step process, a trustee as to personal liabilities, a liquidator as to corporate, and even then there is the further division between the directors' interests and the company's interests.

This can be compounded by business owners not having an accurate idea of how their business is set up. There may be blurred lines between corporate and personal assets and liabilities. The business owner will need to know where the liabilities come from and decide whether their personal insolvency or their company's insolvency is on the line, or both.

An IP registered as both trustee and liquidator will only be able to take a bankruptcy *or* a liquidation and refer the owner on to another firm. This is because of the strict independence rules in insolvency which sees the individual director and the company as separate legal entities.[28] There may have been unfair dealings or transfers of property or contested liabilities between the company and the director. There can be exceptions made for IPs to take both appointments in some cases, ordered by the court.[29]

Co-ordination/consolidation of personal and corporate liabilities of a business has been recommended for consideration internationally, by UNCITRAL and the World Bank. Other options include disallowing the enforcement of personal guarantees but that would have wider implications.[30]

The PJC inquiry itself could take a broad and more holistic view of how insolvency law should address "small business insolvency". The terms of reference do call for inquiry into the law's effectiveness in protecting and maximising value for general economic benefit.

The separation between corporate and personal insolvency has been raised as a productivity issue with the Productivity Commission, and with the government, both by the

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[28] See ARITA Code of Professional Practice; APES 330 – Insolvency Services.

[29] See for example *Application by Solomons* [2013] FCA 1273. New Zealand law goes further. It has both a government company liquidator and a government bankruptcy trustee, the Official Assignee, and in certain cases the OA can be appointed to both a bankruptcy of the director and liquidator of the director's company: s 241 Companies Act 1993.

[30] See also the recently launched International Insolvency Institute – Asian Business Law Institute, *Guide on the Treatment of Insolvent Micro and Small Enterprises in Asia,* at p 17*: "…*many jurisdictions in Asia do not provide an effective DISCHARGE of debts for individuals. Even if they do, a discharge of debts usually requires the commencement of a separate procedure. Therefore, as sole proprietors and shareholders/managers often act as guarantors for the debts of MSEs, there should be greater coordination between the systems of corporate and personal insolvency. Otherwise, honest but unfortunate sole proprietors as well as the shareholders of MSEs who guarantee the debts of the MSEs will not find the corporate insolvency framework appealing. In that case, they might minimise the risk of insolvency by reducing their levels of debt and risk-taking or postponing (if possible, even avoiding) the commencement of insolvency proceedings. Thus, value can be destroyed for the society if, for example, those forms of behaviour lead to suboptimal investment decisions or delay the response to a situation of financial distress, reducing the likelihood of promoting an effective reorganisation of viable MSEs and an efficient liquidation of non-competitive MSEs".[30]

ASBFEO.[31] As a matter of law reform, it would be difficult to simplify legally and conceptually and would require extensive consultation. The need to maintain proper standards of corporate business compliance and conduct is important, that any such reform may disrupt. But a small step would be to consider procedural co-ordination or consolidation of such proceedings, as UNCITRAL suggests. The use of the one court – the Federal Circuit and Family Court - for handling small business insolvency matters would assist. Moving personal insolvency policy to Treasury from Attorney-General's would also help.

Part 5.3B Corporations Act

The relatively recent introduction of Part 5.3B (Restructuring) in 2021 provides a procedure available to companies with less than $1 million in outstanding liabilities. Take up of the procedure has been slow, with few appointments (only 177 since 1 January 2021, compared with 313 in the first 6 months of Part 5.3A voluntary administration in 1993 alone and 2210 in the first 2 years of the procedure).[32]

There are several shortcomings of the Part 5.3B procedure that may be contributing to its low take up.[33] In particular, the maximum liabilities threshold of $1 million seems too low. The small business Chapter 11 procedure in the United States (Subchapter V of 11 USC) has a debt limit of US$2.7m, although during the pandemic this was temporarily increased to US$7.5m.

The prohibition on access to Part 5.3B where a company has not paid employee entitlements in full also cuts off a large proportion of small businesses from using the procedure. The restructuring plan should be allowed to include employee entitlements to be made up during the period of the plan, which would also require employees to be recognised as creditors under Part 5.3B (which they currently are not).

Simplified liquidation

We need not spend much time discussing simplified liquidation because it has only been used in 37 cases since it was introduced in January 2001. In our view, the procedure offers some cost reductions to a standard liquidation, but these are not sufficient to provide a meaningful increase to creditor returns. The timeframes in the procedure are very tight and the compliance reductions for liquidators are minimal.

There is a need for a streamlined insolvency procedure for low/no asset companies, but simplified liquidation can't effectively fulfil that role. Our recommendation is that this procedure could be replaced by an administrative procedure conducted by, or under the supervision and funding of an Official Receiver's office.

The unlawful phoenix reforms

These reforms include the creditor defeating disposition provisions (a type of voidable transaction that can be challenged by a liquidator), and a new power being given to ASIC

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[31] See Submissions | ASBFEO.

[32] The VA figures are drawn from Professor Harris' dataset produced for his PhD thesis on voluntary administration. For Part 5.3B appointment data see ASIC Insolvency Statistics Series 2, Table 2.1 (28 November 2022).

[33] For a detailed discussion see, Jason Harris and Christopher Symes, 'The chimera of restructuring reform: An opportunity missed for MSMEs in pt 5.3B' (2021) 36 *Australian Journal of Corporate Law* 182 (Attachment B to this submission).

to issue administrative notices to recover assets that are creditor defeating dispositions. A similar power exists in personal bankruptcy law (under s 139ZQ of the Bankruptcy Act), but ASIC has not been active in issuing the notices. In our view the creditor defeating disposition provisions were unnecessary because Part 5.7B already contained a range of provisions to claw back transactions that were uncommercial or unfair. The problem was not a lack of legal power, but rather a lack of financial resources to bring proceedings. We recommend that legislative guidelines be produced to guide how ASIC uses the creditor defeating disposition power and that the power be extended to other forms of voidable transactions to assist with saving money in recover proceedings. In particular, we recommend that such guidelines impose a time limit on ASIC issuing the notice. Parties to commercial transactions should not be left in limbo as to whether ASIC will issue a recovery notice, which is punishable by a criminal offence if not complied with. A 12 month or 2 year time limit would seem appropriate.

Operation of the PPSA in corporate insolvency

The interaction of the PPSA with corporate insolvency is a complex issue that involves both policy, economic and legal factors. We note that the government's review of the PPSA undertaken by Mr Bruce Whittaker in 2014 has still not yet been responded to. This inquiry is not a suitable forum to be reconsidering that detailed review and its hundreds of recommendations. We suggest however that some small measures would be beneficial in corporate insolvency.

First, repealing ss 588FL and 588FM of the Corporations Act and leaving vesting of unperfected security interests as a matter for the Personal Property Securities Act 2009 (Cth) (PPSA) itself.

Second, we recommend implementing the Whittaker Review's recommendations to simplify the PPS Register registration process (by reducing the collateral classes) and to reform the system of amendment demands so that asset sales in insolvency are not held up by frivolous and vexations registrations that are not based on perfected security interests.

Third, we support the Whittaker Review's suggestion to harmonise grantor registration details involving trusts so that ACNs are used, which would address the ACN/ABN errors that have taken up much court time.

Last, if s 588FL is not repealed, we recommend that the law be amended to ensure that security interests granted by insolvency practitioners are not automatically invalidated by s 588FL which requires a court extension of time prior to executing the agreement (which is just a waste of time and money that serves no one's interests).[34]

TOR 3

Preferences

The right to recover a preferential payment to a creditor is fundamental in insolvency law. The rationale for it is that the creditor has "jumped the queue" in obtaining payment of its debt and it should repay the money and stand in line with other creditors. Preferences are therefore supposed to promote "equality among creditors" and to deter a "race to the courthouse".[35] While these appear valid reasons, for one thing, the demand and receipt by

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[34] For a discussion see Jason Harris, 'Giving security after insolvency and PPSR extensions of time' (2020) 34(1) *Commercial Law Quarterly* 18.
[35] See Murray and Harris, *Keay's Insolvency,* Thomson Reuters, 11th ed, 2022, [5.135-5.140].

a creditor of what is later found to be a preference, even if with full knowledge of the debtor's insolvency, is not unlawful. It is simply a payment liable to be set aside when, or if, the person goes bankrupt within the requisite time period and when other requirements of the law are satisfied by the trustee. In *Nationwide v Franklins* [2001] NSWSC 1120 at [9], the court said:

> "There is nothing compelling a creditor somehow to remain pure by shunning a payment in respect of which there exists some theoretical future possibility of its proving to be preferential. A normally motivated creditor would be inclined to accept such a payment conscious of any risk of disgorgement, and with fingers crossed to the extent indicated by the circumstances."

The creditor, from whom the trustee or liquidator recovers a preference, is then permitted to lodge a proof of its debt in the bankruptcy: s 122(5) BA; s 588FI(3) CA.

Importantly, and this goes to our threshold issues, with funds so limited in many insolvencies, we suspect that many preference claims are made to recoup the liquidator's fees. Indeed the courts endorse that, the court in a preference recovery case saying that:

> "even if the proceedings were pursued to seek to recover the liquidators' costs or funding which had been devoted to the conduct of the proceedings, it seems to me that that is a proper purpose, where liquidators would less readily accept appointment, and litigation funders would less readily fund proper proceedings in liquidation, if liquidators could not recover their remuneration or litigation funders could not recover the funding which they provided".[36]

While that is not unlawful or even inappropriate, it does not directly support the policy basis of sharing all the funds among the creditors. Also, litigation to recover preference claims can be expensive thereby only large claims might be pursued. Also recovering money from creditors whose debtor has gone into liquidation creates ill will. The law has in fact placed a $30,000 limit on the recovery of preference recoveries in the simplified liquidation process.[37]

Finally, we re-emphasise that the recovery of money for fees through preference claims confirms the limited funds available in many insolvencies.

Trusts with corporate trustees

This is a complex issue, and any reforms would need to take into account how the changes may affect the operation of non-commercial trusts (such as charitable and non-express trusts). We note that the 1988 Harmer Report recommended amendments to corporate and trust law to address the problems posed by commercial trading trusts and insolvency. We endorse those recommendations. We also endorse the submission of the Law Council of Australia, which has made several detailed submissions to Treasury regarding how to adequately address the problem. In short, many trading trusts enter insolvency with minimal assets but many trust deeds remove a trustee who becomes insolvent which turns the trustee into a bare trustee who is unable to deal with the trust assets, even if the trustee has a right of indemnity against the trust assets. This requires the trustee to seek a court appointment as a receiver for sale, but this may cost $20,000 or more to obtain, and many of these trusts have not much more than that remaining. It is perverse that the cost of seeking power to administer the assets will itself exhaust the assets. No one's interest is served by this state of the law. While we endorse the recommendations in the Harmer Report and the Law Council submission, at a minimum

[36] *Re Cardinal Group Pty Limited (in liq)* [2015] NSWSC 1761 at [34].
[37] Corporations Regulation 5.5.04

we strongly recommend amending the Corporations Act to make it clear that external administrators appointed over a company that has been acting as trustee and has a right of indemnity available against the trust assets should be able to deal with those trust assets as property of the company using their statutory power of sale under the Corporations Act (see for example, s 477).

Insolvent trading safe harbours

We note that there has been a detailed review of the safe harbour for company directors against insolvent trading liability in s588GA. We recommend that the committee endorse the implementation of the recommendations from that report.

International approaches

There are many lessons that could be learned from the insolvency law of foreign jurisdictions. As a starting point it is important to consider how the jurisdiction wishes to balance the interests of debtors and creditors, how secured creditors are treated prior to and during insolvency, how government debts are treated in insolvency, how employee claims are dealt with and who has the power to administer insolvent estates. These are big policy choices that require extensive consultation. For example, Australia could move to a broad-based debtor-in-possession regime (beyond what currently exists under Part 5.3B) but this would require a conversation about the role and powers of creditors, the capacity of debtor company management and early warning signs for financial distress. It is difficult to cherry pick particular measures in foreign insolvency regimes and implement them in Australia, because insolvency law is enmeshed within the broader commercial, financial and legal system so that one change can have unintended ripple effects throughout the economy.

We recommend that the Committee consider the streamlined insolvency measures that have been implemented in Singapore and India, as well as no-asset procedures in New Zealand and the UK. Informal, out of court and non-external administration procedures are becoming more popular around the world as a recognition of the low/no asset status of many insolvent debtors means that the cost of external administration (at least by a private profession) can't be justified. This is why we advocate for a greater role for government in corporate insolvency through an Official Receiver's office.

International norms and principles

At a more general but important principles-based level, international agencies of which Australia is a participant member gave particular focus to insolvency law during the period of disruption caused by the virus. The *World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes*, 2021[38] and the *UNCITRAL Legislative Guide on Insolvency Law for Micro- and Small Enterprises* 2022[39] both offer guidance on laws for MSE insolvency, as does the recently launched International Insolvency Institute – Asian Business Law Institute, *Guide on the Treatment of Insolvent Micro and Small Enterprises in Asia*.[40] In particular UNCITRAL offers guidance for its member states on laws concerning the insolvency of MSEs with particular focus on prompt, accessible and quick resolution of

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[38] Principles for Effective Insolvency and Creditor/Debtor Regimes, 2021 Edition (worldbank.org)
[39] UNCITRAL Legislative Guide on Insolvency Law for Micro- and Small Enterprises
[40] *Guide on the Treatment of Insolvent Micro and Small Enterprises in Asia* 2022, Principle 1. The Guide includes Australia and New Zealand in Asia. < https://abli.asia/ >.

their financial difficulties either by way of a restructuring or by a prompt liquidation. Any reform of Australia's laws should at least be measured against the principles in these guidelines.

Importantly, UNCITRAL also gives guidance on insolvent assetless companies, being those businesses that have traded to a point where they are insolvent with few or no remaining assets. The question that then arises is as to whether these require regulatory attention or whether they might simply be allowed to be deregistered. For two reasons UNCITRAL considered that they need attention according to certain principles.

Principles concerning assetless companies

We have explained that a significant number of small companies that may well be insolvent are simply deregistered by ASIC by a default process available under s 601AB of the Corporations Act. his number appears to be increasing.

There are two particular reasons given by UNCITRAL why such companies, even though apparently assetless, should receive some regulatory attention rather than being permitted to fade away by default.

The first is that the lack of assets may be by design, that is, the assets may have been transferred prior to the company's "failure" for use in a new business leaving the old business and its debts behind, sometimes called phoenixing. Or two, the assets may have genuinely depleted such that there is none remaining and no remuneration available for a practitioner to wind up the enterprise, despite the desire of the directors, or the creditors, including employees.

UNCITRAL advises that although there may be no remaining assets, the state should nevertheless play a role in oversighting and as necessary investigating or assisting these assetless companies. In the case of phoenixed companies, it goes against the integrity of the regime and business confidence generally to allow a business to deplete itself of assets and thereby make it difficult for its creditors to recoup their losses. On the other hand, if there is a genuine loss of or run-down of assets by the business there should be an avenue available for the directors to wipe the slate clean and attend to creditors and employees by way of liquidation before any final disposal of the company.[41]

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[41] Those two important policy issues involving assetless insolvent companies are identified and explained by UNCITRAL in this way.

"[73] …. Where an insolvency law does not provide for exploratory investigations of insolvent companies with few or no assets, it does little to ensure the observance of fair commercial conduct or to further standards of good governance of commercial entities. Assets can be moved out of companies or into related companies prior to liquidation with no fear of investigation or the application of avoidance provisions or other civil or criminal provisions of the law.

[74]. A mechanism for administration will assist in overcoming any perception that such abuse is tolerated and may provide a return for creditors where antecedent transactions can be avoided, as well as a means of investigating the conduct of the management of such debtors".

The guide gives positive reasons also:

"It may also encourage entrepreneurial activity and responsible economic risk-taking through the provision of a discharge and fresh start for entrepreneurs and others engaging in economic activities—the punitive and deterrent aspects of insolvency laws will be less appropriate where the debtor is honest. For example, where an application to commence insolvency proceedings might otherwise be denied, some insolvency laws provide an exception for individuals with insufficient assets to fund the administration of proceedings, enabling the affairs of that debtor to be investigated to determine if there are assets that can be recovered and whether the debtor should receive a discharge".

It is for that and related reasons that we are suggesting that a government role or government funded role be provided for assetless companies.

UNCITRAL offers mechanisms[42] for pursuing the administration of such estates including levying a surcharge on creditors to fund the administration; establishing a public office or using an existing office, (such as an Official Receiver); establishing a fund out of which the costs may be met; or appointing a listed insolvency professional on the basis of a roster or rotation system.

In that last example, the guide suggests the IP be paid a prescribed fee by the State or the costs be borne directly by the IP and cross-subsidized by their other matters, with their remuneration rates being adjusted accordingly.

TOR 4

Supporting business access to advice

We recommend that greater attention be given to supporting business managers well before the tipping point of formal insolvency. Many small businesspeople lack the financial management skills needed to monitor their financial position which means that they only face up to the problems of the business after it is too late, such as when the ATO issues a director penalty notice or a garnishee notice. We strongly endorse the policy proposal by the ASBFSO to introduce a "business viability review voucher" so that small businesses can get access to quality advice at an affordable price. An ounce of prevention is worth a pound of cure.

TOR 5

The role, remuneration, financial viability, and conduct of corporate insolvency practitioners etc

The role of the insolvency practitioner is central to the operation of any insolvency regime. It has been said that the two pillars of insolvency are the practitioners and the courts.[43] For that reason the nature of the role, the clarity of their powers and duties and the expectations of conduct are each important. These are contained in the law itself, in court decisions and in codes of conduct such as that of ARITA And APES 330.

We consider that in most respects those powers and duties are clear although the expectation of practitioners in relation to unremunerated estates needs to be clarified.

This is not to say that we accept that all of the duties imposed on a practitioner are valid. As we say in *Keay's Insolvency*,[44] "neither insolvency law nor its practitioners are the panacea for the losses and other harmful outcomes that can occur when a formal insolvency is invoked". Yet some seem to:

> "expect the insolvency practitioner … to act as a protector of the insolvent company or individual, as an asset recovery agent and asset protector, a commercial investigator and problem solver, a public inquisitor, and then, as needed, a distribution agent … [with the practitioner] expected to do this with limited or, in some cases, no funds, or where funds

[42] At [75].
[43] "In the field of insolvency there are two actors whose integrity and expertise are central to the functioning of the insolvency system: judges and administrators': Westbrook, Booth, Paulus and Rajak, *A Global View of Business Insolvency Systems,* The World Bank and Brill, 2010, at 203.
[44] At [1.170].

are available, in the knowledge that these expenses compete with funds which the creditors might see, unrealistically, as theirs".[45]

Our argument is that these unrealistic expectations of the system and its practitioners, are exacerbated by a failure to recognize that many of the tasks of an insolvency practitioner are conducted on behalf of the state, being in the nature of public interest duties. These should be either recognised financially or carved out from the IP's responsibilities to be performed by a public officer. That issue goes to the financial viability of IPs in that the figures we have extracted indicate that in a high proportion of matters liquidators are administering estates in effect for free because there are no funds available to pay their remuneration.

We also note that a new registration and disciplinary regime was introduced in 2017 with a review due in five years' time, that is, 2022.[46] While we don't raise any particular issues here about the regulation of practitioners by ASIC, we do consider that it is inefficient for insolvency practitioners to be regulated both by ASIC and by AFSA in particular where practitioners are one and the same. This is also unsatisfactory given that the Insolvency Law Reform Act 2016, which followed several prior inquiries into ASIC and insolvency,[47] introduced harmonised processes, to the extent possible, between corporate and personal insolvency, which at present are regulated in different ways by each of ASIC and AFSA. Any review of insolvency practitioner regulation should consider whether joint regulation would be desirable. We also note that regulation was delegated in part to a large number of industry bodies who in the five years operation of the new regime appear to have taken no part in the regulation of practitioners; their role may need to be reconsidered.[48] We note also that a broader scope of experience and qualifications was introduced for small business practitioners but that at our last inquiry only one had been so appointed. There would be merit in reconsidering the qualifications and experience required of an insolvency practitioner in order to broaden the perspective of those administering the process on behalf of such a wide range of businesses and individuals in very much a novel 21st century environment.

TOR 6

<u>*The role of government agencies in the corporate insolvency system*</u>

Our threshold position is that the state should take a more prominent role in relation to the establishment and operation of the insolvency regime. That is the case in particular because of the inherent limited funds available for the private sector to provide the services required. Also, many of the purposes and tasks in insolvency are inherently the role of government; for example regulation and prosecution of offences. It is for that reason that we have recommended an official receiver role comparable to that in personal insolvency although with an overarching responsibility over the two regimes.

Beyond that there are a number of government agencies involved in insolvency administration apart from the two regulators ASIC and AFSA. Other government agencies involved are largely creditor based and include the ATO the Fair Entitlements Guarantee scheme (FEG) and other miscellaneous government bodies; for example, the ACCC in

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[45] *Keay's Insolvency,* p 32.
[46] Explanatory Memorandum to the Insolvency Law Reform Bill 2015.
[47] See J Harris, 'Corporate Insolvency Law Reform: Reframing the Dialogue' in Sheelagh McCracken, Shelley Griffiths (Eds.), *Making Banking and Finance Law: A Snapshot*, 2015, Ross Parsons Centre of Commercial, Corporate and Taxation Law, Sydney University, pp. 53-76.
[48] Michael Murray, 'Bodies everywhere - the role of professional bodies in regulating insolvency practitioners' (2018) 17 & 18 BCLB [351].

relation to consumer law or liabilities for other such breaches. The fundamental position of insolvency law is that the government is an ordinary unsecured creditor unless the law dictates otherwise. The ATO was removed as a priority creditor some decades ago but in its place it was given direct rights of claim against directors of companies and it has some other protected arrangements in respect of preferences and the like.

Its main focus in insolvency is that it is reportedly the main instigator of winding up applications against companies for unpaid taxes and hence the most significant creditor in liquidations including at meetings of creditors. Our comment about the ATO probably goes beyond the nature of this inquiry but the large accumulated unpaid tax date is a problem in insolvency. Tax liabilities are usually the most significant debt in any insolvency and the amount and time over which they have accrued can result in other creditors being "swamped" by the ATO liability. The general approach in any insolvency regime is for early action to be taken by companies in relation to their liabilities and delayed action by the ATO does not help that process.

Australian Small Business and Family Enterprise Ombudsman (ASBFEO)

As to the ASBFEO, his office performs a very useful role in bringing together the disparate range of businesses falling within the small business sector. They identify particular common issues among businesses, irrespective of the type of business involved. In that respect and as defined in the legislation he looks at a business as an economic entity not as one divided between sole trader and company.

As we have explained, the distinction between corporate and personal insolvency in relation to small companies is increasingly less relevant. It seems for that reason that the Ombudsman has made submissions that both corporate and personal insolvency should be better aligned in order to accommodate the realities of how small business operates.

We also note that the ombudsman is now located within Treasury along with the Tax Office and ASIC and it is in the context of that alignment that we suggest that bankruptcy also move to Treasury.

ATO

While the priority in insolvencies of the tax office was removed some decades ago it was replaced to an extent by particular remedies against the directors of the company. The "director penalty notice" is one example and the indemnity required to be given by directors under section 588FGA is another. The concern we have is that tax liabilities appear to accumulate to a considerable degree in the SME sector resulting in a large claim being made by the tax office when the company fails. Insolvency law can only do so much by way of recouping creditors their losses in particular if the creditor allows a debt to accrue over a period. We appreciate that this is a matter of tax law not insolvency law, but the reality is insolvency law has to pick up the pieces of whatever law applies to the insolvent company.

We also note that the mix between priorities under the tax law and priorities under the insolvency law are often in conflict. This is despite both tax and corporate insolvency coming within the one department. A process should be in place to ensure that there is communication if changes to the tax law would impact upon insolvency law. The principle of equal sharing, or *pari passu*, in insolvency law is fundamental. However, it remains subject to the legislature elevating certain groups, for example employees, and thereby FEG, above unsecured creditors. When this is done, including in the tax context, the law should be clear, including as to the policy reasons for the change; and the priority of the remuneration of the IP should not be compromised without a clear basis.

FEG

FEG is a creditor in many estates because it pays certain entitlements to employees' unpaid at the date of the liquidation and then stands in their shoes as a creditor: s 561, 556 Corporations Act. Employees and therefore FEG have priority over circulating assets of the company – such as work in progress payments, receivables etc - and the liquidator must take care to use such assets with that priority in mind. There is coupled with uncertainty as to the extent of the priority of the liquidator's remuneration.

Historically, the priority dates back to the 19th century when employees were given priority for their wages over floating charge assets of an insolvent enterprise. The juggling and calculations required of a liquidator in administering a trade-on of the company's business, using circulating assets, can be difficult and has the potential to lead to disputes; this is so in particular when there is a Part 5.3A administration, where FEG/employees have no priority, followed by a liquidation, where the priority arises.

We suggest that the law be clarified by way of law change or regulatory guidance as to the expectations of external administrators in relation to the use of circulating assets and their proceeds to fund trade-on activity. Given that remuneration is also subject to legal uncertainty, we suggest that its position be secured, in order to provide clear priority to insolvency practitioners for payment of their remuneration and expenses. Ultimately, we suggest the PJC take submissions on alternative bases for securing priority payments to employees, that are more certain and less prone to dispute.[49]

The Courts

While the courts are vital to the operation of the insolvency regime, the costs and time involved in seeking court approval for certain actions must be weighed against the benefits. IPs themselves exercise significant quasi-judicial authority and their decisions are subject to court review.

As an example, we suggest that consideration should be given to replacing the requirement for court applications for extensions of time under s 439A of the Corporations Act with an administrative process or alternatively a default approval process. Similarly, there should be no need for IPs to seek court approval for entry into a funding agreement or compromising a debt: see s 477(2A)(2B). Such court approvals are not required for trustees in bankruptcy in identical situations under the *Bankruptcy Act.*

TOR 7

Corporate insolvency covers an extensive field of law and range of interests, one in particular being the duties of directors of an insolvent company and their enforcement. At the same time, there is a balance needed to ensure that genuine failure of a business is not penalised, and that there are no unreasonable impediments to further entrepreneurial efforts. We endorse the recommendation from the Safe Harbour review report that a broad review of director liability laws should be undertaken.

[49] Fully discussed in The Protection of Employee Entitlements in Insolvency, MUP Academic, H Anderson, 2014, including as to international precedents.

Part 3

We do not add further to this submission but do suggest that Chapter 1 of our textbook, *Keay's Insolvency*, 11th ed, 2022, provides much of the views we would otherwise offer to this Committee.

Beyond that, we are available to assist the committee further as needed, in hearings or as required.

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