12 October 2020

Manager
Market Conduct Division
Treasury
Langton Cres
PARKES ACT 2600

By email: MCDInsolvency@Treasury.gov.au

Dear Sir/Madam

Insolvency reforms to support small business

Thank you for the opportunity to lodge a submission in the response to the exposure draft legislation and explanatory material for the insolvency reforms to support small business.

ARITA fully supports the framework outlined in the Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (Bill) and notes that the restructuring process and simplified liquidation reforms detailed in the Bill clearly reflect the mechanisms articulated in ARITA's 2014 thought leadership paper 'A Platform for Recovery' and adopted as key policies by ARITA since the beginning of 2015.

This submission identifies aspects of the changes which may affect the practical operation of the provisions and their aim of delivering a cost-effective mechanism for small businesses. In particular, we highlight the following significant issues which we believe will severely impact the effective and intended operation of the reforms unless they are addressed.

Refinements to registration of liquidators

- **Sub-category of registered liquidator** - In the absence of a lack of clarity around the qualifications, experience, knowledge and abilities requirements by applicants for registration for the new sub-category of registered liquidator for restructuring practitioners, ARITA is concerned that those who will qualify for registration will not have sufficient understanding of Australia's insolvency regime to competently advise and attend to their obligations under the debt restructuring provisions. This places at risk progress demanded by successive Parliamentary Inquiries into insolvency that demanded higher levels of qualification and skill across all forms of insolvency administration.

- We note that the current proposal merely temporarily removes the application fee for registration as a liquidator. We respectfully suggest that this will have zero impact on attracting additional liquidators to the market. Alongside a concerted campaign to encourage liquidators who were taking what ASIC regarded as too few appointments to leave the profession, the near 20% loss in liquidators over the last few years is primarily due to the cost impact of the ASIC Industry Funding Model which levies each liquidator an annual, unforecastable cost of an average of $13,000 but could be many times that. It is the removal of the IFM fee and the cost imposition of ASIC search fees that would provide immediate relief in making the role of registered liquidator more attractive.

  In addition, to promote diversity in the profession, where less than 10% of registered practitioners are women, we propose the concept of an alternate liquidator which would allow liquidators to take career breaks (including parental leave etc).

Proposed Debt Restructuring Reform

- **Voting using proposals without meetings** - We again draw your attention to the drafting issue that arose in the *Insolvency Law Reform Act 2016* with the current proposals without meeting process, which means they are only available for use on matters voted under the Schedule 2 - Insolvency Practice Schedule (Corporations) (IPSs) and IPRs. This needs to be urgently addressed, not just for the issue that it continues to cause in all other insolvencies but for the significant impact it will have on the proposed regime, where meeting are proposed not to be used.

- **Trusts** - We are concerned that a failure to address trading trusts is going to undermine the effectiveness of both the proposed debt restructuring and streamlined liquidation processes. Failure to address this issue will mean that most small insolvencies will continue to require expensive court intervention.

- **Designation of the SBRP as an Officer** - Given the directors remain in control of the company (including during the implementation of the plan) we are concerned that this is inconsistent with the restructuring practitioner's role and responsibilities.

- **Off-set of bank account funds** - The right of secured creditor banks to trigger off-set provisions against funds held in company bank accounts may result in insufficient cash assets to support ongoing trading, with the company directors unlikely to be able to source such funding.

- **Unpaid debts remaining from the restructuring period -** unpaid debts incurred during the development of the plan before voting are not currently provable in any subsequent liquidation.

Simplified liquidation

- **Three-month report** – if a three-month report is retained in the simplified liquidation process there will not be any savings of investigatory costs.

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- **Requests for information** - the formal requests for information processes creates a red tape wrapped cost burden and should be removed for streamlined liquidations as a minimum. Creditors will always have a right to discuss the liquidation with the liquidator and obtain information as a stakeholder in the process.

- **Voting using proposals without meetings** – As noted above, the drafting issue with the current proposals without meeting process means they are only available for use on matters voted under the IPSs and IPRs. There are matters outside the IPSs which may need to be resolved in a simplified liquidation and we note that meetings are not a feature of the new regime.

- **Trusts** – As noted above, we are concerned that a failure to address trading trusts is going to undermine the effectiveness of both the proposed debt restructuring and streamlined liquidation processes.

- **Simplifying remuneration** – An increase in the minimum statutory fee for streamlined liquidations to a commercial amount commensurate with undertaking the process may remove or limit the need for reporting to and approval of remuneration from creditors, thereby further reducing the cost of an administration.

- **Assisting small businesses to cover the cost** - Government needs to provide some funding towards the cost of assetless administrations, possibly via easier and broader access to the Assetless Administration Fund and/or a voucher system for companies in distress to receive the expert advice of a registered liquidator.

Need for full two-year sunset of legislation

While we accept the Government's desire to rush these reforms given the crisis caused by COVID-19, we note that we have identified many drafting errors even at this point in a highly truncated review. Of course, the Regulations and Rules are only likely to be available after the legislation is finalised. As a result, there is a profound risk of errors and problems that will not be picked up due to the rushed nature of this approach. By requiring a two-year sunset to the legislation, an urgency will be mandated for a proper review after a suitable time.

We note that despite a review being mandated in the Safe Harbour legislation, this was not carried out, making a hard sunset the only way to ensure this occurs. Noting that after the commencement of these two new regimes, Australian will have over 20 different corporate and personal insolvency mechanisms, it is our fervent belief that the Government should support a root and branch review of our entire insolvency framework to be completed before the sunset date. This would ensure that Australia developed a future-fit framework that would drive our economic prosperity and ensure our international competitiveness.

Commencement

We maintain a deep concern that it will be a significant challenge for the insolvency profession to be ready to undertake this type of work by the government's planned commencement date of 1 January 2021. With only a few weeks from when the full suite of

legislation will be gazetted until commencement, the necessary training and process changes will not be able to be assured.

$1 million liability threshold

We hold significant concerns with the foreshadowed eligibility liability threshold for both the proposed restructuring and simplified liquidation processes of $1 million. We believe that a liability threshold of $250,000 of unrelated debts is more appropriate and more reflective of the small, non-complex businesses the reforms are aimed at. We believe that a $1 million threshold is too high, capturing a significant proportion of external administrations and enhancing the risk of this framework being used for phoenixing.

General concern

Without being able to simultaneously review and consider the details governing the operation of the new simplified insolvency processes by being able to consider the proposed Regulations and Rules, we note that there may be matters outlined in this submission that are addressed in the subordinate legislation or impact further on this Bill. We also note that the explanatory materials highlights that “[i]n the event that regulations made in relation to debt restructuring plans contain provisions which are inconsistent with the Corporations Act or any other Acts, the regulations will prevail to the extent of any inconsistency” [at 1.135]). We are concerned as to the appropriateness of legislation being constructed in this way.

As always, we look forward to continuing to work closely with Treasury and the Government generally to ensure that this legislation is workable, efficient and effective and the profession is able to implement it in a timely fashion to assist in driving economic recovery from the COVID-19 crisis.

Yours sincerely

John Winter
Chief Executive Officer

About ARITA

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

We have more than 2,200 members and subscribers including accountants, lawyers and other professionals with an interest in insolvency and restructuring.

Around 80% of Registered Liquidators and Registered Trustees choose to be ARITA members.

ARITA's ambition is to lead and support appropriate and efficient means to expertly manage financial recovery.

We achieve this by providing 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. In 2019, ARITA delivered 118 professional development sessions to over 5,300 attendees.

ARITA promotes best practice and provides a forum for debate on key issues facing the profession.

We also engage in thought leadership and public policy advocacy underpinned by our members' knowledge and experience. We represented the profession at 15 inquiries, hearings and public policy consultations during 2019.

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1 Refinements to registration of liquidators

1.1 Significant issues

Key point 1: The qualifications, experience, knowledge and abilities requirements for applicants for registration for the new sub-category of registered liquidator for restructuring practitioners, must ensure that that those who qualify for registration have a sufficient understanding of Australia's insolvency regime to competently advise and attend to their obligations under the debt restructuring provisions.

1.1.1 New sub-class for restructuring practitioners

In 2017 the insolvency profession saw extensive law reform around registration and maintenance of registration via the *Insolvency Law Reform Act 2016* (ILRA), as well as the commencement of the ASIC Industry Funding Model (IFM).

The *ILRA* explanatory memorandum stated:

> "[5.5] The insolvency profession must be skilled, honest and accountable in order for the insolvency regime to operate efficiently. Creditors and stakeholders are often unable to tell how the overall result of a liquidation or administration corresponded to the quality of the service provided by the insolvency practitioner and whether the costs incurred are reasonable. They must therefore be able to place a high degree of trust in the insolvency practitioner's integrity. Regulation that promotes a high level of professionalism and competence of insolvency practitioners is therefore essential to retaining confidence in the insolvency system as a whole."

We are concerned that a new sub-class of registration for restructuring practitioners with lower qualifications, experience, knowledge or abilities requirements undermines the basis of the 2016 amendments.

This places at risk progress demanded by successive Parliamentary Inquiries into insolvency that demanded higher levels of qualification and skill across all forms of insolvency administration.

We are advised by our members that they have the capacity to service the expected increase in insolvencies. We expect that the increase due to the COVID-19 crisis is temporary and it is important to ensure that a temporary increase in insolvencies does not see a permanent reduction in standards, which may impact the quality of the profession for decades to come. It is also essential that current registered liquidators are not disadvantaged by the substantial cost burden imposed on them as a result of the ILRA and IFM.

This position is supported by the Reserve Bank of Australia's Financial Stability Review[1] which predicts that

> "… in the absence of any policy support, the 3 per cent decline in business revenue that is estimated to have occurred in the 2019/20 financial year would have caused about 1,400 additional business failures, relative to normal times. The effect is relatively small because firms tend to offset declines in revenue by reducing their operating expenses and because the COVID-19 shock only affected businesses in the last quarter of the financial year. If there was no recovery in turnover in 2020/21 , annual revenue would be a further 9½ per cent lower than in the previous year and an additional 5,200 businesses would be expected to fail. However, to date, actual business failures remain at historic lows."

Such a limited increase in insolvencies does not warrant any substantial increase in the number of persons registered to manage insolvent entities.

1.2 Feedback on Exposure Draft

1.2.1 Flexibility in registration of Registered Liquidators

We generally support changes to the discretionary powers of registration committees to encourage diversity and entice experienced practitioners to return to the profession. But it is essential that the standards of the profession are maintained. A registered liquidator undertakes an important fiduciary role in dealing with other people's money and it is critical that registration standards are maintained to ensure trust in the profession.

To maintain the alignment between the liquidator and trustee registration processes, a critical focus of the ILRA, this amendment should also be made to Schedule 2 – Insolvency Practice Schedule (Bankruptcy).

We are particularly supportive of greater flexibility for committees to drive greater diversity in the profession. There are less than 10% of registered liquidators and trustees who are women. A key factor to this continuing is the continuous recent experience requirements that mean that any person who has taken a career break for parental leave or other reasons is unable to become registered. Additionally, annual continuing professional development requirements, as opposed to triennial arrangements, make taking career breaks very challenging. A move to reform these requirements will act to encourage more women into the profession.

1.2.2 Alternate liquidator

In addition, we suggest that the Government uses this opportunity to create a new role as Alternate Liquidator. This suggestion has arisen due to the recent work of our members' Balance (Diversity) Committee.

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[1] Reserve Bank Australia, Financial Stability Review, October 2020

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ARITA's Balance Committee considers that an external administrator ought to be able to appoint a suitable person to assume their duties and obligations for a period of time should they be temporarily unable to attend to them due to an extended absence from work. The appointment of an Alternate Liquidator is not intended to cover absences from work that might ordinarily be addressed by a practitioner who takes annual leave in the ordinary course.

The appointment of an Alternate Liquidator would permit an appropriate person to assume the responsibilities of the appointed liquidator. It would also provide for the original appointee to resume their duties upon their return to work.

The Alternate Liquidator, once appointed, would assume all responsibilities for the administration as if they had been appointed in the ordinary course. The powers and statutory obligations of the original appointee would be suspended for the duration of the period of the Alternate Liquidator's appointment.

The ability to appoint an Alternate Liquidator would facilitate the realities of life that require individuals to be absent from work in order to attend to or provide for personal requirements associated with health, especially mental health, and family care responsibilities, without requiring the practitioner to sacrifice professional standing or accepting adverse commercial outcomes.

Similar provisions may be legislated, if practical, to provide for the appointment of an Alternate Voluntary Administrator and Alternate Deed Administrator. Provision may also be warranted for the position of an Alternate Restructuring Practitioner, a role that is proposed to be created under these reforms.

Provision for the creation of the role of Alternate Receiver or Alternate Receiver and Manager is more complicated due to the issues of consent and indemnity provided by secured creditors, but such complications should not be considered necessarily prohibitive to constructive law reform.

In due course, similar provisions should also be included within the *Bankruptcy Act 1966* and its associated regulations and rules, to provide for the role of Alternate Trustee in Bankruptcy and Alternate Controlling Trustee.

Technical considerations around appointment of alternate liquidator include:

- The original appointee shall be required to obtain the formal consent to act and confirmation of independence from the proposed Alternate Liquidator in writing and then formalise that appointment in writing. The Alternate Liquidator should be required to submit notice of their appointment to ASIC.

- The Alternate Liquidator should adopt the same rates as those communicated to creditors by the original appointee. If for any reason the Alternate Liquidator to be appointed is from another firm, then a revised or updated DIRRI would likely be necessary.

- Any additional costs associated with the appointment of an Alternate Liquidator ought to be borne by the original appointee without recourse to the assets of the company in order that creditors be no worse off by the appointment.
- The Alternate Liquidator and the original appointee should be entitled to their remuneration and disbursements on a pro rata basis by reference to the WIP and /or disbursements incurred by each appointee out of the remuneration and disbursements approved by creditors in the ordinary course. The appointment of an Alternate Liquidator should not lead to additional or more complicated processes for approval of remuneration or disbursements by creditors.
- The Alternate Liquidator shall assume full responsibility to meet all the requirements of the original appointee, including but not limited to the meeting of statutory imposed deadlines for submissions and reporting requirements.
- In circumstances where unavoidable delays occur as a result of the circumstances leading to the appointment of an Alternate Liquidator, the Alternate Liquidator ought to be able to apply to ASIC for a limited extension to the timeframes for compliance with their duties.
- The original appointee shall be required to do all things necessary to provide control of the assets of the administration to the Alternate Appointee, such as control of bank accounts, notice to third parties holding company assets such as stock or plant and equipment, etc.
- The Alternate Liquidator shall take responsibility for ensuring all lines of communication with creditors remain functional and may be required to notify creditors of their appointment to ensure that creditors suffer no adverse effects from the appointment.
- Should creditors object to the appointment of an Alternate Liquidator, they should be able to seek the replacement of that Alternate Liquidator with a preferred appointee in the ordinary course. Should Creditors so resolve to replace the Alternate Liquidator, that replacement shall be effective against both the original appointee and the Alternate Liquidator.
- The Alternate Liquidator shall be empowered to take control of all litigation commenced by the original appointee in their capacity as liquidator. Notice of the appointment and the terms of same will need to be provided to all parties to the litigation.
- The original appointee should be able to terminate the appointment of the Alternate Liquidator when they are ready and able to resume their duties and the Alternate Liquidator should be required to return control of the administration to the original appointee when notified that their appointment is no longer required.

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1.2.3 Increased applications and the registration process

As a final point, we are concerned that the widening of the criteria and the Government's stated intention of waiving registration costs for two years will result in a substantial increase in applications, including from applicants that do not meet a required minimum standard. It is important that this is counterbalanced by giving ASIC the ability to vet and reject applications prior to referring them to a committee. It is not appropriate for committees to have to convene and consider applicants who are demonstrably underqualified.

As the prescribed body for nominating members for registration (and disciplinary) committees, ARITA plays an important role in ensuring the integrity of the registration process. At present, and despite seeking specific consent from ASIC, ARITA delegates are barred from disclosing committee decisions and reasons for decisions to ARITA, indeed ASIC has taken the position that any such disclosure by our delegate would constitute an offence. We consider that disclosure of the information requested is in the best interests of the purposes for which the powers are given to ASIC, ARITA and the relevant Minister in the IPSs as it is likely to assist with the consistency of the interpretation and application of the provisions regulating the registration process. We seek specific amendment to confirm that ARITA delegates to committees may share information with ARITA for the above purpose.

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2 Debt restructuring

2.1 Significant issues

Key point 2: ARITA believes that the effective and intended operation of the debt restructuring regime will be severely impacted unless the following significant issues are addressed.

- **Sub-category of registered liquidator** - We understand that a new sub-category of registered liquidator will be created by amendments to the *Insolvency Practice Rules (Corporations) 2016* (IPRs). In the absence of a lack of clarity around the qualifications, experience, knowledge and abilities requirements by applicants for registration as a restructuring practitioner, ARITA is concerned that those who will qualify for registration may not have sufficient understanding of Australia's insolvency regime to competently advise and attend to their obligations under the debt restructuring provisions. This includes the inability of an appointed restructuring practitioner to:

  - advise a company and its directors of the different available insolvency options without bias or influence arising from the fact that they are only qualified to accept restructuring appointments
  - properly consider whether the proposed plan is a better outcome for creditors when compared to liquidation, and
  - be qualified to undertake a liquidation should the restructuring process or plan not proceed or fail (if allowed).

  We also discuss this issue in section 1.1.1 of our submission.

- **Voting using proposals without meetings -** The exposure draft notes that all voting is proposed to be without meetings. We again draw your attention to the drafting issue with the current proposals without meeting process which, due the definition of resolution in s9, means they are only available for use on matters voted under the IPSs and IPRs. The exposure draft does not include an amendment to the definition of resolution in s9 and we are concerned this may prevent the use of a streamline voting process. An overview of this issue is provided at Appendix A.

- **Trusts -** We understand that a substantial percentage of small businesses are conducted through a trading trust. We are concerned that trusts are going to undermine the effectiveness of both the proposed debt restructuring and streamlined liquidation processes. The appointment of either a restructuring practitioner or liquidator is likely to remove the trustee with the trustee remaining only as a bare trustee with no right to be able to deal with the assets unless the practitioner goes to the Court for appointment as a court appointed receiver. Any involvement by the Court will substantially increase the cost of the process. An overview of the issues with trading trusts and possible mechanism for addressing these is attached at Appendix B.

- **Designation as Officer** - A restructuring practitioner for the corporation or restructuring practitioner for the restructuring plan is defined as an officer of the corporation [consequential amendment #8]. Given the directors remain in control of the company (including during the implementation of the plan) we are concerned that this is inconsistent with the restructuring practitioner's role and responsibilities.
- **Off-set of bank account funds** - The right of secured creditor banks to trigger off-set provisions against funds held in company bank accounts has been mirrored from the Part 5.3A provisions. In a voluntary administration the personal liability and indemnity provisions provides comfort for a lender to extend credit to the Voluntary Administrator if there are insufficient cash assets to support ongoing trading (unless such liability is specifically waived by the Court). In the absence of such provisions, the company directors are unlikely to be able to source such funding which is likely to undermine the ability to undertake the restructuring.
- **Unpaid debts remaining from the restructuring period -** Consequential amendment #45 specifies the date for provable debts is the date restructuring began (s513CA and 553(1)). A further amendment captures debts from the period when the company is under a restricting plan (new s553(1A)(b))(consequential amendment #47), but this does not capture the debts from the restructuring period. Therefore, unpaid debts incurred during the restructuring are not provable in any subsequent liquidation. Section 553(1A)(b) has been drafted to mirror the Deed provision at new section 553(1A)(a), however, this does not take into account that the restructuring practitioner is not personally liable for trading debts incurred during the restructuring period and thus if the company ends up in liquidation there may be debts unpaid from this period.

2.2 Feedback on Exposure Draft

We provide the following specific feedback in relation to the Exposure Draft, highlighting key matters and listing other aspects identified by us during our review.

2.2.1 Terminology

ARITA has received, and agrees with, significant feedback from the profession about the confusing use of the terms "restructuring practitioner for the company" and "restructuring practitioner for the plan", this also extends to general confusion around what constitutes the "restructuring" period.

If this is confusing to professionals who operate in the sector, we hold concerns that the small business operators who will be captured by the reforms (as debtors and creditors) will be unable to understand the regime. This is differentiated by the provisions in Part 5.3A where the terms are clearly distinguished.

At a minimum, the terminology used needs to be consistent, with the Exposure Draft interchanging references to "restructuring practitioner"/"small business restructuring practitioner", "for the company"/"for the corporation" and "for the restructuring plan"/"for the agreement".

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2.2.2 Commencement of Part 5.3B

We understand that the proposed commencement date for Part 5.3B is anticipated to be 1 January 2021, however the exposure draft notes it as commencing the day after Royal Assent. This may be prior to 1 January 2021 and prior to the making of the associated subordinate legislation.

An application provision needs to be added to delay the use of Part 5.3B until 1 January 2021, as has been included for the simplified liquidation process, although we also hold genuine concerns that there will insufficient time to upskill practitioners on the new legislation.

2.2.3 Eligibility for Restructuring

The explanatory materials note that the aim of Part 5.3B is to have a plan in place for the company to repay its existing debts, thereby enabling the company to stay in business and avoid winding up. However, proposed section 252A states the object of the Part is to allow companies to retain control of the business, property and affairs while developing a plan to restructure. There is no reference to the requirement for the company's business to be trading (or continue to trade) to utilise the process.

Section 453C(1) sets out the eligibility criteria for restricting the use of the restructuring process and includes a restriction on appointments where:

> "(b) no person who:
> (i) is a director of the company; or
> (ii) has been a director of the company within the 12 months immediately preceding that day;
> has been a director of another company that has been under restructuring or been the subject of a simplified liquidation process within a period prescribed by the regulations, unless exempt under regulations made for the purposes of subsection (2)"

This does not appear to contemplate:

- concurrent restructuring appointments to small corporate groups
- subsequent appointments to the same company (the provision as worded refers to "another company" not "a company"), or
- appointments where the directors may have been involved in another company under restructuring or been the subject of a simplified liquidation process where creditors received full payment or a return[2].

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[2] The *Corporations Amendment (Strengthening Protections for Employee Entitlements) Act 2019* includes director disqualification provisions where the Commonwealth is likely to receive a minimal return of 10 cents in the dollar or less

The Exposure Draft notes the circumstances in which a restructuring practitioner may terminate the restructuring (s 453J) – we query whether this should be a positive obligation (must) and whether there should be a mechanism to transition the restructuring to a creditors voluntary liquidation (including a possible simplified liquidation).

2.2.4 Role of the restructuring practitioner

The Explanatory Materials refer to the directors being responsible for the preparation of the plan and supporting documents [at 1.38]. The balance of obligations between the company directors and restructuring practitioner to be set out in the Regulations, will have a significant bearing on the cost of the process.

Of particular concern, are the matters for the Court to take into account in relation to the s482 powers of the Court to stay or terminate a winding up [consequential amendment # 41] which, including:

- any report that has been lodged with ASIC by the restructuring practitioner, or a former restructuring practitioner, for the company
- any notice that has been given to the restructuring practitioner for the restructuring plan or the company's creditors in relation to a contravention of the restructuring plan
- whether the restructuring plan is likely to result in the company becoming or remaining insolvent.

ARITA has concerns that these matters are indicative of significant investigatory and oversight work being undertaken by the restructuring practitioner. Due to the lack of supporting legislation, we are unable to determine the reasonableness of this provision, but note that it is a direct copy of the s482(2A) which relates to deeds of company arrangement which are a more complex type of administration.

We also hold concerns about the ability of the restructuring practitioner to take a subsequent appointment as liquidator following a restructuring. An argument may be made that it is a continuing appointment, similar to the transition that occurs from an appointment as voluntary administrator to liquidator of the same entity. This makes sense from the perspective of expeditiousness and cost saving. However, there are strong points against this approach as well.

For instance, the argument for expeditiousness and cost saving is lost if the restructuring practitioner is not a fully qualified liquidator as they will automatically be precluded from taking the subsequent liquidation. This would be a system design failure and again highlights why the restructuring practitioner must be a fully qualified liquidator.

There is also a strong argument that a subsequent appointment of a restructuring practitioner fails the court-established independence requirements. The exposure draft provides for the restructuring practitioner to be an officer of the company and provide advice to the directors prior to a formal appointment. Indeed, the restructuring practitioner's work and advice may well be the subject of proper investigations by a future liquidator.

Therefore, a restructuring practitioner could not be in a position to investigate their own endeavours. It would also be reasonable to expect courts to see the establishment, at law, of a restructuring practitioner being sanctioned to be a liquidator as an indication that existing independence requirements for appointments outside of these reforms should be reconsidered and watered down.

If it is intended that the restructuring practitioner will be able to act as a subsequent liquidator (subject to appropriate registration), we highlight that s532 will need to be amended to allow this to occur. The consequential amendments in the Exposure Draft do not currently provide for this.

As creditors are not able to replace a restructuring practitioner, it is even more important that the practitioner is independent. The disqualification provision in the Act (s456C) does not recognise independence as has been developed by the Courts. Professional bodies such as ARITA and APESB set standards for independence that are reflective of court guidance. Currently all registered liquidators are covered by one or both of these professional standards. However, if registration of insolvency practitioners is widened, there is a risk that new registered liquidators will not be covered by these professional standards.

2.2.5 Role of secured creditors

In addition to the cash offset issue noted in the significant issues, we are concerned about the extent of influence secured creditors may have in the process which will limit the ability for small businesses to restructure. This includes:

- their ability to appointment a receiver or receiver and manager
- the right to recover perishable property, and
- the difficulty with assessing PPSA claims and determining vesting of late registered securities.

Ability to appoint a receiver and manager

Given the intent for the restructuring process to be a speedy process (including the ability to issue the plan to creditors any time within the restructuring period), the 13 business day period for secured creditors severely limits this intent.

As an alternative, we suggest that a company seeking to do a restructure give the relevant security holder 10 business days' notice served on the address noted in the PPSR, of their intention to appoint. If the security holder hasn't taken action before the appointment, then they are caught by the stay for the duration of the restructure period.

We are also concerned about the power of secured creditor banks to pressure a restructuring practitioner to extend the decision period by providing a consent to appoint as provided for in s453Q(2). Secured creditor banks are in a position of significant influence and may use this provision to exert influence over the process, which may unreasonably increase time and cost.

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Perishable property

Where a company is in the business of dealing with perishable property (for example a café or restaurant), having the security holder recover that property during the restructure renders the trade on very difficult.

PPSA securities

PPSA securities registered out of time vests on the appointment of a restructuring practitioner (Consequential amendments #60). We query how this works – the vesting of a security could result in debts exceeding the threshold resulting in termination of the restructuring, or the company may decide to not put a plan to creditors, or the creditors could reject a proposal; after this there is not positive obligation on the company to appoint a liquidator (it is at the company's discretion). What happens to the asset? Is it still vested in the company notwithstanding it has not completed a restructure and there is no external administrator acting?

2.2.6 Failure of creditors to accept the plan

The Exposure Draft notes that if the plan is rejected, the restructuring process ends, and the company can seek to use an alternative formal insolvency process [at 1.8]. Placing the onus to make a subsequent appointment in the hands of the company, where no further appointment is assured, is inconsistent with s455A which provides that a company that proposes a restructuring plan is taken to be insolvent.

As such, the company should not be able to be returned to the directors as any trade on is likely to be insolvent trading.

2.2.7 Trading in the ordinary course of business

In the ordinary course of business

We note that directors must seek the consent of the restructuring practitioner if they wish to undertaken transactions outside the ordinary course of business. As yet, there is no guidance in the exposure draft or explanatory materials as to what is intended by the term "the ordinary course of business" and we are aware that the legal concept of ordinary course of business is problematic.

We consider that it is not unfeasible that as part of the debt restructure, a company may also restructure and redirect its business model which may result in a change of what was formerly its ordinary course of business.

While the explanatory materials note that the process is aimed at debt restructuring, there is no limitation in the exposure draft preventing a company restructure via the process.

It would be a perverse outcome if the restructuring practitioner needs to provide consent to day to day transactions if a change in business occurred.

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Consent of the restructuring practitioner

There is no clarity around what the restructuring practitioner needs to satisfy themselves of when providing consent to transactions outside the ordinary course of business. For example, if the company is looking to sell an unneeded asset, does the restructuring practitioner need to obtain a valuation prior to providing such consent? Who needs to meet the cost of that?

The role of the restructuring practitioner in giving consent to these types of transactions gives a further demonstration of the issues that would arise in the restructuring practitioner taking a future appointment as liquidator as it is these types of transactions which may attract the need for independent investigation.

Ransom payments

The operation of the consent provision (s453L(5)) would not prevent situations where ongoing suppliers require payment to continue supply, commonly known as ransom payments. Such payments, or the withholding of supply if the payment is not made, can adversely affect the ability of a company to continue to trade. We believe that the only way to prevent this is to prohibit the payment of any debts that would be admissible to participate in the plan.

2.2.8 Court involvement

We question the large amount of potential court involvement and note that any involvement of the court is going to escalate costs significantly. Involvement of the court is incompatible with the concept of a fixed fee engagement that was envisaged in the Government's announcement regarding these reforms.

2.2.9 Other comments

Section or item	Issue
S 452A(b)	Part 5.3B should include as part of its objective "results in a better return for the company's creditors and members than would result from an immediate winding up of the company". This highlights that the objective of the Part is not to save a company at any cost and that any proposal offered to creditors should be in their interest. We note that this is also an objective of Part 5.3A and Part 5.3B largely mirrors Part 5.3A except for trade on responsibility.
S 453B	Why the variation in wording between s 453B and 436A (mirroring VA provision) 453B – "directors voting for the resolutions have reasonable grounds …" 436A – "in the opinion of the directors"
S 453G	The provision should provide for an offence if a person fails to allow the restructuring practitioner to inspect and make copies of the company's books and records.
S 453M	Should extend to payments made, transactions entered into, or any other act or thing done in good faith by the company in the

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Section or item	Issue
	ordinary course (for new transactions during the restructuring) reflecting s453L(2).
S 453P	In order to minimise costs of the restructuring process and give companies a chance to develop and put a plan, all winding up applications should automatically be stayed. If the restructuring process is terminated before a plan is made or during a plan, the creditor should then be able to proceed with the winding up application.
S 453V	Enforcement of guarantees is only limited to the restructuring of the company, not the implementation of the plan. Due to the often-intertwined nature of the financial affairs of small business and their directors, we see that a failure to prevent enforcement of guarantees during the plan period will adversely affect the likely success of the process. Enforcement of guarantees during the implementation of the plan will likely lead to the bankruptcy of the directors and the failure of any plan to restructure the business. We also query the limitation to directors and their relatives, noting the restrictive definition of relative and the fact that it wouldn't include related entities.
455A	We don't understand how s455A works when directors have to resolve that they have reasonable grounds to believe the company is insolvent or likely to become insolvent in order to be able to appoint a restructuring practitioner.
S 456E(4)	A creditor should not have standing to apply to the Court for the appointment of a restructuring practitioner. We also note that this provision is limited to the restructuring period, what happens in relation to the plan period if the restructuring practitioner dies, resigns, etc?
S 456H	This section only deals with the period for a company under restructuring. What is the position for the period of the plan. The protection should extend to the performance of functions, duties and powers under s 453E.
S 457B	There is a requirement to disclose the appointment of a restructuring practitioner during the restructuring, but we can see no mention of the position during the plan. The disclosure should also be rephrased to "Under restructuring" rather than "Restructuring practitioner appointed" which infers that the restructuring practitioner has a greater role and responsibility than he or she does.
Consequential amendment #18	The extension to s 91 – item 22 of the table currently replicates item 21 of the table. Item 22 of the table needs to be changed to refer to restructuring plan. S 91 is still missing a replication of item 20 of the table for the restructuring plan.
Consequential amendment #39	s 468(2)(ac) should extend to payments made, transactions entered into, or any other act or thing done in good faith by the company in the ordinary course (for new transaction during the restructuring).
Consequential amendment #43 & #44	If a restructuring practitioner's appointment cannot be revoked, how is the company able to appoint a liquidator or administrator while subject to restructuring or a restructuring plan? Does the restructuring practitioner need to terminate the restructuring or plan

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Section or item	Issue
	and then an appointment of a liquidator or administrator can be made? Is this immediate (which is a requirements of the amendment)? What happens if termination occurs and it takes several days for the appointment of a liquidator or administrator to occur, is this immediate?
Consequential amendment #52	We note that there is no information currently available to us that indicates that a restructuring practitioner for a plan would be personally liable for any debts or claims, therefore we query the necessity of this amendment.
Consequential amendment #56	S588FE(2D(d)(ii) – We note that there is no information currently available to us that indicates that a restructuring practitioner for a plan would still need to authorise transactions. As such, we do not understand why transactions not authorised by the restructuring practitioner for the plan could be voidable.
Consequential amendment #57	s 588FE(6B)(c)(iii) should extend to payments made by or with the consent of the restructuring practitioner, or in the ordinary course of business.
Consequential amendment #62	s 588GAB(3) and 588GAC(3) should extend to payments made, transactions entered into, or any other act or thing done in good faith by the company in the ordinary course (for new transaction during the restructuring).
Consequential amendment #65	S453G relates to third parties providing access to the restructuring practitioner to books and records of the company held by them. We are not sure how failure of a third party to provide access can result in a director not being eligible for safe harbour protection.

2.2.10 Sections conflicting with control being retained by the Company

Some sections from Part 5.3A which have been duplicated in Part 5.3B in the Exposure Draft do not reflect the differing position that control of the company remains with the company. The Exposure Draft Explanatory Materials discuss the retention of control by directors throughout the process and that the restructuring practitioner's role is to facilitate and assist the company directors to develop a debt restructuring plan.

It is our view that the following provisions inappropriately place obligations on the restructuring practitioner that should be dealt with by the directors. These provisions are incompatible with a debtor-in-possession model and the concept of a fixed fee engagement that was envisaged in the government's announcement regarding these reforms.

These include (but may not be limited to):

Section or item	Issue
S 453L(3)	The company's bank accounts will need to remain in control of the company to trade in the ordinary course. Payments will need to continue to be made through the company's existing account. In a voluntary administration (VA) the administrator would open a new bank account as he/she is responsible for trading during the VA.

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Section or item	Issue
	This is not the case in restructuring. Section (3) should be removed.
S 453Q(2)(a)	It should be the company that provides written consent
S 453R(1)(a)	It should be the company that provides written consent
S 453T(2)(b) and (d), (3) and (4)	Payments or return of property by the court officer should be made to the company, not the restructuring practitioner. There are protections built into the process to prevent the company using the funds outside the ordinary course of business ((s453L(2)). If the funds are returned to the restructuring practitioner, what does the practitioner do with the money in the event that the restructuring is terminated without putting a plan to creditors, or creditors do not accept the proposed plan but in either circumstance no liquidator is immediately appointed? Requiring a restructuring practitioner to open a bank account and meet funds handling requirements before a plan is accepted will have additional cost.
S 454F(2) & 454M(2)	The company (not restructuring practitioner) should have the power to apply to the Court to limit powers of secured creditor/receiver
S 454H(2)(b)	The secured creditor should remit excess funds to the company for the same reasons as discussed in relation s453T.
S 454P(2)(c)	The period of stay refers to restructuring ending because of a resolution or order for the company to be wound up. There is currently no mechanism for the restructuring to end **because** of a resolution for the company to be wound up. The restructuring would terminate and then a resolution could be considered
S 454P(7)(a)	It should be the company during the restructuring or when the plan is made, not the restructuring practitioner, that should consent.
S454R(2)(c)	The application for the order should be made by the company during the restructuring or when the plan is made.
Consequential amendment #21	Service of documents should not go to restructuring practitioner, it should go to the company
Consequential amendment #22	The company should remain responsible for lodging change of name applications. If the restructuring practitioner is to be involved it should just be via consent to the company.
Consequential amendment #26	The company should be responsible for seeking leave for an exemption to disclose former name on documents.
Consequential amendment #35	It should be the company subject to the restructuring or plan, not the restructuring practitioner for the company or restructuring practitioner for the plan, that applies for an order to vary a receiver's remuneration
Consequential amendment #36	It is more likely that the receiver will be dealing with the company undertaking a restructuring or subject to a plan, than the restructuring practitioner.
Consequential amendment #40	The reference should be to the company, not to the restructuring practitioner for the plan.
Consequential amendment #77	There should be no requirement for the restructuring practitioner to make a notification regarding paid parental leave. Employee entitlements are to be paid up to date and will have to be met on an ongoing basis.

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Section or item	Issue
Consequential amendment #78 and #79	A restructuring practitioner for the company or restructuring practitioner for the plan should not have the obligation to notify essential suppliers. The obligation should be on the company where it is in restructuring or a restructuring plan.
Consequential amendment #82	The appointment of a restructuring practitioner for the company or restructuring practitioner for the plan to a responsible entity should not have an entitlement regarding indemnity rights in relation to scheme property per s 601FH. Though we question whether a responsible entity is a small non-complex business.
Consequential amendment #83	The appointment of a restructuring practitioner for the company or restructuring practitioner for the plan to an AFSL should not trigger the s911A requirements as they do not carry on the financial services business – it remains with the company.

2.2.11 Sections not aligned with 'small non-complex business'

The restructuring processes are designed for non-complex small businesses and we believe that an eligible company under restructuring or a restructuring plan would not have a requirement for the following provisions:

Section or item	Issue
S 453N	Transfer of shares - is this necessary for small non-complex businesses? An eligible company is highly unlikely to be concerned with shareholding or contributories.
Consequential amendments #29 & #30	Class-order exemptions from ASIC. This is particularly relevant to consequential amendment #30 which relates to public companies.
Consequential amendment #31	Relates to trustees of debentures
Consequential amendment #75	Relates to the restructuring practitioner being able to publicly examine officers of the company. There is insufficient time to undertake this during a restructuring, noting short time frame and limited opportunity for extension (which is to appear in the regulations). We do not object to eligible applicants being able to examine former restructuring practitioners.

2.2.12 Possible drafting errors

From our review of the Exposure Draft we believe the following issues may be possible drafting oversights.

Section or item	Issue
S 453L(1)(b)	Director should be officer. Also recommended adding into s453L(2) a transaction by the restructuring practitioner.
S 453LA(1)(a)	Should be a reference to s 453L(1) not 453(1)
S 454E & 454L	Aligns with VA sections 441C and 441G. However, unlike the VA sections the restructuring sections do not include a carve out (VA carve out in 437D). These provisions should include a reference to a 453L (carve out for limitation on dealings in the ordinary course).
S 456C(5)	Exclusion should refer to external administrator not liquidator

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Section or item	Issue
S 456F(3)(b)	S457A is a regulation forming power so not sure if this reference is correct.
S 456K(2)(b)	No comma after “or to the restructuring practitioner”
Consequential amendment #9	The definition of restructuring practitioner refers to “agreement” but this concept has not been used anywhere else. We wonder if it should be “plan”.
Consequential amendment #15	S 60(1)(1A)(a)(vi) – a liquidator cannot appoint a restructuring practitioner (only the company can), so a company cannot have been in liquidation and then do a restructuring process.
Consequential amendment #27	Carve out for the exercising of officer powers should be extended to the restructuring plan
Consequential amendment #31	External administrations include restructuring so therefore there should be no need to make this change.
Consequential amendment #32	We note that this provision has been extended to include a restructuring plan, but it does not include Deed of Company Arrangement. We think this is an oversight that should be corrected.
Consequential amendment #42	The instruction is incorrect. It should be “After paragraph 513A(d)”. There is no 513A(1)(d).
Consequential amendment #49 – Note 4	The reference to paragraph 556(1)(b) should be to 556(1)(a). We note that there is no information currently available to us that indicates that a restructuring practitioner for a plan would be personally liable for any debts or claims, therefore we query the necessity of this note?
Consequential amendment #92	We note that there is a note to 60-2 which indicates where remuneration of provisions liquidators and liquidators appointed by ASIC can be found. A note for remuneration of restructuring practitioners should be added here.
Consequential amendment #96	Does the wording “restructuring plan that has not yet terminated” mean that the limitation on inspection only applies while the plan is in progress?

2.3 Other issues

2.3.1 High cost of being a liquidator

The current IFM is dysfunctional (charged retrospectively where liquidators may not know for up to 18 months what the cost of a charge they have incurred is). The actual cost per liquidator is also not sustainable (average of $13,000 per person), especially in an environment where liquidators have been very heavily financially impacted by COVID and the government’ temporary measures. Some 55% of insolvency firms have been on JobKeeper (note most insolvency firms are actually SMEs and not major firms).

ASIC’s supervision of liquidators costs the 620 liquidators in Australia a total of $9 million and ASIC have about one staff member for every 40 liquidators in Australia – almost classroom level supervision. Despite this, on average ASIC takes action against just 3 or 4 liquidators each year, highlighting that the supervision is excessive

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Given the impact of COVID, the government is urged to either waive the IFM fees for liquidators permanently, or charge it in an alternative way (e.g. require all companies to submit their annual solvency declarations to ASIC and charge a nominal fee for such – e.g. $5. This is similar to a concept first mooted in the Harmer Inquiry in the 1980s)

In addition, as much of a liquidators' work is to investigate on behalf of ASIC, liquidators should not be charged to undertake ASIC record searches or pay ASIC filing fees. Free ASIC searches are even provided to journalists, yet liquidators, who are also providing a public service, are required to fund these searches even when the liquidator is unfunded to complete the liquidation.

These are specific examples of costs that must be borne by liquidators which needlessly add to the cost of insolvency.

2.3.2 Director penalty notices

The Exposure Draft does not address whether the appointment of a restructuring practitioner to the company will end a director's exposure to personal liability for tax debts under a Director Penalty Notice.

The current provisions of the *Taxation Administration Act 1953* provide a director with a defence and no liability for a director penalty if they took all reasonable steps to ensure that an administrator was appointed to the company or the directors began winding up the company (assuming tax reporting has been done). This should be extended to cover the appointment of a restructuring practitioner.

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3 Simplified liquidation

3.1 Significant issues

Key point 3: ARITA believes that the effective and intended operation of the simplified liquidation process will be severely impacted unless the following significant issues are addressed.

- **Three-month report** – A liquidator is required to issue a three-month report to creditors under IPR 70-40. In order to prepare this report (taking into account the law and the form that accompanies its lodgement with ASIC), the liquidator must undertake a level of investigation consistent with that required for the s533 report (which has been removed). As such, if a three-month report is retained in the simplified liquidation process there will not be any savings of investigatory costs.

- **Requests for information** - the formal requests for information processes under IPS 70-40 to 70-47 and IPR 70-1 to 70-35 create a red tape wrapped cost burden and should be removed for streamlined liquidations. We are aware of this process causing ongoing issues in external administrations due to repeated requests for information from creditors that must be dealt with within specific time periods with written responses adding additional costs, even if the request is vexatious. Creditors will always have a right to discuss the liquidation with the liquidator and obtain information as a stakeholder in the process.

- **Voting using proposals without meetings** - The exposure draft notes that all voting is proposed to be without meetings. We again draw your attention to the drafting issue with the current proposals without meeting process which, due the definition of resolution in s9, means they are only available for use on matters voted under the IPSs and IPRs. The exposure draft does not include an amendment to the definition of resolution in s9 and we are concerned this may prevent the use of a streamline voting process, noting that it is not intended that meetings will be held in a simplified liquidation. An overview of this issue is provided at Appendix A.

- **Trusts** - We understand that a substantial percentage of small businesses are conducted through a trading trust. We are concerned that trusts are going to undermine the effectiveness of both the proposed debt restructuring and streamlined liquidation processes. The appointment of a liquidator will remove the trustee with the trustee remaining only as a bare trustee with no right to be able to deal with the assets unless the practitioner goes to the Court for appointment as a court appointed receiver. Any involvement by the Court will substantially increase the cost of the process. An overview of the issues with trading trusts and possible mechanism for addressing these is attached at Appendix B.

- **Simplifying remuneration** – An increase in the minimum statutory fee for streamlined liquidations to a commercial amount commensurate with undertaking the process may remove or limit the reporting and approval of remuneration from creditors. Fulfilling the

reporting and approval process has a substantive cost and our view is that in many instances practitioners may choose to take a reasonable statutory fee (which does not require approval), rather than incurring the additional time and cost of reporting and seeking approval for a streamlined liquidation. The current statutory fee of $5,000 (indexed) would need to be increased to cover the reasonable cost, even with the streamlining detailed in the exposure draft (particularly noting the retention of the three-month report and creditor requests for information noted above).

- **Assisting small businesses to cover the cost -** Even with an adjustment to the minimum statutory fee, a large number of companies (and their directors) are not going to have financial resources to fund even a streamlined liquidation (too broke to go broke). This issue will be heightened due to the effects of the pandemic. Government needs to provide some funding towards the cost of assetless administrations, possibly via easier and broader access to the Assetless Administration Fund or a voucher system.

3.2 Feedback on Exposure Draft

3.2.1 Dividends

As there is the requirement for the company's tax documentation to be up to date, there should be no obligation on the liquidator to obtain a tax clearance before making a distribution. Of course, if the ATO is a creditor they will receive the same notifications as other creditors about proofs of debt and dividends (though we are not sure what that process will be until the regulations are released). However, we understand from practitioners that even when tax lodgements are up to date, obtaining a tax clearance from the ATO can be difficult and time consuming. As such, we suggest the obligation for the actual clearance be removed.

3.2.2 Written notice by creditors

Section 500AB provides that the creditors are able to give written notice to the liquidator at any time requesting the liquidator not to follow the simplified liquidation process. However, it is not clear what the outcome of this is:

- Does the liquidator just hold and "collect" these until the 25% threshold is passed (s500A(2)(c) and 500AD)?
- Can this happen over any timeframe?
- If a request was given to the liquidator over a certain time period ago does the liquidator need to confirm that that is still what the creditor wants?
- If the liquidation is nearly complete, does the liquidator then essentially have to start again doing investigations and lodgements with ASIC, reporting to creditors etc?

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We also believe that when determining the 25% threshold regard should not be had to related party creditors.

3.2.3 Eligibility

Our comments on eligibility for simplified liquidation are the same as for restructuring set out at section 2.2.3 of this submission.

3.2.4 Other comments

Section or item	Issue
S 498	The provision does not include any consequences for an incorrect declaration. We note that in respect of a Declaration of Solvency for a members' voluntary liquidation, s 494 incorporates offence provisions into the section (s 494(4) and (5)).
S 500A(2)(b)	Why does notice have to be given to members when only creditors can object? Members should be removed.
S 500A(3)(c)	There needs to be a timeframe prescribed in s 500A(3)(c) for creditors to give notice to prevent the liquidator adopting simplified liquidation at 20 business days.
S 500AC(1)	Should this section include an option that the required percentage of creditors have given a direction in writing to the liquidator?

3.3 Other issues

3.3.1 High cost of being a liquidator

See 2.3.1.

4 Virtual meetings and electronic communications

4.1 Feedback on Exposure Draft

Key point 4: Electronic communication from an external administrator should be taken to come from their primary place of business.

Place where an electronic communication is sent or received

Proposed s105B does not recognise communication from an external administrator. Where communication is sent in relation to an external administration or receivership, the electronic communication should be taken to be sent from their primary place of business which is registered with ASIC.

5 Insolvency Law Reform Act fixes

As you are aware, ARITA has previously identified a number of errors and anomalies in the *Insolvency Law Reform Act 2016*, including the *Insolvency Practice Rules (Corporations) 2016*, such as the issue noted above in respect of the use of proposals without meetings.

A complete list of the areas of concern is provided at Appendix C.

We have previously raised these concerns with Treasury via numerous formal and informal avenues and we ask that consideration be given to addressing the issues raised in this list as part of these reforms to ensure the effective operation of the insolvency regime. This is particularly important noting concerns about rising numbers of insolvencies in 2021.

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Appendix A - Voting using proposals without meetings

Proposals without meeting have been a hallmark of Bankruptcy Act administrations for some time. ARITA's understanding is that the ILRA was intended to provide a similar streamlined mechanism for voting in corporate external administrations. However, the new provisions as drafted appear to restrict the use of proposals without meetings to a very narrow range of matters. Other than remuneration approvals in administrations commencing on and after 1 September 2017 or consent to early destruction of books and records, it is difficult to see what practical use can be made of proposals without meeting in corporate external administrations.

For corporate external administrations, the problem arises because a proposal without meeting under s 75-130 of the IRSs can only be used to pass a mere 'resolution' for the purposes of the Insolvency Practice Schedule (Corporations). If a resolution is required under a provision of any part of the Corporations Act **other than the Insolvency Practice Schedule**, then **the amended definition of 'resolution' in s 9 of the Corporations Act require a meeting to take place**.

This problem extends to matters such as:

- varying or terminating a DOCA (ss 445A and 444E);
- approving certain acts of a liquidator under s 477; and
- seeking approval of remuneration in ongoing administrations (the ILRA provides that the old Act provisions will continue to apply to the approval of remuneration in ongoing administrations).

This problem will also extend to resolutions under the new Part 5.3B and in simplified liquidations, noting that meetings are not proposed to be able to be held in either type of external administration.

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Appendix B - Reform of Winding Up Corporate Trustees

In October 2016, ARITA convened a roundtable of leading commentators and practitioners to discuss the current problems and uncertainty associated with the liquidation of corporate trustees (trading trusts). While the issues associated with the insolvency and liquidation of corporate trustees are broad, varied and complex, there was a consensus at the roundtable that the following issues are pressing in respect of the need for clarity and law reform:

- the power of liquidators to sell trust assets (owned by a corporate trustee but held on trust for beneficiaries of the relevant trust), and
- the automatic ejection/removal of corporate trustees and the issues this creates for a cost-effective winding up.

ARITA's current view is that:

- The insolvency practitioner profession and economy will be waiting for a considerable time before one or more appellate court decisions can provide clarity and certainty on these issues; and
- Modest amendment to the Corporations Act is a preferable way to resolve the issues, rather than the introduction of a separate regime or procedure for the winding up of insolvent corporate trustees.

The 1988 Harmer Report: A starting point

The October 2016 roundtable noted the extensive recommendations of the Harmer Report in 1988 regarding many of these same issues affecting corporate trading trusts. It was acknowledged that the Harmer Report suite of recommendations – including draft legislative provisions – provides a helpful platform or starting point for the consideration of suitable reforms (if not a renewed call for the some of the same recommendations made by the Harmer Report almost 30 years earlier).

Liquidator's power of sale of trust assets (s 477 of the Corporations Act)

Since the decision of Brereton J in *Re Stansfield DIY Wealth Pty Ltd (in liq)*,[3] there is considerable doubt over the ability and power of a liquidator of a corporate trustee to sell trust assets. The decision in Re Stansfield contradicted earlier Federal Court authority by holding that s 477 did not grant a liquidator such power. Therefore, applications to court for appointment of the same practitioner as a receiver of the trust assets have become necessary. Naturally, this is viewed as an unnecessary cost of winding up the affairs of an insolvent company.

[3] [2014] NSWSC 1484.

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Amend the Corporations Act to extend the notion of 'property', 'business' and 'affairs' of a company to trust assets owned by a corporate trustee and that company's business or affairs as trustee. This was recommended by the Harmer Report in 1988. If anything, the case for this legislative change is stronger today in light of case law since 1988 referred to above which has undermined liquidators' powers and created the need for separate administrations.

An amendment of this kind could be made – and confined to - s 477 (powers of liquidator). Alternatively, amendments could be made to the various provisions in Parts 5.4B, 5,5, 5.6 and 5.7B of the Corporations Act which define 'property' which would have more far-reaching application across those parts of the Corporations Act which provide for the winding up of companies in insolvency or by the court. The goal of this legislative amendment would be efficiency of administrations of windings-up by ensuring that a liquidator can:

- control all aspects of the property and business activity of the company, including as trustee; and
- collect, realise and distribute trust property (property or assets held by the company as trustee).

The Harmer Report recommended a provision which extended the notion of 'property or assets of a company' to include 'a reference to property or assets held by the company as a trustee <u>so far as</u> the company is entitled to a charge or other beneficial interest in respect of the property or assets.' This qualification of the extension – by requiring an entitlement of the company to a charge or beneficial interest – would limit extension (and the liquidator's power of sale of the asset) to situations where the corporate trustee has a right of indemnity supported or secured against the asset (whether a right of reimbursement or a right of exoneration). Query whether an unqualified extension of 'property' is preferable, so that the liquidator has all the powers necessary to deal with property of the company (held on trust or otherwise) even where there is no interest in the property via the trustee's indemnity.

Removal of the company as trustee (ejection clauses)

Trust deeds may contain provision for automatic removal of a trustee upon an insolvency event such as the commencement of a winding up. The new trustee's right to the trust assets will conflict with the right of the 'old' corporate trustee (now in liquidation) to assert a charge over the trust assets to secure its right of indemnity in relation to debts incurred in the proper administration of the trust (that right of indemnity and charge is of course of real value to the creditors in the winding up). There is conflicting authority among states as to whether the interest of the outgoing trustee takes priority over the right to possession of the new trustee.[4]

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[4] See Hannan N, 'Liquidators dealing with trust assets', (2015) INSLB 7, citing *Re Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99 and *Lemery Holdings Pty Ltd v Reliance Financial Services Pty Ltd* (2008) 74 NSWLR 550

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Renewing another recommendation of the Harmer Report, **this issue could be resolved by the insertion of a provision into the Corporations Act which voids any provision in a trust instrument (eg, trust deed) which ejects or removes the company as trustee once a company is being wound up in insolvency**.

This would avoid the potential conflict and inefficiencies arising from a liquidator and a subsequent new trustee laying claim to company assets or property. This ‘ipso facto’ prohibition - specific to corporate trading trusts - would be subject to both the liquidator’s right to cause the company to resign as trustee and court intervention.

A view has been expressed that a general ‘ipso facto’ prohibition may be circumvented or ineffective in the context of a trust instrument providing for the ejection of (or ability to eject) a corporate trustee.[5] A specific legislative fetter on the power to remove a corporate trustee upon winding up would provide ultimate certainty.

[5] Butler D & Connelly A, ‘Practicalities of Winding up Trusts and Realising Trust Assets’ (2016) 28(3) ARITA J, 27.

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Appendix C - Consolidated List of Outstanding Issues/Errors in ILRA-related Legislation

The following further errors, issues and anomalies in the legislation - i.e. Schedule 2 to the *Corporations Act 2001* ('IPS') and the *Insolvency Practice Rules (Corporations) 2016* ('IPRs') - have been identified since the introduction of the amendments:

Issue
Funds Handling provisions in Division 65 of the IPS: Applications to Court have been necessitated by the strict application of the funds handling provisions in Division 65 of the Insolvency Practice Schedule (Corporations). It is less than ideal that the new legislation is necessitating such applications to the Court for relief. It appears that an amendment needs to be targeted at (or focused on) both group appointment scenarios and pre-appointment account arrangements which are either impractical or prejudicial to company/creditors to terminate.
Requirement of applicants for registration as a liquidator to have been engaged in relevant employment at senior level that provides 'exposure to processes (including bankruptcy) under the Bankruptcy Act 1966': This requirement under ss 20-1(2)(c) and 20-1(3)(c) of the IPRs has been construed and applied by ASIC to require that applicants demonstrate recent senior-level experience in bankruptcy. This presents an unreasonable 'barrier to entry' for applicants for registration as many firms, especially regional ones and even major boutiques, do not run bankruptcy practices. Such a requirement also appears anomalous when compared against the 'bankruptcy experience' of many current registered liquidators (some of many years standing). Throughout discussions around the drafting of the rules it was always understood that 'exposure' was taken to mean suitable education and understanding sufficient to allow a registered liquidator to know the interplay between regimes and the impacts of bankruptcy law on corporate insolvency that they may undertake. It is our view that the latter position needs to be expressly confirmed.
Prohibition of Committee of Inspection ('COI') member benefit: Section 80-55 of the IPS prohibits a member of a COI deriving any profit or advantage from the external administration of the company. Section 80-55(2)(b) provides that a COI member is taken to have derived such a benefit from the external administration if the member derives a profit or advantage from a creditor of the company. Therefore, if in the ordinary course a COI member deals with a creditor the terms of s 80-55 are breached and the COI member commits a strict liability offence: s 80-55(7). These sorts of breaches are not a matter of the EA's duties but are a real risk for creditors who choose to participate as a COI member. Indeed, the strict terms of s 80-55 and the risk of breaches create a disincentive for creditors to participate in external administrations through COI membership. This would appear to work against the spirit and intention of the ILRA changes. Unless some sort of 'ordinary course' exception is introduced into IPS s 80-55, it may become more difficult to encourage creditors to nominate for COI membership and COIs themselves may become defunct.

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Issue
Reviewing Liquidator: Section 90-26(4)(c) of Schedule 2 to the *Corporations Act* appears to erroneously refer to ss 90-28(2)(c) and (3)(b) which refers to the Court's power to replace a reviewing liquidator in circumstances where a reviewing liquidator has already been appointed and the review has not been completed. It appears that the correct reference should instead be to ss 90-23(6) and (9) of Schedule 2. The key issue is the intended scope of the Court's power to make an order for a reviewing liquidator to review remuneration/costs/expenses relating to (or incurred during) a period beyond the usual 'prescribed period'. It appears that the intention of s 90-26(4) of the IPS is to establish the default 'prescribed period' position, subject to the Court's ability to make an order for some other period. As the provision is currently drafted, that power of the Court to determine some other period (i.e., to disturb the usual prescribed period) only seems to extend to the situation of an 'incoming' reviewing liquidator who is appointed to replace an 'outgoing' reviewing liquidator (either due to resignation or a court-ordered removal from office). This limitation appears difficult to understand or justify.
Initial notification to creditors: IPR 70-30(3)(c) appears to require a replacement liquidator in a court liquidation to provide the information under IPR 70-30 to creditors within 20 business days of their appointment. This requirement does not extend to replacement voluntary administrators (under IPR 70-30(3)(b)) or liquidators in a creditors' voluntary liquidation (under IPR 70-30(3)(d)) due to the different events that trigger the requirement. Is the fact that court liquidators are required to do this a drafting error? We think a preferable solution is to provide for a consistent requirement for insolvent liquidations (both CVL and Court-ordered), so that for an incoming liquidator who has been appointed under s 90-35 of the IPS, that 'new' liquidator be obliged only to send the information in IPR s 70-30(2)(a) within 10 business days of his/her appointment. The other information in subsection (2)(b) through to (f) does not need to be sent again. Such an obligation would also trigger the requirement to send an IRN under IPR s 70-35(5)(b) (it appears that this rule would need no amendment).
Statutory report by a liquidator: IPR 70-40 will require a replacement liquidator in either a court liquidation or creditor's voluntary liquidation to provide a statutory report to creditors within 3 months of their appointment, notwithstanding when their appointment occurs and whether the incumbent liquidator has already provided one. If the liquidator was replaced multiple times by creditors, each and every replacement liquidator would have to provide this report. Is this the intention or an unintended consequence of the amendment to IPR 70-40? We tend to think that it makes sense that a three-month report be required again, given that it might be a perception of inadequate investigations or reporting which prompted creditors to make the replacement in the first place.
Requirement to send an IRN in a MVL IPR 70-35 requires a liquidator in an MVL to send an IRN to creditors (where there are any creditors) even though it is members that approve the liquidator's remuneration. This should be excluded for an MVL, or specified to be sent to members where it is intended that a remuneration determination will be sought? It may not be appropriate to be sent to members as generally remuneration is approved at the meeting appointing the liquidator, which is what is contemplated under IPR 60-10(2).

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Anomalous rights of creditors in a MVL Following on from point 6 above, the following provisions provide for certain rights of creditors in MVLs which appear anomalous: a. IPR ss 70-30 and 70-40 require a liquidator in a MVL to give initial information (including about creditors' rights) and/or a 3-month report to any creditors which may exist in a MVL at the time when the information and/or report is due. b. IPS ss 75-15 and 90-35 appear to grant creditors in a MVL the right to request a meeting and to replace the liquidator. In a 'solvent winding up' (MVL), where creditors will ultimately be paid in full, these rights of creditors are difficult to understand and justify. If a company in MVL turns out to be insolvent, then the MVL is converted to a CVL under s 496 of the *Corporations Act*. Accordingly, we contend that MVLs should be 'carved-out' or excluded from the reach and application of these four provisions. An example of where this has been done is IPS s 85-5: MVLs are excluded from this provision which provides creditors the right to give directions to an external administrator.
Remuneration reporting requirement in an MVL: Based on the wording in IPS 60-10, it appears that a proposed liquidator in an MVL can seek a resolution to approve a remuneration determination at the general meeting of the company at which he or she is appointed liquidator. The remuneration reporting requirements in IPR 70-45(4) only apply to an external administrator, not a 'proposed' external administrator. Prior to that meeting in an MVL, the proposed liquidator is not yet the liquidator so technically is not required to comply with IPR 70-45(4). The former section that dealt with this situation for MVLs prior to 1 September specifically provided for the 'proposed liquidator' to report to members prior to the approval of remuneration: repealed s 495(5). So, we suggest that both IPS s 60-10(2) and also IPR s 70-45(4) be extended to also cover 'proposed' external administrators in a members' voluntary winding up. We also query whether provision might be made for remuneration approval in an MVL to be obtained via a proposal without meeting (such proposals presently being limited to creditors and contributories: IPS s75-40).
Replacement of external administrators (process). There are a number of apparent anomalies in the procedural requirements for the replacement of external administrators under IPS s 90-35 and IPR s 75-265. a. The inconsistent notice periods for the meeting in IPS 90-35(2) and IPR s 75-20. We think the preferred solution is simply to repeal s 90-35(2) and then the various meeting notice provisions for those meetings covered (or not covered) by s 75-20 should operate effectively. It would also be helpful if the Rules made it clear that a resolution for removal and replacement of an external administrator will not be valid or effective if notice of that resolution is not included in the notice of meeting sent to creditors (as a safeguard against 'ambush' resolutions at meetings convened for another purpose). b. It is unclear whether it was intended that IPS s 90-35 and IPR 75-265 (or parts thereof) apply to replacements of voluntary administrators at a first meeting in a VA (s 436E of the Act). IPR s 75-265 provides that it applies to removal and replacement of an external administrator under IPS s 90-35 which would appear to mean that this rule does not apply to replacements pursuant to s 436E of the Act (first meeting in a VA). However, we also note that IPR s 75-265(3) places specific

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obligations on replacement voluntary administrators and it would appear this could only apply to a first meeting in a VA, as creditors do not have the power to request a meeting in a voluntary administration. c. If IPR s 75-265 is intended to apply to replacements of VAs at the s 436E meeting, then subsection (4) of the rule needs to be amended to exclude s 436E meetings (because it is not practically possible for a DIRRI of an incoming administrator to be sent with the first meeting notice). d. The lodgements required under IPR s 75-265(6) are required regardless of whether the removal and replacements resolutions were successful. We do not think that the DIRRI and consent of the proposed incoming external administrator should need to be lodged if that external administrator did not end up being appointed. e. The note at the foot of IPR ss 75-265(2) (3) creates confusion and, in our view, should be deleted. Two of the provisions cited in the note – ss 436DA and 506A of the Act – do not related to 'incoming' administrators but refer to appointments made when the external administration is commenced in the usual way. There is no clear mechanism by which, upon receiving notice of a meeting to replace an external administrator, creditors can propose an *alternative* incoming administrator to the one whose DIRRI is sent out with the notice under IPR s 75-265(4). Is it possible for an amendment which would allow for this, on the condition that the DIRRI of the alternative incoming administrator is tabled at the meeting?
The heading to IPR s 75-145. While it is strictly not part of the Act, we suggest that the heading to this rule be amended to accurately reflect the fact that the rule applies to all types of meetings concerning companies under external administration (not just meetings of creditors). See IPRS 75-1 and IPR s 75-145(3).
Exercise of casting vote and operation of IPR s 75-115 during transition between forms of appointment. Doubt has arisen in practice over the operation of IPR s 75-115, particularly during the transition period between forms of external administration. When a company transitions from a voluntary administration to a creditors voluntary liquidation, by the operation ss 439C(c), 446A(1) and 499(2A) the Act has the effect that this is treated as a "new appointment" rather than a "removal". However, there appears to have been inconsistency in the interpretation of the restrictions on the exercise of an external administrator's casting vote in IPR s 75-115(5) in these circumstances.

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The doubt concerning the operation of IPR s 75-115 is illustrated by apparent differences in reasoning in two recent decisions, particularly when considering the interaction between s 75-115(5) and IPS s 75-43. In the decision of the Supreme Court of New South Wales, *In the matter of Glenfyne Farms International AU Pty Ltd (in liq)* [2019] NSWSC 16, there was a vote at the second meeting of creditors to change external administrator. One creditor proposed that an alternative external administrator be appointed as the incoming liquidator of the company. The resolution was defeated on the voices and a poll was taken, the result of which was a spilt between numbers and value. The incumbent external administrator (who had acted as voluntary administrator) exercised his casting vote against the resolution (effectively maintaining his own appointment). In that decision, Rees J found (at [39] to [40]) that there had been a breach of IPR s 75-115(5) by the incumbent external administrator but the application made by the creditor was based on IPS s 75-43 and the requirements for that provision had not been satisfied in the circumstances of this case. As a result, the matter was treated as if the resolution for change of external administrator had simply failed to pass and the incumbent moved to become liquidator by operation of the Act. In contrast, the decision of Justice Black in *In the matter of Iris Diversified Property Pty Ltd (in liquidation)* [2018] NSWSC 834 applied IPS s 75-43 and noted that s 75-115(5) would have operated to prevent the exercise of the casting vote and made orders to give effect to the replacement. In this case, the resolution for replacement of the liquidators was made at a specifically convened meeting of creditors, as opposed to during the transition between forms of appointment. ARITA has concerns with the uncertainty and whether the amendments are operating in accordance with their intended effect.