Insolvency system roundtable of 4 August 2021

The roles of the state and the private profession in the insolvency system: do we have the right balance?

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Chat questions asked at the roundtable [names deleted] and responses subsequently provided by the presenters

Thank you to all those who attended this on-line roundtable hosted by the Australian Academy of Law and the Ross Parsons Centre of the University of Sydney. We received many comments and questions through the 'chat' facility and also through emails and calls before and after the session. While we answered some at the session, we have now gathered them all in this paper – from 1 to 16 - and provided our considered although necessarily brief replies. Given the Chatham House Rule applying, no names are shown. However, if anyone would like further particular comment on our answers, or any references, we would be pleased to respond.

We are continuing to pursue this issue, much assisted by the roundtable, and would also be pleased to hear any further thoughts or comments, on this paper, or otherwise.

Question 1

There may no longer be a presumption of misconduct, but aside from reporting under s 533 Corporations Act reports, what else do you define as the separate public interest which insolvency practitioners [IPs] are now fulfilling?

The reasons for the insolvency system are based on the public interest. Insolvency Law imposes a mandatory collective process on individual creditors and the debtor, where there might otherwise be disorder and conflict, with the IP given the authority of the state to administer the insolvency according to agreed rules. Insolvency serves other interests, including economic. It is not just about rights of the debtor and its creditors, nor only about pursuing any misconduct.

Question 2

Doesn't rethinking insolvency at this fundamental level also a need a rethink about the corporate veil and when it should be lifted or made more porous?

My question is motivated by an issue I have been contemplating for some time based around the history of incorporation. On one view, corporations were created to be means of aggregating capital to undertake some economic activity with the shareholders being active participants. Hence, for example, the early limitation on the number of corporators. The creation of separate legal personality was incidental to that. However, for many, corporations are now not means of aggregating capital (in many cases it is debt these days anyway) but simply to avoid personal liability. That is recognised in many cases by lenders and others requiring directors to give personal guarantees. In such cases, one might ask, what is the point of incorporation. Lurking somewhere in all of that is potentially a fundamental rethinking of the corporate form.

If the concern is about bolstering returns to creditors, then perhaps a directors' guarantee of a minimum dividend such as 10c in the dollar could be looked at. Alternatively, directing civil penalties levied against directors to a fund to compensate creditors would be another potential response. However, many directors of failed companies have little or no assets

themselves, in part because of the extensive use of personal guarantees demanded by major creditors, and also because of effective asset protection. A more productive avenue for reform may be to try to improve the governance and accounting standards of all businesses so that financial problems are acted on earlier in the decline curve and putting in place warnings and disincentives to discourage directors trading on a business into oblivion. In addition, the freedom to incorporate without identity requirements and connection with tax and related regulatory registration, only serves to allow directors to treat the corporate form as dispensable.

Question 3

What is the role of an Official Receiver in insolvency matters involving environmental clean-up bills? This is quite a vexed issue at present and the personal liability risks for private liquidators are only going to become more significant as we transition towards a net zero emissions future – there will be enhanced primary obligations for entities (and, necessarily, their officers and external administrators) and the clean-up bills will be substantial as we see the closure of coal-fired power stations and other non-renewable power facilities. These may become assets that are simply 'too hot to handle' and the liability risk will mean that private liquidators will not wish to accept appointments in these cases. In the absence of clearer, more cohesive regulations (which would require a substantial recalibration across state/territory and Commonwealth legislation) that limit the personal liability risks for private liquidators, there is a clear public interest in having an Official Receiver step in to fill the vacuum – and perform functions that are, necessarily, beneficial to the community. Do the panellists have a view?

This question deserves more of a response than we can offer here but there are insolvencies that call for a public role, to assume responsibility for the potential liabilities you explain, and to administer the insolvency with whatever public assistance may be available. Examples in the UK are British Steel (environmental liabilities, money), Carillion Constructions (public works programs) and Thomas Cook (air traveller repatriations). Co-administration with the private sector is feasible. Reframing laws to lower standards to a level commensurate with the role of the IP, as in Canada, is also an option. Recent government responses to clean up costs generated by insolvent off-shore oil rigs on the North West Shelf are also an option, that is, to impose a clean-up levy on the industry, with whatever risk premiums might be set.

Question 4

The data shows that a major problem is lack of assets to pay creditors, so the issue of [the cost of insolvency procedures] doesn't address that problem. I think the role of the state needs to include appropriate debt management procedures by the ATO, banks and other creditors.

That may be so but given we operate on a cash flow test, we must accept that having assets of substance and on hand is not necessary for a business; the nature of many new businesses – services and internet based – further diminishes the need for assets; and if there are hard assets then will most likely be secured, as mortgages over land, or under the Personal Property Securities Register (PPSR); and the business itself as an asset may well be secured under the PPSR. Debt management by the ATO and major banks can lead to prolonging financial distress for some companies. Better public notice of repeat offenders who fail to comply with multiple repayment arrangements may also assist with a more efficient allocation of capital.

Given the centrality of revenue debts in most insolvencies, and in significant amounts, there may be a basis for a more effective tax collection system, for example through single touch

pay-roll (STP); or, putting that another way, the reliance of business taxpayers on unremitted tax payments as cash buffers well beyond the due date, in effect allows insolvent companies to continue to trade, and creates unfair competition.

As for other creditors, there is a case for saying that with greater access to credit information, quicker and more secure payment methods, and the PPSR, there is now a greater responsibility on creditors to protect themselves, rather than have an insolvency regime so much focused on their rights.

Question 5

A corollary of some of the statistics that you have quoted is that there is an incentive for malevolently-managed (or malevolently-advised) debtors to dispose of all of the debtor's assets before deregistration or appointment.

The pursuit of wrongdoers is complicated, time consuming and expensive. In my experience, without assets, wrongdoers are only punished where they have 'form' with a government actor – typically the ATO.

What legislative tools might there be to reverse that incentive, whether in a hypothetical new system where pursuit is not funded from the debtor's assets but in a system like the existing one? Might there be some merit in adopting a presumption that any disposal of assets within a defined period before liquidation or deregistration is a liability of the directors?

Yes, that is an inherent incentive to transfer assets so as to impede or prevent funds being available to investigate, unless from an external source. To some extent that is inherent in any debt recovery, that it costs money to recover a debt. Unless the public interest is triggered (criminal conduct, wrongdoers have 'form' with ATO etc) that is a matter for the creditors to provide external money, or, on a commercial basis, for a litigation funder to be engaged. An alternative is to have some insurance or bond provided by the company.

As to legislative tools to reverse that incentive, presumptions are an option, subject to fairness/rule of law considerations, based, for example, on some special policy considerations applying to liquidators and trustees (a collective action, need to enforce the insolvency laws). A presumption as you suggest might have deterrence impact; but putting personal liability on directors simply showed, in one study, increase in the number of directors' assetless bankruptcies. We can't focus all of the regulatory attention on cleaning up the mess left behind by failed businesses, more attention needs to be given to dealing with failing businesses before they collapse, and creating an environment where they can be identified earlier by those dealing with them. Greater attention on building regulatory red flags and surveillance to identify businesses at risk and facilitating easy access to affordable or free financial advice would help save some businesses.

Another option would be a demand in the nature of a section 139ZQ notice in bankruptcy. Its introduction in 1993 was predicated on the issues you raise, that "many transactions which are entered into by a bankrupt before bankruptcy, and which are void against the trustee of the bankruptcy, cannot be set aside because the trustee has no or insufficient funds to mount a court action to have the transaction set aside. … [this] will provide an administrative mechanism for the setting aside of transactions which are void against the trustee, thus making the recovery of funds into bankrupt estates simpler and more cost effective and ensuring a better return to creditors".

Question 6

Recovery and Investigation often both apply in an insolvency matter. In that event is Investigation undertaken by the IP? The investigation and reporting being done by IPs is for two purposes, recovery and (arguably incidental) the public interest.

These are good questions and ones to be worked out in detail. The UK Insolvency Act 1986 seems to operate on a reasonable division, with the OR taking the main responsibility for investigating and reporting. A practical explanation of the relationship between the OR and the liquidator is here: 2. Winding-up orders - initial actions - Technical guidance for Official Receivers - Guidance - GOV.UK (www.gov.uk)

Question 7

Consideration of the merits of this proposal might benefit from an analysis of the effectiveness of the Official Trustee as a trustee in bankruptcy. Has that office been effective in its investigations and recoveries?

The law requiring investigations and reporting by trustees is more focused in bankruptcy (see s 19 Bankruptcy Act) than in corporate. But we don't see the current role of the OT as appropriate for the new system given that trustees are nevertheless required to investigate and report to AFSA the results and assist with any prosecution. We are advocating an independent investigation by an OR, or to have the OR fund IPs to conduct some or all of the investigation.

Question 8

The current system does not distinguish between micro, small and large. Nor does the current system distinguish between industries.

It is generally only those who work in insolvency who see it from the legal perspective of company, trust or individual. ATO, ASBFEO and others see the business as micro, small and large; or based on aggregated turnover, number of employees etc. We can't see that focus of insolvency on the legal structures changing soon and some close consideration would be needed. But international guidance, eg UNCITRAL, calls for MSE insolvency law to have all the MSE's debts covered in a single simplified insolvency proceeding, whether personal or corporate, or at least that there should be procedural consolidation or coordination of linked personal and corporate insolvency proceedings.

Question 9

Becoming a company director requires no education or qualification.

This is a common comment though query whether it is company director skills or business and accounting skills that are really required, including knowledge of the tax, superannuation and employment systems. One idea would be to link new company registrations to receipt of an ABN which process itself could require some test of tax and/or financial knowledge.

Question 10

If there were an Official Receiver could you have a joint appointment with a private liquidator – so the OR could take the environmental or other public role?

That could be a good arrangement, and one that we have considered, for the state to take on liabilities that should not be imposed on a private professional [barring negligence etc], something like the special manager role in the UK we referred to earlier. A joint-appointment would also resolve many of the regulatory issues about IPs.

Question 11

If the Government were to fund the Official Receiver function, it could recoup some of the cost if those operating a business through a company were required to pay a deposit of some amount as security for the costs of dealing with a failed business, and/or perhaps impose an annual levy (based on turnover) to fund those costs.

Yes, we are aware of several funding models, such as you describe. Another example is AFSA's % levy on asset realisations; or NZ's $1 levy on company registrations. The Harmer Report's original assetless companies fund bears revisiting. We would not support ASIC's current funding model insofar as it applies to liquidators.

Question 12

Should courts take the unfunded work into account when assessing remuneration of IPs? Are courts well equipped enough to assess remuneration?

Unfunded and public interest work of IPs properly only impacts their charge out rates; it is not a reason for an IP to inflate work or hours actually performed. In so far as courts take account of rates, eg in the Courts' 'consent to act', and in remuneration determinations, we consider some notice could be given to what we say is a reason for the amount of those rates. It would assist if the regulators also acknowledged this; AFSA does this, but only indirectly.

Courts can properly determine remuneration, but the evidence required to support a court hearing can be disproportionate to the amount involved, such that court hearings might properly be left for seriously contested matters, or where matters of principle need to be decided. The better option is that which applies in personal insolvency, to have the regulator assess remuneration, or in some cases, court officials, with a right of review to the courts.

Question 13

As to lack of data, don't FEG and ATO as major creditors keep data on their recoveries etc?

If they do, it is not published to any significant degree. The Inspector-General in Taxation was recently critical of the ATO for the limited attention it gives to evaluating the effectiveness of its debt recovery processes, including from insolvency, and the IGT further recommended that this be improved.

Question 14

A common reason for there being very little assets left in an insolvent administration is that secured creditors have already had recourse to secured assets to recover their claims. If one of the problems to be addressed is how to fund the public interest functions of an insolvent administration, then do you see any scope for adopting a similar partial solution that currently exists in corporate insolvencies where employee entitlements are given priority in respect of circulating assets? Should there be some access given to secured assets to contribute to the cost of public interest functions?

That is a good question that seeks to address what we say is a threshold problem at the moment, that there are insufficient remaining funds in insolvent estates to properly fund the system. What that could or should be resolved by way of access to the assets of secured creditors beyond employees is a large question that brings in policy issues more of economics than of law and which is beyond our focus. We would however need to examine,

for example, the idea of a 'ten per cent fund' suggested by the UK Cork Report for unsecured creditors.

Question 15

In personal insolvencies, especially those that are assetless and usually administered by AFSA, case officers can be caught in the conflict between trying to administer the estate to achieve dividends to creditors, while at the same time answering to the pressures exerted by consumer groups that advocate for the rights of debtors, presumably on the basis that bankrupts are asserted to be "consumers" of insolvency services. If a new system involves establishing an Official Receiver to take over the public interest functions in administrations which is completely detached from the task of trying to achieve a return to creditors, there is a prospect that we would see an expanding consumer advocacy movement to place pressure on the OR. How would you propose keeping such pressures in check?

While we appreciate the question, we don't think our proposal raises an issue that is not already confronted in many areas of government. AFSA at present has several roles, as Official Receiver, Official Trustee and as Inspector-General, each of which has different stakeholders and pressures. There is also a clear separation of policy, which lies with the Attorney-General's Department. The ATO, ASIC and the ACCC and other agencies that might, on one view, be said to have conflicting priorities. In any event, the issue you raise is one that does bear consideration in the formulation of the detail of the proposal.

Question 16

1. The private profession is more efficient and effective at undertaking the role of liquidator.
2. The AAF should be radically increased to fund the profession on non-paying jobs.
3. Offsetting point 2, significant red-tape should be cut from the responsibilities of liquidators to reduce the cost of insolvencies more generally.
4. A Government liquidator would add a layer of cost and delay, which then may jeopardise the potential recovery actions that have relatively tight limitation periods of 3 years.
5. Government funding would be better utilised in making the examination process, an incredibly useful tool for liquidators to investigate actions in the smaller jobs, more accessible and streamlined. IPs should not have to wait months to get examination dates, particularly on the smaller jobs. Perhaps a Registrar and Court room dedicated to examinations (much like 77Cs in the bankruptcy arena). Query if the AAF should fund IPs with, say, $20,000 to conduct examinations in warranted cases.
6. The risk of greater phoenix activity.

Responding briefly to these in order,

1. is a view that we believe is debatable, although we accept it is a professional view. Are the 80% or more of individual bankruptcy matters that are conducted by the Official Trustee clearly handled less efficiently than the privately appointed trustee run matters? Our proposal to have public duties attended by a public agency, and private duties for creditors attended by IPs may also address this point.

2 & 3, we support increasing the scope and funding for the Assetless Administration Fund of ASIC, but we are not advocating simply throwing more money at the problem. There should be a corresponding responsibility to reduce red-tape and costs in private practice - for example by greater take-up of IT and AI processes - and not simply to fund IPs more.

4, time limitation periods can be adjusted, and administrative recovery tools may be quicker than court recoveries.

5, streamlined examinations have been operating in personal insolvency since 1992, it is perhaps a product of not having a government role that corporate insolvency still relies on the expensive court process.

6, as we say, there is perhaps a greater risk of phoenix activity under the present system with 10 times the number of companies being deregistered each year, with little oversight, compared with the numbers entering formal external administration, each with rather close oversight.

Question 17

The basis for remuneration: as a lawyer who charges by the hour I am probably a pot calling kettles black, but my experience from creditor meetings is that those who are owed money cannot come to terms with the rates IPs charge (including right down to secretarial functions) and this brings the whole process into disrepute. It is no comfort for them to know that if they are unhappy, they can force the IP to go to court and still be paid at their commercial rates. I wonder if it would be more palatable to creditors to have remuneration fixed by percentage commission on realisations. Most would be familiar with remuneration by way of commission on the amount achieved (eg in real estate sales). Remuneration by commission has always been allowed in personal Bankruptcy even pre-federation (see e.g. Bankruptcy Act 1898 (NSW) s 82). The present default position where the OR administers a bankrupt estate, is, as I understand it, a fee of $4,000 (presumably to allow something if there are no realisations) plus 20% of the realised balance: see Fees Determination section 3.09).

I agree that we need to consider an Official Receiver or Inspector General type of role for company liquidations. There has been a legislative trend in favour of allowing outside bodies certain roles in a winding up in addition to the role of the appointed liquidator. See for example the roles of the DCT, the Fair Work Ombudsman and the Department administering FEG (sections 588ZB and s 596AF). Also see the role of ASIC in making orders to reverse creditor defeating dispositions under s 588FGAA, which mirrors in some respects the powers of the OR under s 139ZQ of the Bankruptcy Act.

The question then arises as to whether we can have a more comprehensive role for such a person in parallel to a private liquidator. The Government officer could be charged with investigations, examinations, claw back etc leaving a private appointee to conduct asset realisations and proof of debt administration perhaps using a fixed fee/commission model of remuneration.

Remuneration is a difficult issue for many reasons in insolvency which have explained to some extent in our paper; for example, as to the work carried out on behalf of the state, and in administering assetless estates. A commission-based system would need to be carefully calculated and explained. To some extent we would say that the initial focus should be on refining and readjusting the extent of work required in administering an insolvency, which may in many cases mean less work, and then look at remuneration.

As to government agencies already involved, that is a valid point. To some extent the real regulator of insolvency is the ATO, which has more relevant powers than ASIC. We would also say that some government agencies as creditors benefit most from insolvencies, because of their priority position. But no agency has the right to assume a liquidator role. Your following description of the idea of a government officer is along the lines of what we propose.

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