ARITA
AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

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Senior Adviser
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Treasury
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Dear Sir/Madam

Financial System Inquiry Final Report

We thank you for the opportunity to provide further comments in relation to the Financial System Inquiry Report (FSIR).

Other than our short comments to follow, the Australian Restructuring Insolvency and Turnaround Association (ARITA) would commend to you our two detailed Financial System Inquiry (FSI) submissions, on which the FSI did not substantially report. In addition, we have subsequently completed further policy work which we provide for your information.

Time for review

Even though it is one of the cornerstones of an effective market, restructuring, insolvency and turnaround has received only tangential legislative attention in the last two decades. We believe the time is right for a focussed inquiry into this critical function.

The existing Australian insolvency and restructuring framework not only serves the Australian financial system and economy well, but also stands up strongly in comparison to other regimes across comparable global markets.

Nonetheless, we believe there is room for improvement, particularly in the area of encouraging the recovery of viable businesses in financial distress. To that end ARITA, has developed a list of policies which address the need for a fundamental review of Australia's insolvency and restructuring framework. Our Policy Positions Paper is attached at Appendix A.

Law reforms

In addition to our Policy Positions Paper, ARITA has identified other needed law reforms for personal and corporate insolvency. These have been the subject of submissions to government over several years. However, many of these reviews and inquiries were limited in scope or had insolvency issues only as a by-product of a larger review.

Appendix B provides a listing of ARITA's prior submissions, Appendix C provides details of law reform matters previously raised with Treasury and Appendix D provides a listing of other matters that require reform to ensure the ongoing smooth operation of the insolvency regime.

In many cases, our submissions and recommendations (and those of other highly qualified experts in the field) have not been embraced or resulted in the reforms we were seeking. Disappointingly, many inquiries ended with no action being taken at all. We had anticipated that the FSIR would provide some high level structure and guidance on how our insolvency laws are operating and how they need to change. The Report instead made limited comment.

It is apparent from this that the attention given to review and reform of the insolvency regime is of low priority. This is in the context of significant ideas and developments being pursued in the UK, Europe and the US.

Australia cannot afford to be left behind if our regime is to retain or improve its standing in the global economy. By contrast, Singapore is currently pushing to become a regional centre for insolvency and restructuring, as the UK has already become in Europe. With our stable political regime, transparent and robust legal system and a global reputation for low levels of corruption, Australia is otherwise very well positioned to become a profitable hub for these services.

Golden opportunity

As we are presently experiencing very low levels of corporate insolvency, the government should grasp the opportunity of a quieter period to undertake a wide reaching, focused review of Australia's insolvency and restructuring regime, beyond that suggested by the FSIR.

Australia has not had a comprehensive review of its insolvency laws since the referral to the Australian Law Reform Commission in 1983. This resulted in the 1988 Harmer Report and the introduction of the revolutionary voluntary administration regime in 1993.

But times have changed, and the way of doing business has changed. For example, businesses are now much less 'bricks and mortar' and far more service- and virtual-based than in 1988.

As such, it is time for Australia to reassess its insolvency regime and make the changes required to ensure the regime's ability to save viable distressed businesses and to efficiently and effectively redistribute the capital of those businesses that cannot be saved.

Any reform of corporate insolvency should include personal bankruptcy. The process of alignment of bankruptcy and corporate insolvency commenced under the Insolvency Law Reform Bill 2014 should be continued.

We have taken the liberty of suggesting some terms of reference for this review of our restructuring, insolvency and turnaround laws which we have attached at Appendix E.

Should you wish to discuss any aspect of this letter, its attachments, or our submissions to the FSI, please do not hesitate to contact me or Ms Kim Arnold, ARITA Technical Director, on 02 8004 4344.

Yours sincerely

John Winter
Chief Executive Officer

About ARITA

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

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

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

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

We deliver this through the provision of innovative training and education, upholding world class ethical and professional standards, partnering with government and promoting the ideals of the profession to the public at large.

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

Appendix A – ARITA's Policy Positions Paper: February 2015

ARITA has previously provided you with a copy of its discussion paper, *A Platform for Recovery 2014*. This discussion paper has recently been finalised into a Policy Positions paper and a copy is attached for your reference.

The policies in the Policy Positions paper form the key basis of ARITA's position on needed reform to Australia's insolvency framework:

- Policy 15-01: ARITA Law Reform Objectives (Corporate)
- Policy 15-02: Aims of insolvency law
- Policy 15-03: Current Australian corporate restructuring, insolvency and turnaround regime and the need for change
- Policy 15-04: Creation of a Restructuring Moratorium (Safe Harbour)
- Policy 15-05: Stronger regulation of directors and creation of a director identification number
- Policy 15-06: Advocate for Informal Restructuring
- Policy 15-07: Reworked Schemes/Voluntary Administration regimes to aid in the rehabilitation of large enterprises in financial distress
- Policy 15-08: Extension of moratorium to ipso facto clauses
- Policy 15-09: Streamlined Liquidation for Micro Companies
- Policy 15-10: Micro Restructuring
- Policy 15-11: Pre-positioned sales

Fundamentally, ARITA believes that the existing Australian insolvency and restructuring framework not only serves the Australian financial system and economy well, but that it also stands up strongly in comparison to other regimes across comparable global markets. Nonetheless, we believe that the policies identified above are key areas for improvement of the existing framework to provide the best outcomes for the wider community.

Appendix B – Previous ARITA submissions

- ARITA (then the IPA) submission and letters of 26 November 2003, 8 March 2004 and 30 August 2005 to CAMAC in relation to its discussion paper on Rehabilitating large and complex enterprises in financial difficulty
- ARITA (IPA) submission of 15 June 2007 to Treasury in relation to the Review of Sanctions in Corporate Law
- ARITA (IPA) submission of 16 May 2008 to CAMAC in relation to its discussion paper on Issues in external administration
- ARITA (IPA) submission to Treasury jointly with the Law Council of Australia and the Turnaround Management Association Australia dated 2 March 2010 in relation to its discussion paper on Insolvent trading: A safe harbour for reorganisation attempts outside of external administration; supplementary submission of ARITA dated 18 March 2010.
- ARITA (IPA) submission to CAMAC of 7 October 2011 in respect of its June 2011 Managed Investment Scheme discussion paper
- Strengthening APRA's Crisis Management Powers – Consultation Paper – September 2012, ARITA (IPA) submission December 2012
- ARITA submission to CAMAC of 10 June 2014 in respect of its March 2014 discussion paper on the Establishment and operation of Managed Investment Schemes
- ARITA submission to UK consultation paper – Strengthening the regulatory regime and fee structure for insolvency practitioners, 28 March 2014
- ARITA submission of 26 August 2014 in response to the Financial Systems Inquiry Interim Report
- ARITA submission of 4 September 2014 to the Senate Standing Committees on Economics inquiry into Forestry Managed Investment Schemes
- ARITA supplementary submission to the Financial Systems Inquiry of 13 October 2014 regarding the use of technology
- ARITA submission of 2 March 2015 to the Productivity Commission in response to their inquiry into Business Set-up, Transfer and Closure
- ARITA's numerous submissions to the Personal Property Securities Act Review
- Numerous consultations and submissions to Treasury in relation to the Insolvency Law Reform Bills 2013 and 2014

Appendix C – Specific areas for amendment

These suggestions for amendment are in the nature of minor or technical amendments and are in two groups, by reference to particular sections and by reference to terminology across sections. They were initially provided to Treasury in 2009. This list only contains outstanding matters.

Comments on particular sections of Chapter 5	
Section of *Corporations Act*	**ARITA Comment**
421A	The requirement to prepare a report in this section is described as being 'to a day not later than 30 days before the day when it is prepared'. We think this is very unclear wording, in fact have difficulty in clearly understanding it, and suggest that it be changed.
435C	Section 435C(3)(h) provides that an administration ends when 'management of the general insurer vests in a judicial manager of the company appointed by the Federal Court under Part VB of the Insurance Act 1973 or Part 8 of the Life Insurance Act 1995'. Part 8 of the *Life Insurance Act* deals with judicial management of life companies, as that term is defined. It seems that section 435C(3)(h) should say '...management of the general insurer vests in a judicial manager of the company appointed by the Federal Court under Part VB of the Insurance Act 1973 or management of the life company vests in a judicial manager of the company appointed by the Federal Court under Part 8 of the Life Insurance Act 1995'.
440D and 440F	Section 440D provides that during the administration of a company, 'a proceeding in a court against the company or in relation to any of its property' cannot be begun or proceeded with, except with the administrator's written consent or with court leave. Section 440F provides that during the administration of a company, 'no enforcement process in relation to property of the company can be begun or proceeded with' except with court leave. There is a difference in grammar and voice between these two sections, the reason for which is not apparent.
442C	Section 442C(4) refers to a situation where the administrator proposes to dispose of property *of the company* under paragraph 442C(2)(a) and provides that the Court may by order direct the administrator not to carry out that proposal. However, section 442C(5) refers to orders being made on the application of persons affected by either paragraph 442C(1)(a) or (b) and paragraph 442C(1)(b) of course refers to property that does not belong to the company.

	In the context of what is anticipated by section 442C(5) i.e. that an order may be made referable to disposals of property referred to under either paragraphs 442C(1)(a) or (b), then section 442C(4) needs to be amended to accommodate this. It should state either: *(4) 'If the administrator proposes to dispose of property under paragraph (2)(a), the Court may, by order, direct the administrator not to carry out that proposal'.* In other words, delete '…of the company.' or: *(4) 'If the administrator proposes under paragraph (2)(a)to dispose of property of the company or property of which someone else is the owner or lessor, the court may, by order, direct the administrator not to carry out that proposal'.*
466/556	In s 466, there is a reference to 'taxed costs' and these are accorded a priority under s 556(1)(b). However there is no longer concept of costs being 'taxed' in some jurisdictions where costs are assessed – see *Morepine v Crush Pacific Industries* (1996) 14 ACLC 898. As well, the amount involved is such that any formal process of determining the costs should not be required – we suggest that the phrase 'as taxed, assessed or agreed'.
477	Section 477(1) refers to the fact that the liquidator may carry on the business of the company 'so far as is necessary for the beneficial disposal or winding up of that business'. Is there any logical reason for the different wording in s 493 which provides that the company must 'cease to carry on its business except so far as is in the opinion of the liquidator required for the beneficial disposal or winding up of that business'?
491	Section 491 refers to a 'printed copy of the resolution' – we think that what is meant is a copy of a written record of the resolution. In any event, it is clear enough to say 'a copy of the resolution' – see s 507(11) as an example.
497	Section 497(1) requires the liquidator to 'cause' a meeting of the creditors to be 'convened' within 11 days. The word 'convene' means to arrange the holding of a meeting; this is the way the term is used elsewhere in the *Corporations Act* and in the equivalent provisions in the *Bankruptcy Act*. We do not think this is what was intended – the Explanatory Memorandum [4.196] says that 'the required timing for the creditors meeting will be extended to 11 days after the day of the members' meeting'; if that was so, the section would say the liquidator should cause the meeting to be 'held' within 11 days. As it is, ARITA is generally content with the present wording and timing, that is, to require the convening of the meeting within 11 days and then the holding of it

	7 days thereafter. This is so particularly in light of the fact that directors have 7 days to provide a RATA (s 497(5)). However, we think that a time limit should be set on the maximum period of notice that can be given for the meeting. At the moment, there is a minimum notice requirement of 7 days (s 497(2)) but no maximum, so theoretically a liquidator could give a lengthy notice period for a meeting. We suggest that the words 'must cause a meeting of the company's creditors to be convened' might more simply be expressed as 'must convene a meeting of the company's creditors …' and s 497(2)(a) should read 'give to the creditors at least 7 days but no more than 14 days notice of the meeting'. ***We note that if the ILRB 2014 proceeds, the section is subject to significant amendment ***
497(8)	Section 497(1) requires the liquidator to convene the meeting of creditors. Section 497(8) states that 'the creditors may appoint one of their number or the liquidator to preside at the meeting', but regulation 5.6.17 states that if a meeting is convened by 'a liquidator [etc] …that person, or a person nominated by that person, must chair the meeting'. An issue of inconsistency was discussed in *Re Henry Walker Eltin Group Limited (Administrators Appointed)* ACN 007 710 483 [2006] FCA 353. ARITA suggests that an inconsistency arises here because originally (pre 2007) the CVL meetings were convened by the company, not the liquidator. That is why creditors had a choice in appointing a chair for the meeting. However, now that it is the liquidator convening the meeting, CVLs should be made consistent with other meetings held by liquidators and it should be the liquidator, or his or her nominated alternate, that chairs the meeting. The difference, if any, between 'presiding (over)' and 'chairing' a meeting is raised at the end of this schedule.
536/423	You are referred to the decision of the Victorian Supreme Court in *Vink v Tuckwell* [2008] VSC 100 which was critical of the drafting of this section. The Court said that [185] '... the legislature should consider amending s 536 of the Act to limit the persons who may complain to the court to those who have an interest in the liquidation'. The *Bankruptcy Act* equivalent is s 179. There is no similar issue involved – s 179 limits the applicants to the Inspector-General, a creditor or the bankrupt. It may be that you should consider something similar to s 179. The same issue affects s 423.

548	Section 548 provides that the liquidator must, if so requested by a creditor or contributory, convene separate meetings of the creditors and contributories for the purpose of determining whether a committee of inspection should be appointed etc. This appears to be the only power whereby a committee can be appointed and it strictly means a committee can only be initiated by a creditor or contributory. This compares for example with the simplicity of s 436E(1)(a). ***We note that if the ILRB 2014 proceeds, this provision is subject to significant amendment ***
565-567	Will these pre-1993 sections be repealed?
588FE(4)	Section 588FE(4) is as follows: The transaction is voidable if: (a) it is an insolvent transaction of the company; and (b) a related entity of the company is a party to it; and (c) it was entered into, or an act was done for the purpose of giving effect to it, during the 4 years ending on the relation-back day. We consider that the term a 'related entity of the company is a party' is broader than intended and that it was properly meant to say 'the transaction is in favour of a related entity of the company' or some such words. To illustrate the issue, if X1 grants a charge to its (unrelated) bank for a previously unsecured debt, the bank would expect only to have to wait for 6 months for the security to 'harden'. However, if, as part of the price for the bank agreeing not to press for repayment of its debt, it not only requires X1 to give security but also that X2, a related entity of X1's, to give a guarantee (and maybe security), it is at least arguable (and may be more or less arguable depending on exactly how the deal is documented) that there is a single 'transaction' (being the whole deal) to which not only X1 but also a related entity of X1 is a party. In that instance, the bank would have to wait 4 years for its security to harden. We do not consider this is contemplated by the provision. This issue may bear further consideration.
601AH	In *Foxman v Credex* [2007] NSWSC 1422, Justice Richard White of the NSW Supreme Court was critical of the drafting of s 601AH, saying that the section 'is a law reform measure itself in need of reform'. We refer you to that judgment for your assessment of the legal and drafting issues raised. As you have said, this issue may bear further consideration.

Comments on general issues of terminology across a number of sections	
Issue	**ARITA Comment**
Fixing and determining remuneration	Section 425 refers to the Court's power to 'fix' remuneration; as do sections 495, 499, 473 and 484. Section 449E refers to remuneration being 'determined', as does section 473(3). There appears to be no reason for the difference in wording; the word 'fix' is used in the *Bankruptcy Act* and is preferred as the historically based and well known term used. The word 'determine' is used in other senses in the *Corporations Act*.
Timing and service	As a general comment, we suggest there be a review of how time limits are expressed in Chapter 5, with a view to simplicity and consistency; and of document service requirements. Time limits are important in insolvency and often strictly applied. Practitioners should be able to readily calculate the time within which an action should be taken, by them or by creditors or others. Likewise, means of service and at what time a document is served should be clear. We have not done a detailed review but suggest that Chapter 5, and the Act itself, is not simple or consistent. Examples are: • Under s 439A(3)(a), written notice of a meeting is given at the time it is put in the post for the purpose of sending it to the person by prepaid post as required by Regulation 5.6.12(2)(b) – Re *Vouris; Epromotions Australia Pty Limited v Relectronic-Remech Pty Limited (in liq)* [2003] NSWSC 702; 47 ACSR 155; *Yates, in the matter of G Retail Ltd (Adm'r App'd)* [2006] FCA 370. That approach has the benefit of certainty but it relies upon judicial interpretation; • A similar but more significant issue (as to the date of service of a tax penalty notice) arose in *Deputy Commissioner of Taxation v Meredith* [2007] NSWCA 354, which again relies upon judicial interpretation. • General issues of complexity as to timing and service are raised in *Scope Data Systems Pty Ltd v David Goman as Representative of the Partnership BDO Nelson Parkhill* [2007] NSWSC 278; (2007) 210 FLR 161, which we consider a simpler regime would avoid. Even in relation to relatively straightforward timing calculations under what appear to be clear provisions, judicial assistance can be required – see *Weston Application; Employers Mutual Indemnity (Workers Compensation) Ltd v Omni Corporation Pty Ltd* [2009] NSWSC 264 (s 588FF(3)); and *Amorin Constructions Pty Ltd v Kamtech Electrical Services Pty Ltd* [2008] NSWSC 267 (s 459R).

Appendix D – Other matters for reform

There are other matters for reform that should also be examined, as these issues can directly affect the effectiveness of Australia's insolvency regime. We bring the following matters to your attention, although we note that this list is not exhaustive:

The insolvency of trading trusts – The nature of trusts results in many problems when they become insolvent. This is clearly demonstrated in the recent failures of managed investment schemes and the large number of complex court actions required to progress them. We refer you to our many submissions on this issue listed at Appendix B.

Tax – Many problems and inconsistencies arise due to the fact that tax legislation is written from the perspective of an ongoing business that will continue to trade and pay its tax debts in due course. The financial failure and wind down of a business, with a change of control to an external administrator, terminates this process and tax legislation largely does not cope well with this occurrence. Two examples of this are:

> **Capital gains tax** – There is much uncertainty around the liability for, and priority of, capital gains tax in insolvency. We refer you to the recent decisions in *Australian Building Systems Pty Ltd v Commissioner of Taxation* [2014] FCA 116 and its appeal in *Deputy Commissioner of Taxation v Australian Building Services Pty Ltd (In liquidation)* [2014] FCAFC 133. We note that the Deputy Commissioner of Taxation has also lodged a High Court special leave application which is being heard on 17 April 2015.
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> The position put forward by the ATO suggests that the following inconsistency can occur: If an asset is sold for a profit one day prior to the appointment of a liquidator, the capital gain would fall as pre-appointment income and would be a provable debt. However, if the same asset were sold one day after appointment, the whole amount of the capital gain would be income of the liquidation, with the resulting tax payable an expense of the liquidation which has a high priority under s 556, and possibly a personal liability of the liquidator.
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> **Superannuation Guarantee Charge** – Misalignment of obligations to pay interest under the Superannuation Guarantee Act and how interest is treated under the Corporations Act when proving a debt.

Personal Properties Securities Act – We draw your attention to recommendations 365 and 366 from the report on the Personal Property Securities Act 2009. These reform issues referred to Treasury relate to the treatment of securities in insolvency. ARITA made numerous submissions to this review and they are available on the Attorney-General's website for the Review.

Lack of clarity in the priority of employee entitlements – The problem of employee priorities has been mentioned in several court decisions, particularly where there are multiple appointments (for example a receiver and a liquidator), and we refer you to a submission by the Law Council to Treasury, which was supported by ARITA, and the following recent articles in The Australian Insolvency Journal (attached for your reference).

- ‘Employee entitlements in corporate insolvency: some unresolved issues’, Dr Garry Hamilton, Minter Ellison lawyers
- ‘Employee priority, subrogation and breach of trust developments’, Michael O’Donnell and Sam Carragher, Thomson Geer Lawyers

Appendix E – Suggested terms of reference for a restructuring, insolvency and turnaround inquiry

The 1983 terms of reference for the Australian Law Reform Commission's General Insolvency Inquiry form an excellent starting point for the terms of reference that we suggest for Australia's next restructuring, insolvency and turnaround inquiry. However, we believe that the terms of reference should place an emphasis on the recovery of viable businesses that are in financial distress.

ARITA suggests that the federal Attorney-General and the Treasurer ask the Australian Law Reform Commission or other suitable body to inquire into the law and practice relating to the insolvency of both individuals and bodies corporate, in particular:

(a) the provisions of the *Bankruptcy Act 1966*, in their application to both business and non-business debtors
(b) Chapter 5 of the *Corporations Act 2001* so far as it relates to the restructuring, insolvency and turnaround of companies, and
(c) any related matter

with a view to:

(a) alignment of the personal and corporate insolvency laws
(b) encouraging the restructuring and turnaround of viable businesses in financial distress, and
(c) ensuring the efficient and effective redistribution of capital of those businesses that cannot be saved.