Insolvency Law
Bulletin

Offence reporting by insolvency practitioners

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There is said to be ongoing tension between the Australian Securities and Investments Commission (ASIC) and the corporate insolvency profession about offence referrals by liquidators. The profession says that its members refer many breaches of the law to ASIC pursuant to their duties to do so under s 533 of the Corporations Act 2001 (Cth)[1] (Corporations Act) but that few regulatory proceedings or prosecutions eventuate. These referrals number in the thousands each year.[2]

If this is the case, then there is something amiss with the law if it has created a situation that is so patently unmanageable. The task of investigation and reporting of the circumstances of an insolvency addresses an important feature of the law — to provide some accountability for the losses suffered by creditors. The extent to which that task is needed in each insolvency is a relevant question. The problem here may lie with the broad terms of s 533 itself.

Section 533

Section 533 requires liquidators to report all apparent offences under Commonwealth, state or territory law, in relation to the company; and to report anyone who has misapplied or retained or become liable or accountable for the company's money or property; and those who may have been guilty of any negligence, default, breach of duty or breach of trust in relation to the company. In the 2017/18 financial year, ASIC reported that external administrators reported alleged misconduct in 6577 reports out of the 7613 lodged, or 86.4%.

A further reporting obligation applies if the company may be unable to pay its unsecured creditors more than 50 cents in the dollar. Given that 97% of external administrations pay under 11 cents in the dollar,[3] the breadth of that last requirement alone is apparent.

ASIC's guidance on the section exceeds 35 pages, with four detailed reporting schedules.[4]

Earlier law

Earlier company laws in the states and territories were not as demanding. Section 223 of the Companies Act 1936 (NSW) did require a liquidator to report as to capital, assets and liabilities, the cause of the company's failure, and whether further inquiry was desirable, including a public examination. This was based on English company law. That provision eventually became s 476 of the Corporations Act, which was itself replaced in 2017 by a separate reporting requirement.[5] Then there was s 418 of the Companies Act 1981 (Cth) which became s 533 of the Corporations Act 1989 (Cth). In all, s 533 represents an amalgam of former s 418 and other state law provisions.[6]

Should s 533 be changed?

Whatever its genesis, the section could usefully be changed in several respects:

a) to clarify whether there should in fact be an obligation on a liquidator to investigate and report at all
b) if so, by whom, and
c) to investigate what
d) at what level of materiality and
e) across what range of misconduct

a) Whether there should in fact be an obligation to investigate and report

A starting point could be that insolvency does not of itself imply legal fault; insolvency law has long moved way from its original criminal law focus in bankruptcy. While there may be good reason to find out why the company failed, and to locate and pursue assets, to go further and require an assessment of any liability in relation to that failure might be questioned; or, if that is to be done, that it be the subject of a separate regulatory focus. Only if the liquidator finds breaches of the law in the course of such investigations would there be an obligation to report.[7]

It is however generally accepted that there is a need to inquire into any unlawfulness when an insolvency occurs as being a quid pro quo for the release from debts that insolvency provides, and as a means of maintaining confidence among creditors in the insolvency system. Such investigations have long been a basic feature of insolvency law.[8] The corporate form is open to abuse, and insolvency itself, and there is the reality that a struggling business will more often be more in default of its legal obligations than one that is stable and well-resourced.

As to the obligation to report, the current wording "if it appears to the liquidator" is unclear although it is

interpreted by ASIC as a positive obligation. This could be made clear including by way of allowing the liquidator a statutory discretion whether or not to report, even if some explanation will be required for not doing so. As we see from the decision in *Murdaca v Australian Securities and Investments Commission (ASIC)*[9] (*Murdaca*) discussed below, the standard of belief expected of the liquidator is quite low, and could be raised.

b) Who should investigate?

The law requires liquidators to conduct the investigation, given their proximity to the insolvency, and their standing under the law. An alternative is to have an Official Receiver role created to attend to what are essentially public interest matters, or to put that task upon ASIC. That raises the prospect of substantial changes in the way that corporate insolvency is structured in Australia, beyond the scope of this article. But it would serve to clarify or resolve the imposition of public duties on insolvency practitioners as private professionals, requiring them to balance the cost of misconduct investigations against remaining company funds that are otherwise destined for creditors.[10]

The role of the UK Official Receiver, including in conjunction with the private profession, is discussed below.

c) What type of misconduct to investigate and report, and by whom

The types of misconduct to be reported under s 533 are very broad, being all offences under Australian law, misapplication of money or property, breaches of duty, and more. This could be confined to offences under the Corporations Act or to serious criminal conduct under laws such as money laundering, tax or financial fraud. And it should be noted that the term "offences" can refer to both criminal and civil offences. The range of persons who are the potential subject of report could also be limited.

d) What materiality test should be used

Even if the type of conduct were to include all offences and breaches of duty, how serious should these be before they have to be reported? One might confidently say that any trading business would be in breach of some law on any given day, even if trivial; and perhaps more so an insolvent company. The appropriate materiality test needs to be examined in terms of the policy of the section — to alert ASIC on breaches of the law that may reasonably call for attention. Materiality of misconduct could be defined by being causative of the company's failure, or by its financial impact above a certain threshold, or the summary or otherwise nature of the offence.

e) What should be the connection of the misconduct with the company?

The final point might then be as to how the misconduct is to be connected to the company. Section 533 is confined by the requirement for the misconduct to be "in relation to the company" which is broad and in practical terms has sufficed.

Review of the section

ASIC has said that it is reviewing the "content and format" of these reports but it is the terms of the section that need attention.[11] Any review of s 533 could result in a provision that limited the task of a liquidator to one within his or her initial discretion, to report a serious breach of the Corporations Act, or serious criminal misconduct, with a relevant connection to the company in liquidation.

Case law and overseas experience offer us some ideas for reform.

The liquidator's task under s 533

The task expected of the liquidator in reporting under s 533 was addressed in *Murdaca* in the context of the deregistration of a director under s 206F of the Corporations Act. ASIC can rely on a report under s 533(1)(c) as to payments of less than 50 cents in the dollar in order to take action against the director under s 206F.

As the court explained in *Murdaca*, the function of the s 533 report is to promptly alert ASIC to potential problems identified in relation to particular corporations. The wording of s 533(1)(c) that if it *appears* that a company *may* be unable to pay its unsecured creditors more than 50 cents in the dollar, it means that a liquidator need not conclusively demonstrate or prove that fact. The liquidator is obliged to act bona fide and hold genuine views expressed in the report; but "the terms of such a report are not conclusive of anything".[12] The report is merely a trigger for potential future action by ASIC, at which point ASIC can be called upon to assess its worth in order to decide whether disqualification is justified.

As explained earlier, the number of reports that triggered off a low threshold is unmanageable. If there were any purpose in the reporting under the current section, it is that its statistical content assists in showing the extent and nature of various breaches of the law of insolvent companies, for regulatory or law reform purposes. *This does assume that the legal assessments of misconduct made by liquidators are valid. ASIC's data shows only a limited range of the main offences referred, all under the Corporations Act. One would need to know*

the extent of referrals of employee "wage theft", visa offences and tax fraud in ASIC's data, in order to be satisfied as to the breadth and accuracy of current referrals.

Assetless companies

There is also the important issue of the extent to which the liquidator is required to investigate at all if the estate is unfunded, in light of s 545 of the Corporations Act, one view being that the section "expressly confirms that liquidators are under no obligation to conduct any investigations beyond the bare minimum required for the statutory [s 533] report".[13] ASIC's view is that an "unfunded external administrator must still comply with their statutory obligations to prepare and lodge reports and other documents with ASIC",[14] with s 545(1) merely relieving the liquidator from the burden of incurring expenses other than those that must be incurred in order to carry out their statutory reporting and document lodgment obligations.

Section 545 is a section which impacts s 533 and which itself could be clarified by reform.

Some further insights can be gained from the Australian Bankruptcy Act 1966, and from English and New Zealand law.

Bankruptcy Act

The Bankruptcy Act gives a general power of investigation to a trustee: s 19AA. The duties of a trustee are listed in s 19 and include the need to consider whether the bankrupt has committed any offences under the Bankruptcy Act itself and referring those. This is a more sensibly confined obligation. It is also assisted by the pre-referral processes offered by the Australian Financial Security Authority (AFSA) to help trustees decide whether an offence should be referred and by AFSA's issued and current guidance.[15] AFSA regularly reports the prosecution outcomes based on trustees' referrals.

New Zealand

New Zealand is introducing a new reporting provision under s 60 of the Insolvency Practitioners Regulation Act 2019 (NZ) in recognition that the criteria for referral have been too broad, with no materiality restriction.[16] The obligation of a liquidator will be to report "serious problems" — similar to those listed in s 533 — but in respect of which the liquidator must have reasonable grounds to believe that they have occurred. The section also broadens and specifies the agencies to which offences must be reported, including the New Zealand Police, and the anti-money laundering authority.

Importantly, the duty of a liquidator is qualified by s 60(6) that "nothing in [the] section requires an insolvency practitioner to take any steps to investigate whether a serious problem has arisen".

England

England is different again because of its retention of the position of the Official Receiver upon whom the law imposes the task of investigating the causes of a company's failure and to inquire generally into its promotion, formation, business, dealings and affairs, with a discretion to refer any matter to the court.[17] The Official Receiver and liquidators have specific reporting obligation to report director misconduct under s 7A of the Company Directors Disqualification Act 1986 (UK). UK liquidators have other obligations to refer offences, including as directed by the court.[18] These public law obligations of practitioners are seen as being beyond the purpose of getting in and realising the company's assets for the benefit of the creditors.[19]

The requirement of UK practitioners to report misconduct of directors was a task imposed by the government in the 1980s as a means of maintaining commercial morality and legal compliance.[20] Successful actions against directors are frequently reported by the English regulator.

Another purpose behind s 533

The English Government saw the requirement for insolvency practitioners to report on directors as having another purpose, operating "as a secondary monitor over the professionals themselves" whose offence reporting could be checked.[21] That in fact was also seen as a purpose of s 533 by the court in *Murdaca*, the court saying that its supervisory role:

> … might be engaged if, for example, it could be demonstrated that a liquidator had prepared a s 533 report which was incorrect and actuated by malice … It may also be the case that the decision to prepare and lodge such a report might be susceptible to judicial review. It is not necessary to postulate all conceivable ways and means by which both directly and indirectly a rogue liquidator might be brought to heel and an invalid s 533 report removed from consideration for the purposes of s 206F.[22]

Trustees' compliance with offence referrals is an aspect of AFSA's regulation of trustees.[23]

Comment

Insolvency law does require a balancing of interests. Some accountability should be available and if there were any serious offences that the ultimate deregistration of the company might conceal, then they should be reported. Some thoughts as to how that evident policy behind s 533 can be achieved is offered in this article.

As a threshold issue, while ASIC says that liquidators are the "front-line investigators of insolvent corporations",[24] the reality is that the government relies upon a

private profession to perform a public investigation and reporting task. As a public task it should properly be performed by a public agency, as in the UK, or as a delegated and funded role.[25] Australia did not adopt the role of the UK Official Receiver after federation;[26] the imposition of investigation and reporting and other such responsibilities might be seen as a product of that.

A further perhaps contentious issue is that assessments of illegal conduct are being made by insolvency practitioners who are not legally qualified. The only breaches of the law are all under the Corporations Act.

Beyond that issue, the way to respond to the tension between the regulator and the profession is to change the need for the profession to refer thousands of reports to ASIC, and introduce a more refined statutory provision the drafting of which might usefully be informed by the experience of other comparable jurisdictions and by the mass of data already collected from these reports over the years.

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Footnotes

1. And related s 422(1), s 438D(1) or s 533(1).
2. See Australian Securities and Investments Commission (ASIC) *Insolvency Statistics: External Administrators' Reports (July 2017 to June 2018)* Report 596 (November 2018) https://download.asic.gov.au/media/4936726/rep596-published-14-november-2018.pdf. See also H Anderson "Shelter from the storm: Phoenix activity and the safe harbour" (2018) 41(3) *Melbourne University Law Review* 999.
3. Above n 2.
4. ASIC *External Administrators: Reporting and Lodging* Regulatory Guide 16 (July 2008) https://download.asic.gov.au/media/1237317/rg16.pdf, which gives a certain view of the law.
5. See Insolvency Practice Schedule (Corporations), s 70-50; Insolvency Practice Rules (Corporations) 2016 (Cth), s 70-40.
6. For example, see the Explanatory Memorandum, Companies Bill 1981 (Cth) [968]–[970].
7. This was the view of the The Law Reform Commission *General Insolvency Inquiry* Report No 45 (1988) [952] www.alrc.gov.au/wp-content/uploads/2019/08/alrc45_Summary.pdf.
8. B G Carruthers and T C Halliday, *Rescuing Business: The Making of Corporate Bankruptcy Law in England and the United States*, Clarendon Press, 1998, p 281.
9. *Murdaca v Australian Securities and Investments Commission (ASIC)* (2009) 178 FCR 119; 110 ALD 500; [2009] FCAFC 92; BC200907351.
10. Thomson Reuters *McPherson's Law of Company Liquidation* (online) at [15.250].
11. Above n 2.
12. Above n 9, at [118].
13. H Anderson "Insolvency — It's all About the Money" (2018) 46(2) *Federal Law Review* 287.
14. Above n 4, RG 16.19.
15. Australian Financial Security Authority *Inspector-General Practice Statement 14: Referring offences against the Bankruptcy Act to the Inspector-General* (February 2010, updated June 2019) www.afsa.gov.au/about-us/practices/inspector-general-practice-statements/inspector-general-practice-statement-14.
16. That section is yet to commence; see s 2.
17. Insolvency Act 1986 (UK), s 132, in relation to court-ordered liquidations.
18. Above n 17, s 218.
19. *Official Receiver v Wadge Rapps & Hunt (a firm)* [2003] UKHL 49.
20. Above n 8, p 281.
21. Above n 8, p 282.
22. Above n 9, at [118].
23. Above n 15, s 8 — Failure to refer — Inspection errors.
24. Above n 4, RG 16.4.
25. The existence of the Assetless Administration Fund is acknowledged.
26. Above n 10, at [1.410].