

11 September 2020

Mr Matthew Bowd
The Treasury
Langton Crescent
PARKES ACT 2611

By email: matthew.bowd@treasury.gov.au
And to: jodi.keall@treasury.gov.au
And to: ruth.moore@treasury.gov.au

Dear Mr Bowd,

Extension to temporary insolvency emergency measures

1. This submission is made by the Insolvency & Restructuring Committee (**Committee**) of the Business Law Section of the Law Council of Australia.

Purpose of this submission

2. The purpose of this submission is to raise concerns in relation to the extensions to the temporary insolvency emergency measures that were announced jointly by the Treasurer and the Attorney-General on 7 September 2020 (**Announcement**)¹.
3. The Announcement advised of the intention to –
 - a. extend the temporary increase in the threshold at which creditors can issue a statutory demand;
 - b. extend the time companies have to respond to statutory demands;
 - c. extend the temporary relief for directors from any personal liability for trading while insolvent;
 - d. as the Announcement states that there will also be an extension to temporary bankruptcy protections, this indicates there will also be a temporary increase in the threshold at which creditors can issue a bankruptcy notice and an extension of the time to respond to such a notice.
4. It was noted that the rationale for the proposed extension of these measures is to lessen the threat of actions that could unnecessarily push businesses into insolvency

¹ “*Extension of temporary relief for financially distressed businesses*” 7 September 2020, accessed at <https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/extension-temporary-relief-financially-distressed>

and external administration at a time when they continue to be impacted by health restrictions, and help to prevent a further wave of failures before businesses have had the opportunity to recover.

5. While the Committee does not cavil with the intention for the proposed extension, it submits that there are additional, consequential matters that should be addressed, and there are also further considerations that should be taken into account when considering the terms of this proposed extension and whether any further extensions beyond the end of the year should occur.

Previous submission

6. The Committee as well as other committees within the Business Law Section have previously communicated with Treasury officers in relation to law reform issues, particularly in relation to measures that will assist in the conduct of business dealing with the current situation regarding COVID-19.
7. Following the passing of the *Coronavirus Economic Response Package Omnibus Act 2020* (Cth) and the temporary measures enacted by instrument, the Committee made substantial submissions to Treasury in respect of a number of consequential issues which were identified and which need addressing (**Previous Submission**).² Specifically for present purposes, we highlighted the following:
 - a. Changes to voluntary administrators' personal liability so that they are extended the same protection as company directors;
 - b. Consequential changes to other provisions of director's duties during the insolvent trading moratorium so that the purpose of the temporary instrument is not defeated;
 - c. Changes required to 'safe harbour' provisions so that they may more easily be implemented to meet the needs of companies and directors during the period of the crisis;
 - d. Changes required as a result of changing the periods relating to statutory demands;
 - e. Changes to preserve the integrity of voidable transaction provisions with respect to relation-back and recovery periods;
 - f. Consequential changes that should be made in relation to the *Fair Entitlements Guarantee Act* (Cth), which may not fall within the power currently granted to the Treasurer, but which, it was submitted, should be considered for reform as soon as practicable;
 - g. Other timing provisions in the *Corporations Act 2001* (Cth) which should not be changed.

² Submission from the Committee to Treasury dated 31 March 2020 which can be accessed at <https://www.lawcouncil.asn.au/publicassets/60a186e5-a5a0-ea11-9434-005056be13b5/3803%20-%20Consequential%20corporate%20insolvency%20emergency%20measures.pdf>

8. All of the proposed changes and issues identified in the Previous Submission were supported by detailed explanation.
9. It is appreciated that the circumstances of the pandemic to date have put considerable strain on the legislative agenda. However, with the proposed extensions to the temporary insolvency emergency measures which were outlined in the Announcement, it is submitted that it is now even more imperative that the changes and issues raised in the Previous Submission be considered.

Further concerns over the proposed extensions to the temporary insolvency emergency measures

10. The proposed extensions to the temporary insolvency emergency measures have the following consequences:
 - a. With further delays to steps being taken that would otherwise lead to the liquidation of unviable businesses, more viable businesses will become substantial creditors of those unviable businesses, thereby spreading the contagion, making the eventual insolvency wave more widespread and difficult to resolve.
 - b. The policy rationale behind the recovery of voidable transactions in insolvency administrations (e.g. the recovery of preferential payments made to selected creditors) is that there should be an equitable redistribution of realised assets of the insolvent business for the benefit of all creditors, not just those that have been fortunate enough to have been preferred by those running the insolvent business. However, the recovery of voidable dispositions of assets, such as voidable preferential payments to selected creditors, is dependent upon steps being taken by a liquidator or trustee in bankruptcy within strict time periods from the date of the voidable transactions.³
 - c. When the temporary emergency measures and all other relief being afforded distressed businesses during the current pandemic are eventually removed, as they surely must, the insolvent entities that may remain will likely be so bereft of assets or possible recoveries that external administrators (who themselves generally conduct small business enterprises) may be reluctant to take on the arduous tasks of liquidating insolvent entities (which tasks include many non-remunerative statutorily imposed obligations⁴).
 - d. Extending the inevitable commencement of liquidations and bankruptcies allows even more time to pass from the date of otherwise potentially voidable transactions, thus increasing the opportunities for pre-insolvency advisors to assist in structuring of an insolvent entity's affairs to defeat the claims of creditors. Such prolongation assists illegal phoenix activity which –

³ See, for example, section 588FE(2) of the *Corporations Act 2001*, and section 122 of the *Bankruptcy Act 1966*.

⁴ See, for example, section 533 of the *Corporations Act 2001*.

- i. has been the target of recent law reform⁵, the effect of which is being eroded by the delays to the commencement of liquidations⁶;
- ii. continues to be a key concern for regulators;⁷ and
- iii. is estimated to have cost the Australian economy from \$1.8 billion to \$3.5 billion in lost gross domestic product (**GDP**), representing approximately 0.11 per cent to 0.21 per cent of GDP in 2015-16⁸.

11. As a result of these concerns, the Committee submits that any further extensions to the temporary insolvency emergency measures should be reviewed carefully and, if continued beyond 31 December 2020, then any ongoing measures should only be formulated after extensive consultation designed to overcome the concerns expressed above, as well as any further economic impact that may be foreshadowed from broader industry and profession consultation.

Recommendations

12. The Committee recommends further consultation as discussed above prior to any further extensions or modifications to the temporary insolvency emergency measures. Some of the issues that are recommended for such consultation include:

- a. Legislative measures to address the issues raised in the Committee's Previous Submission where consequential amendments are needed to overcome unintended adverse impacts of the current temporary insolvency emergency measures;
- b. A staged and targeted approach to the winding back of temporary insolvency emergency measures;
- c. Financial assistance measures to allow directors and managers of insolvent businesses to seek proper advice from appropriately experienced and regulated advisors;
- d. Financial assistance to allow for the orderly external administration of abandoned insolvent entities; and

⁵ *Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2019* (Cth)

⁶ See section 588FE(6B) of the *Corporations Act 2001* which sets generally of 12 month from the relation-back day for challenging a "creditor-defeating disposition".

⁷ See, for example, "Illegal Phoenix Activity" published at <https://asic.gov.au/for-business/small-business/closing-a-small-business/illegal-phoenix-activity/#:~:text=Penalties%20for%20illegal%20phoenix%20activity,for%20company%20directors%20and%20secretaries>.

⁸ *The Economic Impacts of Potential Phoenix Activity*, July 2018 (report prepared by PricewaterhouseCoopers Consulting (Australia) Pty Limited (PwC) at the request of the Australian Taxation Office (ATO), Fair Work Ombudsman (FWO) and the Australian Securities and Investments Commission (ASIC), accessed at https://www.ato.gov.au/uploadedFiles/Content/ITX/downloads/The_economic_impacts_of_potential_illegal_Phoenix_activity.pdf

- e. Investigation of simplified processes for restructuring⁹ or liquidating¹⁰ businesses in distress.

13. If you would like to discuss this submission, please contact the writer at greg.rodgers@rbglawyers.com.au or on 0404 093 589.

Yours faithfully,



Greg Rodgers
Chair, Business Law Section

⁹ For example, a process modelled on Part IX of the Bankruptcy Act. For how such a process could look, see ARITA's response to The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) 'COVID-19 Recovery Plan' which can be accessed at [file:///C:/Users/SCB/Downloads/ARITA%20response%20to%20ASBFEO%20COVID%2019%20Recovery%20Plan%20\(June%202020\)%20FINAL.pdf](file:///C:/Users/SCB/Downloads/ARITA%20response%20to%20ASBFEO%20COVID%2019%20Recovery%20Plan%20(June%202020)%20FINAL.pdf) and ARITA's 2014 white paper, 'A Platform for Recovery' which can be accessed at <https://www.arita.com.au/documents/Technical/Public-policy/a-platform-for-recovery-2014.pdf>

¹⁰ See recommendation 15.1 of *Productivity Commission Inquiry into Business Set-Up, Transfer and Closure*, which was accepted by the Australian Government in its response https://web.archive.org/awa/20170816202706mp_/http://www.treasury.gov.au/~media/Treasury/Publications%20and%20Media/Publications/2016/Government%20response%20to%20the%20Productivity%20Commission%20Inquiry%20into%20Business%20Set-up%20Transfer%20and%20Closure/Downloads/PDF/Final%20Government%20Response.ashx