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Dear Sir/Madam,

I hereby make the following submission to Treasury in respect of the **Insolvency Reforms to Support Small Business** ("the Reforms").

I have many years of experience in the wider insolvency profession, previously as an insolvency accountant (Official Liquidator, Registered Liquidator and Registered Trustee) and now as a legal practitioner, specialising in the area. You will find a description of the many roles I have played within the insolvency profession over many years at http://www.helpingclients.com.au/geoffrey.php .

In this submission, I focus upon one particular issue and that is the **conflict of interest** and **lack of independence** of the Restructuring Practitioner.

I accept that most insolvency accountants will properly manage any potential conflicts and will carry out the very difficult work required of insolvency practitioners with great professionalism and skill. But in my opinion, the proposed Reforms are incapable of reconciling the two positions of the Practitioner; advising the company (before or after the formal appointment) and then acting in the interests of creditors.

This is a subject on which I have lectured for many years and which remains a bone of contention for the profession. As has been eloquently stated on behalf of the professional; "an insolvency accountant can pre-plan a process, but not pre-pack the outcome" (*ARITA Technical Paper; General law independence standards of Australian liquidators and administrators; Mark Wellard, Legal Director, 18 October 2017*).

In my opinion, the role of the Small Business Restructuring Practitioner, under these Reforms, places that person on the wrong side of the above line and in a position of conflict. The Reforms recognise that independence is an important part of the new proposed laws (Explanatory Memorandum at 1.31), but the Reforms need to better recognise the conflicts.

When I gave evidence to the Senate Enquiry into insolvency, I commented upon the tension between the financial incentive of an insolvency accountant to obtain work, by being appointed as the external administrator to a company, and the duties or obligations of that practitioner upon their appointment. For better or worse, my comments were noted in the Report of the Committee on the "Regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework" (see https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Completed_inquiries/2008-10/liquidators_09/report/index). This is an issue effecting the general conduct of the profession and also the duties under these Reforms.

Under the Reforms, it is proposed that the company directors will approach the Restructuring Practitioner for advice. The proposed Reforms expressly state that a function of the Practitioner is to provide "advice" to the company.

In order to win the work, particularly compared to the next Restructuring Practitioner, the incentive for the advisor is to provide advice that is favourable to the Company. In some ways, that is their duty; to act in the interests of the client to whom they are providing advice. If there is to be a restructuring plan, the same principle applies; make that plan as favourable to the company, as is possible.

The announcement of these Reforms by Treasury around 22 September 2020 (https://ministers.treasury.gov.au/sites/ministers.treasury.gov.au/files/2020-09/Insolvency-Reforms-fact-sheet.pdf) made it clear that the small business facing financial distress is to approach a Practitioner to discuss their options, the Practitioner provides advice and the owners accept that advice to then subsequently appoint the Practitioner on a formal basis as a Small Business Restructuring Practitioner.

It is these pre-appointment discussions which secure the appointment of that Practitioner and their entitlement to be paid fees.

However, immediately upon being appointed as the Restructuring Practitioner, the duties/functions/role of that person change.

Under the Reforms, the Restructuring Practitioner has to undertake some role in preparing the restructuring plan and then has an obligation to report on the adequacy of that plan, presumably in the interests of creditors and not for the benefit of the Company. Yet, it was the Company who engaged the Practitioner to provide advice and assistance on that same restructuring plan.

It has been recognised amongst the profession that the "client" of the Practitioner changes from being the directors/company to being the creditors. The law considers that, at a particular point, the officers of the company, which will now include a Restructuring Practitioner, have duties which (at marginal commercial solvency) extend to the creditors of the company. The concept is not without criticism, but it has been approved for many years (see *Hayne, K M --- "Directors' Duties and a Company's Creditors" [2014] MelbULawRw 28; (2014) 38(2) Melbourne University Law Review 795*).

The Restructuring Practitioner cannot be the servant of two masters, particularly when the roles are separated in time by the mere minutes taken to complete the mere act of making a formal appointment.

The finer points of the Reform provide further support to my concerns.

As an example, the restructuring plan is capable of being declared void. This is the plan which the directors could rightfully complain was prepared with the paid assistance and even support of the Restructuring Practitioner.

Imagine the circumstances in which the Restructuring Practitioner assisted the company to prepare that plan and then made a declaration to creditors that the plan was in the interests of creditors and then a court declared the plan to be void. In normal circumstances, a person who was involved in such a manner would face severe consequences and a professional would face allegations of negligence and/or misconduct. It is not dissimilar to the criticisms of an Administrator or Controlling Trustee when a DOCA or PIA is set aside by the Court.

However, under the Reforms, the Restructuring Practitioner is expected to have a role in providing advice and assistance (to the Company, but in the interest of creditors). The directors will have an expectation that the Restructuring Practitioner is there to help them. In simple terms, the Reforms suggest that to be the case.

With respect, having regard to this obvious position of conflict, the role of the Restructuring Practitioner is misconceived.

The responsibility for providing advice to the Company and its director(s) and also assisting with the preparation of a restructuring plan, must not be with Restructuring Practitioner. That person is the very person obligated to report on the adequacy of that plan and then, for further remuneration, implement that plan. No matter how competent the Practitioner, there is an incentive to support a plan which, on an objective view, should not be supported.

There needs to be a separation in those roles. That separation will not necessarily escalate the costs. The company and directors should be entitled to obtain advice for their benefit, whilst having regard to the ultimate interests of creditors. Those advisors should be paid for giving that advice. The Reforms are based on the "debtor in possession" principle, so the concept of the directors/company obtaining their own advice should not be foreign to the principle.

I note that there does not appear to be any prohibition upon any person providing, for example, legal advice to a company and legal assistance with the preparation of a restructuring plan, either before or after the appointment of a Restructuring Practitioner. The problem for such person is in being paid for their work. The simple answer may be for the Restructuring Practitioner to approve the payment by the Company under restructuring of the costs of the company's own advisor. This is common to the US Chapter 11 regime.

I digress to note that there is rarely any appreciation for the many times in which an insolvency practitioner provides significant credit in favour of the Company, for example, for the delayed payment of fees/costs/charges and in some cases for the expenses of trading the company under administration. The fact that such fees are secured or given a priority makes all the

difference and allows such credit to be given. But that protection only applies to the fees/costs/charges arising after the formal appointment and still involves a significant risk being taken by the Practitioner.

In due course, market forces will dictate the choice of any pre-appointment advisor or Restructuring Practitioner. However, the point remains that an independent advisor to the company, being a person other that the Restructuring Practitioner, will not be in the position of conflict, noted herein, which the Reforms are likely to create for the Restructuring Advisor in their role as advisor to the Company.

In my respectful opinion, in order to change the balance in some meaningful way, without throwing out the whole Reform proposal, section 435E should be re-cast in the following manner

453E Functions, duties and powers of the restructuring practitioner

(1) The functions of the restructuring practitioner for a company under restructuring are:

(a) subject to any duties to creditors, to provide advice to the company on matters relating to restructuring; and

(b) to assist the company to prepare a restructuring plan; and

(c) to make a declaration to creditors in accordance with the regulations in relation to a restructuring plan proposed to the creditors; and

(d) any other functions given to the restructuring practitioner under this Act.

Further, the Explanatory Memorandum should be amended to make it clear that the type of advice which can be provided by a Restructuring Practitioner, prior to the company being under restructuring, is limited. It may be about the process, but it must not promise or suggest an outcome. It may be about eligibility and costs, but the costs estimate need to be realistic and reliable. The principle of independence should be paramount in the mind of the Restructuring Practitioner whenever providing advice to or making decisions for the Company, noting the principle that the interests of creditors replace those of the shareholders, once the company is insolvent.

These are my thoughts, within the limited time allowed to make these submissions.

Yours Truly

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Barrister at Law,
12 October 2020

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Dear Sir/Madam,

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I make this submission so as to identify what may be an **error in the current legislation** relating to support for small business.

It is well known that under the March and September amendments to the Corporations Act, the laws in respect of "trading whilst insolvent" were temporarily suspended or hibernated (see *Coronavirus Economic Response Package Omnibus Act 2020, Schedule 12—Temporary relief for financially distressed individuals and businesses, section 31)*

In effect, directors could not be liable under section 588G of the Corporations Act for incurring debts in the ordinary course of business. This protection was given under section 588GAAA;

588GAAA Safe harbour—temporary relief in response to the coronavirus
(1) Subsection 588G(2) does not apply in relation to a person and a debt incurred by a company if the debt is incurred:
(a) in the ordinary course of the company's business; and
(b) during;
(i) the 6 month period starting on the day this section commences; or
(ii) any longer period that starts on the day this section commences and that is prescribed by the regulations for the purposes of this subparagraph; and
(c) before any appointment during that period of an administrator, or liquidator, of the company." (emphasis added)

The period during which the above section takes effect, for the purpose of sub-section (b)(ii), was prescribed by the *Corporations and Bankruptcy Legislation Amendment (Extending Temporary Relief for Financially Distressed Businesses and Individuals) Regulations 2020* to be;

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5.7B.01 Extension of temporary relief for insolvent trading safe harbour

For the purposes of subparagraph 588GAAA(1)(b)(ii) of the Act, the period prescribed is the period starting on the day that section 588GAAA of the Act commenced and ending at the end of 31 December 2020.

However, the wording of sub paragraph (c) of 588GAAA(1) is critical. Arguably, it contradicts the principles of the Reforms. In short, there is a timing issue.

The wording of s 588GAAA(1)(c) suggests that, for the protection of the section to apply, the company must appoint a Liquidator or Administrator during the period which expires on 31 December 2020.

The proposed amendments under the "Insolvency reforms to support small business" are due to take effect on 1 January 2021.

If I am correct, the aforementioned protection to a company director expires on 31 December 2020 and most importantly, the protection will not operate at all, unless the directors appoint an administrator or liquidator to their company, prior to 1 January 2021. On my reading, the directors cannot wait one more day, to use the new laws which are proposed under the Reforms.

This must be contrary to the intention of the Government in proposing these new Reforms to start on 1 January 2021.

I urge the government to recognise this potential mistake and make the amendment of deleting sub-paragraph (c), so as to avoid any potential confusion.

I make this comment on the premise that the Government does not want a rush of insolvency appointments before the new Reforms are even implemented. That could make a mockery of the Reforms.

Yours Truly

Geoffrey McDonald
Barrister at Law,
12 October 2020