McGrathNicol

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Manager
Corporations and Schemes Unit
Financial System and Services Division
The Treasury
Langton Crescent
Parkes ACT 2600

Attention: Mr Peter Levy
Email: insolvency@treasury.gov.au

Dear Mr Levy

**Insolvency Law Reform Bill 2014- Exposure Draft**

McGrathNicol is a national practice including 19 partners who are registered liquidators. The majority of our registered liquidators are members of the Australian Restructuring Insolvency & Turnaround Association (**ARITA**). Our insolvency practice is confined to corporate matters; we do not practise in bankruptcy.

We welcome the government's interest in improving the legislative framework for the important work undertaken by insolvency practitioners in contributing to the stability and effectiveness of Australia's economy.

We appreciate the opportunity to make a submission in regard to the proposed amendments to the *Corporations Act 2001* (**Act**) detailed in the Insolvency Law Reform Bill 2014 (**ILRB**).

Our detailed comments are set out in the attachment to this letter. Our comments address only those aspects of the proposals where we wish to point out practical implications, concerns regarding the effectiveness of the law reform proposals or the manner in which they may be implemented. We have confined our comments to the area of corporate insolvency.

By way of highlighting the themes which underlie our detailed comments we make the following comments in regard to the overall direction and scope of the proposed amendments:

**Amendments to Corporations Regulations and Introduction of Insolvency Practice Rules (IPRs)**

Much of the reform proposed by the IRLB will be implemented through the introduction of the IPR**s**, and to a lesser extent, through repealing various Corporations Regulations. The IPR Proposal Paper November 2014 provides some guidance as to the proposed content of the IPRs, however until the proposed IPRs are released for comment, we are not in a position to fully understand their impact and provide constructive input as to the practical consequences on implementation. We would welcome the opportunity for consultation on these aspects of the law reform in due course.

**Support for Submission from ARITA**

McGrathNicol is an active supporter of ARITA. We have been privy to and support ARITA's submission in regard to the ILRB. In particular we endorse ARTIA's submissions advocating principle-based drafting and simplification of creditor meeting and voting procedures.

**Strict Liability Offences**

The ILRB contains a number of strict liability offences (nine) for various defaults by external administrators.

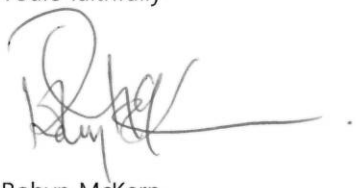
Proof of fault is a fundamental requirement in criminal offences to ensure that people are not subject to criminal sanctions for a failure to act or for actions that are unintended, unless such actions are reckless. As strict liability offences do not require proof of fault, they should be utilised in limited circumstances. While an external administrator may be able to raise a defence of an honest and reasonable mistake to the offence, many of the strict liability offences in the ILRB are directed at an external administrator's failure to act on administrative processes within a specified time. In such instances, it is our view that strict liability offences are inappropriate or should at least allow for some exception.

**Remove unnecessary costs and increase efficiency**

One of the stated goals of the ILRB is to remove unnecessary costs and increase efficiency in insolvency administrations. While many of the amendments target issues which, through the Senate Inquiry and subsequent consultations, have been identified as in need of reform, many also will add complexity and/or additional administrative, compliance or evidentiary burdens and as a result will increase the cost of external administrations and reduce returns for stakeholders. In our detailed comments we have noted key examples where we believe protections for the few have been proposed at the expense of efficiency for the many or where the proposed reform adds little when considered in the context of other reforms in the overall package.

Thank you for the opportunity to be engaged in this important process. Please do not hesitate to contact me or Clare Lethlean if we can provide further assistance.

Yours faithfully



Robyn McKern

Partner, CEO

Detailed comments

McGrathNicol

**Detailed comments and submissions in relation to the Insolvency Law Reform Bill 2014**

**Schedule 2 – Amendments relating to the Insolvency Practice Schedule (Corporations)**

***Part 1 – Insolvency Practice Schedule***

| Section | McGrathNicol Commentary |
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| **Part 2 Registering and Disciplining Practitioners**<br>20-20 Committee to consider applications | In relation to the committee satisfying itself that the applicant has the experience, knowledge and abilities prescribed, we consider that the Insolvency Practice Rules should include as prescribed experience and knowledge, the experience and skills obtained through undertaking restructuring, receiverships and advisory work such as independent business reviews. The skills and experience obtained are an invaluable base for and are directly relevant to external administration (as defined in 5-15), and equip practitioners to search for solutions which preserve economic value and employment.<br>The proposed qualifications needed to satisfy the committee, as set out in the Insolvency practice rules Proposal Paper (**Proposal Paper**), appear to dilute the current tertiary educational requirements. We look forward to being able to provide further comment prior to the release of the Insolvency Practice Rules (**IPL**). |
| 20-70 – 20-75 Renewal | To improve efficiencies for insolvency practitioners and reduce unnecessary duplication of data, we suggest combining the renewal process with the annual return process for the renewal year. |
| 40-10 Registered liquidator to correct inaccuracies | We suggest that the time frame for ASIC to direct a liquidator to review/amend lodged documents be limited to 12 months from the date of lodgement so documents are not permanently subject to review/amendment.<br>We also suggest that it is inequitable to remove a practitioner's right to appeal to the AAT from ASIC's direction (as is contemplated in Part 2 item 38 by the amendments to section 1317C of the Act) given it is contemplated by 40-10(4) that ASIC can direct a liquidator to not take further appointments (restrict the liquidator's potential income earning capacity) for a failure review/amend. |
| 40-45 – 40 – 65 Disciplinary action by committee | We are of the view that express rights of appeal to the AAT are required for practitioners in respect of decisions made by the committee (40-55) to which ASIC must give effect (40-65). Although section 1317A of the Act permits appeals to the AAT for review of a decision by ASIC, the proposed provisions vest the decision making power in a committee and compel ASIC to comply with the decision of the committee. Accordingly, it is unclear whether a practitioner has any rights of appeal from the committee's decision and ASIC's mandatory enforcement of that committee's decision. |

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| **Part 3 General rules relating to external administrations**<br>60-20 EA must not derive profit or advantage from the administration of the company | We are supportive of measures to counter practices such as secret commissions and kick-backs but we are of the view that in practical application this provision will have unintended consequences which create unnecessary inefficiencies in insolvency administrations.<br>For example, in practice, very many EAs operate their businesses utilising staff who are employed by a service entity, which in most instances would be an entity related to the EA. To seek creditors' consent to the engagement of the service entity prior to the commencement of any work in the external administration would increase the costs of administration and hamper the EAs ability to commence work quickly to secure the company's assets, including electronic information.<br>We endorse the submission by ARITA in relation to this issue, which advocates principles-based drafting such that specific practices are neither ruled in nor out but are proscribed to the extent they offend clear principles. This approach enables appropriate efficient modern business practices to be adopted whilst minimising the risk of "creative" practices being developed to exploit technical loopholes. In the absence of principles based drafting we believe an exception should be made for the EA's firm and related entities employing and supplying staff and other professional services and resources to the EA. |
| 60-30 Remuneration for former EAs | We suggest that the provision specify that the remuneration is not previously approved remuneration, but rather remuneration which is not determined at the time the former EA ceases to be the EA.<br>We also suggest that the new administrator and the creditors not unreasonably withhold their agreement and endorsement and that the ability to endorse the remuneration be extended to Committees of Inspection. |
| 60-35 Expenses of former EAs | Our comments in relation to Remuneration for former EA's at 60-30 apply equally to the expenses of former EAs. |
| 65-5 The administration account | The proposed provision will result in additional administration costs and complexities for insolvency practitioners. Currently regulation 5.6.06(1)(a) requires only liquidators and provisional liquidators to open a bank account, unless otherwise directed by the Court or the Committee of Inspection.<br>The proposed provision requires all EAs to maintain a bank account but does not provide the CoI with the ability to direct otherwise. As the failure to maintain a bank account is a strict liability offence, EAs are compelled to maintain a bank account and bear the costs of the account (irrespective of whether the company or EA collects any funds). The only alternative appears to be to incur substantial costs seeking a Court direction that opening and maintaining and account is unnecessary.<br>We submit that the proposed provision should enable a CoI (or in its absence the creditors in a general meeting) to direct or ratify the decision of the EA not to open or maintain an account where there are no funds to bank. |

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| 65-10 EA must pay all money into the administration account | We submit that the requirement to pay money received into the administration account within 5 days after receipt should be 5 'business' days after receipt.<br><br>As the failure to comply with the provision is a strict liability offence, we submit that an exception should be included in respect of the banking or money where it would prejudice a recovery action by having to bank a cheque tendered as an offer of settlement of a dispute.<br><br>We are also concerned as to whether the common practice of retaining the company's pre-appointment bank account for the purpose of collecting debtor receipts which are habitually paid to that account by direct bank transfer would offend the provision on the basis that the account is not "the administration account" |
| 65-15 External administrator must not pay other money into the administration account | It is not uncommon for the assets of a non-pooled group of related entities to be subject to a composite sale and the proceeds of sale are remitted as a single payment.<br><br>Similarly, due to the prevalence of direct debit payments by customers it is common for monies to be received into an account after a business has been sold to a third party.<br><br>As the failure to comply with the provision is a strict liability offence, we submit that exceptions are necessary to enable these common and efficient business practices to subsist. |
| 65-35 Receipts for payments into and out of the administration account | The proposed provision will result in additional costs for external administrations.<br><br>The proposal appears at odds with modern business practice and its purpose is not apparent. The provision does not contain a threshold limit for the amount of a payment requiring a receipt or for any exceptions. Whilst the requirement is limited to cases where it is 'practicable' to obtain the receipt, how is 'practicable to be determined? – does this mean a receipt must be sought in all cases but can only be considered impracticable if the recipient refuses to provide the receipt?<br><br>We submit that this amendment is impractical and burdensome and we question its purpose in the present corporate business environment. For example, in trade-on appointments, the request for receipts for payments made to employees and suppliers is likely to be poorly received, as they would not normally have provided such receipts in the normal course of dealing with the entity during the pre-appointment period.<br><br>Furthermore, the requirement for the EA to seek receipts will unnecessarily increase the costs of administering the estate, which is likely to be unwelcome by the stakeholders. |
| 65-50 Rules in relation to consequences for failure to comply with this Division | This provision contemplates that IPLs may provide for the consequences of an EA failing to comply with provisions 65-5 - 65-45. The consequences suggested are extremely serious and will have a grave financial impact on an EA. The lack of any detail on the proposed IPLs hinders our ability to provide constructive input. We look forward to being able to provide further comment prior to the release of the IPLs. |

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| 70-5 & 70-6 Annual & end of administration returns | We submit that notifying any members, creditors, contributories, the Court or the company that an annual administration return has been lodged will add to the costs of external administrations for little benefit.<br><br>In the context that there will be a legislative window within which such lodgements must be made and the documents are on public record, we think the imposition of the additional cost of advising stakeholders that the EA has complied with his or her legislated obligations is unnecessary.<br><br>We suggest that ASIC's website information sheets for members and creditors of insolvent companies could advise them of the requirement that EAs lodge annual returns with three months of the end of financial year and how they may be accessed.<br><br>We would anticipate that as a matter of best practice, when first communicating with stakeholders we would advise them of the information they can expect to receive and alert them to our obligation to submit annual returns, but we do not think it is necessary to legislate for this.<br><br>Further, the new provisions which allow creditors to seek information are more than adequate to ensure that they receive information which is of interest and relevance to them.<br><br>To improve efficiencies in insolvency administrations and for EAs to manage workflow consequences, we suggest that the time frame for end of administration returns be aligned with the time for lodging annual administration returns, namely three months after the end of the financial year. |
| 70-15 Audit of administration books - ASIC | It is unclear what level of priority is to be given to the audit costs but we submit that these audit costs should not have priority over the EA's fees and costs.<br><br>It is also unclear how the costs of an audit will be addressed in assetless administrations. |
| 70-25 EA to comply with auditor requirements | As the offence is a strict liability offence subsection 70-25(4) should be subject to 70-25(3) for clarity. |
| 70-30 Transfer of books to new administrator | Depending upon the volume of the books and records of the company and whether the books and records are held in storage, 5 business days may not allow sufficient transfer time. We submit 10 business days would be a more appropriate time frame. It is unclear who must bear the costs of the transfer. |
| 70-40 – 70-47 Rights of creditor/s to request information from EA and member/s to request information from EA in a MVL | We note that the IPRs provide some guidance as to the circumstances when a request is not considered to be reasonable. However we are concerned that key elements of the language are subjective concepts and could therefore be open to different interpretation by EAs and creditors/members.<br><br>We look forward to being able to provide further comment prior to the release of the IPLs. |

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| IPR 3.7.2 Inherently reasonable request for information | We note that the IPL sets out various types of information that is deemed to be a reasonable request at all times. However, it is not clear how this guidance interacts with the guidance that a request for information is not reasonable where for example, there is not sufficient resources available to comply with the request. If a creditor requests the current creditor list (a deemed reasonable request at all times) but the administration has insufficient resources to comply with the request, is the EA entitled to consider the request not reasonable? We submit some clarity is needed around the competing definitions of what is a reasonable request and what is not reasonable.<br><br>We note that the use of the term 'Work in Progress (WIP) reports' in the IPRs is confusing as it implies that WIP reports include historical data and future planning information. This is not the case as WIP reports may be, as described, a report as simple as a list of current work in progress. If more is expected from a WIP report it will need to be defined.<br><br>Depending upon the volume of information requested, 5 business days may be insufficient time to comply with the request. We submit 10 business days would be a more appropriate time frame. |
| 70-50 & 70-60 Reporting to creditors and members and reporting to ASIC | This provision contemplates that a number of rules may be made about EAs' obligations in respect of giving information, providing a report and producing documents. The lack of detail hinders our ability to provide constructive input in relation to rules that may be made in the future on a broad range of topics relating to EAs obligations.<br><br>Giving creditors, members or CoIs the ability to replace or modify by resolution specific requirements imposed by IPRs should be limited to procedural matters. |
| 70-65 – 70-90 External administrator may be compelled to comply with requests for information<br><br>Part 2 Item 238 | In principle we have no objection to the process.<br><br>However, it appears to be inequitable to allow both the person who made the request for information or ASIC who made the direction, to be able to apply to the Court for directions that the EA comply, yet the EA has his or her ability to apply for a review of ASIC's decision specifically removed under section 1317C of the Act. |

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| 75-1 – 75-35 Meetings | Our view is that this new mechanism creates a complex process for convening meetings and will unnecessarily add to the costs of external administrations.<br><br>A percentage value criteria for being able to call a meeting creates practical difficulties when proofs of debt may not have been requested.<br><br>In only one example is the provision of security for costs of the meeting, a requirement before the convening of the meeting and it is unclear why meetings called by creditors of less than 25% but more than 10% in value of the creditors must provide security for costs but not others.<br><br>None of the provisions address any requirement for the purpose and agenda of the meeting to be disclosed before the meeting is called.<br><br>We note that the IPRs provide some guidance as to the circumstances when a request for a meeting is not considered to be reasonable. However we are concerned that key elements of the language are subjective concepts and could therefore be open to different interpretation by EAs and creditors/members and open significant scope for costly dispute |
| 75-50 Rules relating to meetings | This provision contemplates that a number of rules may be made about EAs' obligations in respect of meetings. The lack of detail hinders our ability to provide constructive input in relation to rules that may be made in the future on a broad range of topics relating to meetings.<br><br>In relation to meetings and in particular to voting, we endorse the suggestions made by ARTIA in its submission insofar as it advocates for a common set of simple rules across creditor meetings in bankruptcy and corporate insolvency. |
| 80-5 Creditors may request meeting to establish committee of inspection | We query how this provision operates in conjunction with provision 75-15 which sets out a detailed process by which creditors may require an EA to call a meeting of creditors. |
| 80-15 – 80-30 Appointment of members of CoI | Our view is that this new mechanism creates a complex process for appointing a CoI which will add to the costs of external administrations.<br><br>A percentage value criteria for membership creates practical difficulties when there has been a limited response from creditors in submitting proofs of debt in response to the notice of meeting. |
| 80-30 – 80-35 CoI – procedures and functions | It is our strong view that it is inappropriate to give supervisory and advisory responsibilities to the CoI.<br><br>Whilst we are strong supporters of the appointment of and engagement with CoIs to assist the EA in efficient administration of insolvent companies, CoI members are generally neither qualified nor impartial and may be unrepresentative of the creditor body.<br><br>Language such as 'give directions' is unhelpful as it will likely create an expectation in creditors that their directions will be complied with. We suggest that it is reasonable that EA's must have regard to the opinion of the CoI (which infers that an agreed collective opinion is required of the members of the CoI). |

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| 80–40 – 80-45 CoI requesting information and reporting to a CoI | Currently the IPRs do not provide any guidance upon the terms 'not relevant' or 'not reasonable' in this context, however if the IPRs that are contemplated mirror those relating to the giving of information to creditors or members, we repeat that key elements of the language are subjective concepts and could therefore be open to different interpretation by EAs and CoIs.<br><br>A number of rules may be made about EAs' obligations in relation to reporting to CoI. The lack of available detail hinders our ability to provide constructive input in relation to rules that may be made in the future relating to reporting to CoIs. |
| 85-5 EA to have regard to directions given by creditors | Consistent with our comments in relation to section 80-30 to 80-35, language such as 'give directions' is unhelpful as it will likely create an expectation in creditors that their directions will be complied with. We suggest that it is reasonable that EA's must have regard to the opinions the CoI (which infers that an agreed collective opinion is required of the members of the CoI). |