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By email: MCDInsolvency@Treasury.gov.au

Dear Sir/Madam

Submission on “Insolvency reforms to support small business”

Thank you for the opportunity to provide a submission on the Exposure Draft of the Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (“the Bill”) and associated Explanatory Materials. This submission is my own (as an independent academic) and should not be attributed to UTS or UTS Law.

Credentials

I am a Senior Lecturer in Law at UTS Law (Sydney). I am a published insolvency law academic and have been a lecturer in insolvency law for six years. Prior to academia and two years as ARITA’s Legal Director, I spent 10 years as a solicitor in private practice with firms in Australia and the United Kingdom (qualified in both jurisdictions), specialising in insolvency law and commercial litigation.

In my current role at UTS Law, I am the Program Head and principal lecturer of the “ARITA Advanced Certification”, a postgraduate-level course of study the completion of which fulfils the requirements laid down by the *Insolvency Practice Rules (Corporations) 2016* (Cth) (“IPR”) s 20-1(2)(b) (academic requirements of applicants for registration as a liquidator).

Qualifications of the new “Small Business Restructuring Practitioner”: The importance of knowledge and education in insolvency law and practice

As the program head and principal lecturer of Australia’s leading postgraduate course in insolvency law and practice, I have a unique perspective on the importance of insolvency education for aspiring practitioners as well as a deep understanding of the syllabus, curriculum, currency, standard and rigour (assessment) required of a postgraduate course that, upon successful completion, meets one of the legislated eligibility requirements for registration as a liquidator.

Insolvency law and practice is a complex, broad and continually evolving (ever-changing) field of professional expertise. As well as the significant technical content, concepts, principles, understanding and application of insolvency law and practice that is studied in my postgraduate course, one module in the two course units (and a discrete assessment task) is dedicated to the study of ethics theory, applied professional ethics and “professionalism”. Ethics and adherence to standards is an integral characteristic of a true “profession”.

From this perspective, I submit that the qualifications and ethical compass of the new proposed “restructuring practitioner” will be of fundamental importance to the integrity and the success of the new restructuring procedure set out in proposed Part 5.3B of the *Corporations Act 2001* (Cth) (‘the Act’). Apart from the importance of preventing and discouraging abuse of a streamlined procedure, the success of the new procedure in promoting the prospective approval of restructuring plans will not be achieved unless creditors (who will be voting on proposed plans) have confidence in the procedure and the practitioner who plays a central role in its implementation. To refer to one example, if the “restructuring practitioner” is to recommend a plan on the basis that it delivers a better outcome to creditors than a liquidation, that practitioner must have the requisite experience and knowledge of administering liquidations (including recovery actions, voidable transactions etc) so that creditors can reasonably rely upon the information presented by the practitioner.

In a recent article (published in the December 2018 *ARITA Journal*) regarding the World Bank's 2018 Report on MSME insolvency law reform¹, I stated:²

An aspect of the [World Bank] Report that has significance ... is the emphasis upon the “integrity, transparency and competence of a country’s institutional framework and professionals” in the successful implementation of any MSME insolvency regime ... the success of any new regime will depend upon the confidence creditors can place in the insolvency practitioner as a trusted intermediary who will properly assess both the debtor’s bona fides and the substance of any proposal.

¹ World Bank. 2018. ‘Saving Entrepreneurs, Saving Enterprises: Proposals on the Treatment of MSME Insolvency’ (English). Washington, D.C.: World Bank Group.

² “World Bank report on MSME insolvency: Implications for Australian law reform”, *ARITA Journal* 30(4), 18-21.

For the above reasons, I agree with the current terms of the proposed Bill that the new “restructuring practitioner” must be a registered liquidator: new s 456B of the Act. Further, if any new class of registered liquidator were created, applicants for registration as a liquidator in that new class should, in my view, be required to meet the same “insolvency education” eligibility requirements currently required of applicants for registration as a liquidator, including the requirements of IPR s 20-1(2)(b). I note that, for “eligible solicitors” who may accept appointments as a controlling trustee under Part X of the *Bankruptcy Act 1966* (Cth), the required “courses in insolvency” approved by the Inspector General in Bankruptcy for the purposes of *Bankruptcy Regulations 1996* reg 8.35 ([by notice dated 25 July 2018](#)) are the two “*courses in insolvency available from the Australian Restructuring Insolvency and Turnaround Association in partnership with the University of Technology Sydney: (a) Fundamentals of Restructuring, Insolvency and Turnaround; and (b) Advanced Insolvency*”.

My further comments and observations on the technical aspects of the exposure draft legislation and explanatory materials follow (on the basis of a limited review given the very short consultation period). I have also had an opportunity to review the submission of ARITA and I endorse its submission.

Debt Restructuring Procedure (new Part 5.3B of the Corporations Act)

- **Section 453A**: The circumstances of the “end” of a restructuring will be “prescribed by the regulations”. The draft Explanatory Materials (“EM”) at [1.8] contemplate that “if the plan is rejected, the restructuring process ends, and the company can seek to use an alternative formal insolvency process (such as liquidation or voluntary administration).” I submit that where a plan is rejected, there should be an automatic transition to a creditors’ voluntary liquidation. Section 455A provides that a company that proposes a restructuring plan is “taken to be insolvent” (not just “presumed” to be insolvent). Why then should there be any possibility of returning an insolvent company back to the control of directors to then decide whether to appoint a voluntary administrator or liquidator? Indeed, if that were to occur it creates an unnecessary duplication of cost and time. If an automatic conversion to liquidation did exist, I note that this would add to the extensive power vested in the restructuring practitioner under s 453J to terminate the restructuring (i.e., the restructuring practitioner could effectively convert the procedure to a winding up due to his/her belief on reasonable grounds as to the matters set out in that provision). Indeed, one of those grounds is that the restructuring practitioner believes that “it would be in the interests of the creditors for the company to be wound up”. However, if there is no automatic transition to a CVL, it would be anomalous if a restructuring practitioner could form that view, and terminate the restructuring, but the ultimate decision to initiate a CVL be left in the hands of the directors;
- **Section 453C and EM [1.23]**: The eligibility criteria – that no director of a company can use the procedure if he/she has been a director of another company that has used the new procedure – appears very strict and could render many small businesses ineligible simply on the basis of one person holding two directorships (though I note that exemptions will be made in

regulations). Presumably, there are many Australians that are directors of more than one small incorporated business;

- Section 453M: Subparagraph (b) of this provision requires the addition of “ordinary course” transactions and dealings during the restructuring period so that these transactions and dealings are also valid and effectual and not liable to be set aside by the subsequent application of ss 468 or 501 of the Act (ie, if there is a subsequent liquidation that follows the restructuring period). This amendment to s 453M would align with the proposed consequential amendment (insertion) of ss 588FE(2C) which will provide that transactions entered into, or done, in the ordinary course of business during a restructuring (or with consent of the restructuring practitioner) cannot be recovered as a voidable transaction. Some consideration may need to be given to the interaction of ss 453M and (new) 588FE(2C). Section 468(2) appears to also require further amendment to include “ordinary course” dealings during a restructuring as an “exempt disposition”.
- Section 453P is the equivalent to s 440A in Part 5.3A. I query whether this provision is appropriate to replicate for the new small business restructuring procedure. Nowadays, where a voluntary administrator is appointed just prior to the hearing of a pending winding up application, judges sometimes are prepared to refuse to adjourn the hearing and will proceed to wind up the company unless something more than a “mere speculative possibility” that it is in the interests of creditors for the administration to continue can be demonstrated. While these decisions relating to s 440A clearly (and appropriately) address situations of a “last-minute” appointment of an administrator following a statutory demand and winding up application, I query whether the nature and purpose of this new procedure will require a different approach from a judge when considering the adjournment of a winding up application. Indeed, as a matter of cost effectiveness, would an automatic and absolute adjournment under s 453P be appropriate and preferable to simplify the position? Many s 440A cases in courts regarding the appropriateness of an adjournment necessitate a significant volume of affidavit material: would it not be better to avoid this?³ Some would argue against an automatic adjournment on the basis that this would simply assist directors who wish to “prolong the inevitable” (liquidation). The new Part 5.3B procedure has a different complexion and purpose (see s 452A) in comparison to a Part 5.3A voluntary administration. I appreciate that reasonable policy arguments made on both sides; I simply raise the question whether it is suitable to simply replicate s 440A of Part 5.3A;
- Section 553(1A): As the draft provisions currently stand, debts incurred in the ordinary course during the restructuring period will not be provable in any subsequent liquidation if creditors reject a proposed restructuring plan: ss 553(1A), 513A, 513B and 513CA. Section 553(1A) requires amendment to address this anomaly by adding (as provable claims) debts incurred

³ See, for example, *In the matter of Polar Agencies Pty Ltd* [2019] VSC 43.

during a restructuring period in the ordinary course or with a restructuring practitioner's consent;

- *Ipso facto* stay (ss 454P ff): I note that there is provision for prescribed exceptions to the ipso facto stay. I submit that this new procedure would better fulfil its purpose and goals if the ipso facto stay provisions apply to pre-existing contracts (ie, contracts that were in place at the date of the commencement of Part 5.3B). The fact that the Part 5.3A stay provisions do not apply to pre-1 July 2018 contracts significantly limits its effectiveness;
- Section 453E: The nature and depth/scope of the restructuring practitioner's "declaration to creditors" will be detailed in regulations. A comparative point of reference here is the certification required of a debt agreement administrator under the *Bankruptcy Act*: e.g., "reasonable grounds to believe "that all required information has been provided by the debtor: s 185C(2D). At the other end of the spectrum would be a required report along the lines of current IPR s 75-225 but that of course would carry significant cost;
- Electronic notices: This amendment to s 600G appears sensible and long overdue. On my reading of the draft legislation, any appointee under any external administration will be able to send notices electronically to creditors where, upon appointment, the company's books and records provide reasonable grounds for a belief that a particular electronic address (e.g., email address) exists for the purposes of a creditor receiving electronic communications (this scenario will fall within the definition of "nominated electronic address" in s 9 of the Act).

Simplified Liquidation Procedure

- Sections 500A to 500AD: In my view, related party creditors should be prescribed in the regulations as creditors that are not to be taken into account for the purposes of the "25% in value" threshold for creditors requesting that a liquidator not follow the simplified liquidation process;
- Eligibility criteria under s 500A: I repeat the comments made above in relation to disqualifying a company solely on the basis that it has a common director with another company that has previously utilised the procedure. I understand the importance of preventing abuse but this seems very restrictive;
- Trust property and the clarity of a liquidator's power of sale: Neither the draft EM nor the draft legislation seeks to address one obvious matter which unnecessarily wastes time and costs in many "small liquidations": The lack of clarity of a liquidator's power of sale of trust assets under s 477 of the Act. As is well known, liquidators must often apply to court to be appointed receiver of the trust assets and the costs of such an application are often disproportionate to the total value of the very trust assets which are the subject of the application/liquidation. A simple amendment to s 477 of the Act could save a great deal of time and money on many "small" liquidations of corporate trading trustees. I would also recommend a specific provision that prohibits clauses in trust deeds which provide for the "automatic ejection" of a corporate

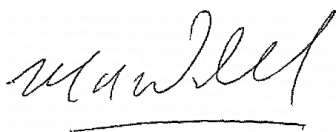
trustee upon liquidation. These improvements to the *Corporations Act* were recommended by the Harmer Report in 1988;

- Unfair preferences recoverable under ss 588FA and 588FE: Referring to [3.73] of the EM, rather than abolishing the recoverability of unfair preferences below a certain threshold or outside a certain period, preferential payments could instead be deemed void or absolutely repayable to a liquidator. Provision for “absolutely repayable” preferential payments would promote a cost-effective, streamlined liquidation procedure by:
 - Facilitating and promoting recoveries and *pari passu* distributions in a timely and cost-effective manner by removing the prospect of the liquidator and “preferred” creditors engaging in the usual arguments regarding the “no reasonable grounds to suspect insolvency” defence under s 588FG; and
 - Better achieving the ultimate objective of the present unfair preference recovery action, namely fair allocation of the impact of a company’s insolvency by avoiding the effect of a transaction that gives one creditor an advantage over other creditors.

Indeed, arguably there is a present anomaly in the Act by reason of s 569 of the Act which provides that a creditor who has issued execution against property of the company within six months prior to a winding up “*must pay to the liquidator* an amount equal to the amount received by the creditor as a result of the execution”. In a streamlined liquidation process, why should there not be a provision for the recovery of preferential payments cast in similar, absolute terms? At the very least, preferential payments to related party creditors – within a certain period prior to the liquidation – could be deemed *void and/or automatically repayable* instead of remaining subject to the present s 588FA and s 588FG defences.

I am more than happy to speak to any of the above points (or my submission generally) and can be contacted by [email or via UTS Law](#).

Yours faithfully,



Mark Wellard