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Corporate Criminal Responsibility Discussion Paper 87

Thank you for the opportunity to lodge a submission on the discussion paper.

The submission is made by me in my capacity as the Chairman of the National Pitcher Partners Business Recovery and Insolvency practice, which is made up of practices in Melbourne, Sydney, Adelaide and Perth.

This submission will address only proposals 21 (a) & (b), 22 (a)-(c), and questions J and K.

Yours sincerely

[redacted]

Paul Weston
Chairman
National Business Recovery and Insolvency

Proposal 21: The Treasury Laws Amendment (Combatting Illegal Phoenixing) Bill 2019 should be amended to:

(a) provide that only a court make orders undoing a creditor-defeating disposition by a company, on application by either the liquidator of that company or the Australian Securities and Investments Commission.

Our submission will not consider any questions concerning the constitutionality of the proposed section 588FGAA (of the Corporations Act 2001) powers to be given to ASIC under the existing bill to make directions for the transfer of property or requiring a person to pay money as a result of a creditor defeating disposition.

In relation to the question of whether only a court should make orders undoing a creditor-defeating disposition, we comment as follows:

- We are agnostic as to whether only the court should have this power, or whether powers should be given to ASIC to achieve similar outcomes.
- As acknowledged in the ALRC Report, the ongoing issues with ASIC being given these powers are:
    - ASIC's appetite to deploy the powers.
    - The level of funding and resourcing given to ASIC to deploy the powers.

As to the issue of both the liquidator and ASIC being entitled to apply to court for relief against a creditor-defeating disposition, we comment as follows:

- We have no objection to ASIC and the liquidator concurrently having this power. In relation to ASIC, we raise similar concerns to those set out above; namely that ASIC is appropriately funded and resourced to exercise this power in a meaningful way and has sufficient appetite to do so.
- There are a number of practical issues that flow from this proposal.
- With both ASIC and the liquidator to be empowered to bring the application:
    - Which of them will in fact bring it? If one brings it, is the other precluded from doing so?
    - How will ASIC become aware of the creditor-defeating disposition?
    - If ASIC intends to bring the application, who will be required to conduct the investigation to obtain the evidence in support of the application? Who will bear the cost of the investigation?
    - If the liquidator is obliged to support ASIC's application either through an investigation or the provision of evidence, how will the liquidator be remunerated for their time?
- We note that in relation to the other voidable transaction provisions of the Corporations Act, such as uncommercial transactions, unreasonable director- related transactions, insolvent transactions etc, ASIC currently does not have the specific power to apply to Court for remedies for the benefit of the company. We query why a creditor-defeating disposition is in a special category that warrants ASIC being given the power to bring an application for remedies that financially benefit the company in liquidation? Why would ASIC not be concurrently be given those powers in relation to the other voidable transaction provisions?

(b) Provide the Australian Securities and Investments Commission with the capacity to apply to a court for an order that any benefits obtained by a person from a creditor-defeating disposition be disgorged to the Commonwealth, rather than to the original company, where there has been no loss to the original company or the original company has been set up to facilitate fraud.

In response, we submit the following:

- We do not believe that there will be a significant number of transactions that will fall into this category whereby a creditor defeating disposition occurs, and the company suffers no loss.

- Notwithstanding this, we can't see a downside to ASIC having these powers, provided that the liquidator is not excluded from recovering and receiving compensation (i.e. without having to disgorge it to the Commonwealth) on behalf of a company if the original company has been set up to facilitate fraud and a compensable loss has occurred.
- We reiterate our earlier comments concerning ASIC's resourcing, funding and litigation appetite.

Proposal 22: The Treasury Laws Amendment (Combatting Illegal Phoenixing) Bill 2019 should be amended to:

(a) provide the Australian Securities and Investments Commission and the Australian Taxation Office with a power to issue interim restraining notices in respect of assets held by a company where it has reasonable suspicion that there has been, or will imminently by, a creditor-defeating disposition.

(b) Require the Australian Securities and Investments Commission and the Australian Taxation Office to apply to a court within 48 hours for imposition of a continuing restraining order; and

(c) Grant liberty to companies or individuals the subject to a restraining notice to apply immediately for a full de novo review before a court.

We support this proposal.

Question J Should there be an express statutory power to disqualify insolvency and restructuring advisors who are found to have contravened the proposed creditor-defeating disposition provisions?

In our view, any registered liquidator, registered bankruptcy trustee, lawyer or other registered professional ought to be at risk of disqualification if they are found to have knowingly contravened the law. In those instances, the power of disqualification should rest concurrently with the Court and with the appropriate professional regulator or body.

The more difficult problem arises with those advisors who are presently unregulated and potentially without qualification. We support the introduction of a licensing or registration regime that applies to 'insolvency and reconstruction advisors' and carries with it a requirement to hold some form of professional indemnity insurance. In our experience, bad advice is given by those who have little to no financial resources, backing or insurance to compensate those who fall victim to the advice that they have given. A licensing regime which comes with obligations of insurance and minimum qualifications may lead to an increase in the cost of 'insolvency and reconstruction advice'.

We note that the Australian Small Business and Family Enterprise Ombudsman is concurrently considering these and similar issues in the Insolvency Practices Inquiry Discussion Paper dated December 2019 (SBFEO Inquiry). A key consideration underlying the issues raised in the SBFEO Inquiry is the quality and timeliness of the advice being given in relation to the insolvency and reconstruction options, particularly to small business. Accordingly, there is significant overlap between the issues in the ALRC's law reform paper and the SBFEO Inquiry.

The following matters need to be balanced:

- On the one hand, ensuring that people giving insolvency and reconstruction advice are sufficiently qualified to do and have insurance to cover negligent advice.

- On the other hand, ensuring that there are no unreasonable barriers imposed (such as cost or a limited pool of advisors) that prevent individuals and businesses (particularly small business) from seeking advice.

This balancing act is not easy. It is apparent that such a regime will be difficult to define and will require considerable thought. We set out our concerns below.

A licensing regime?

Insolvency and restructuring advice is complicated.

The existence of other qualifications and memberships does not automatically qualify a person to give insolvency & restructuring advice. For example:

- A member of the CPA or CA is not required to have any experience or education in insolvency and reconstruction to be a member of those organisations.
- A member of the various Law Institutes or holders of legal practising certificates are likewise not required to have any experience or education in insolvency and reconstruction.

Accordingly, a holder of a practising certificate or membership of a professional accounting or legal body does not mean that the person has the ability or capacity to give proper insolvency and reconstruction advice.

Consequently, how do we determine what advice and which advisors will be captured under a licensing regime? The primary difficulty appears to arise in formulating an appropriate definition of 'insolvency and reconstruction advice' that:

- Captures the advice and the advisors which ought to be regulated.
- Does not capture the advice and the advisors which need not be captured by an insolvency and reconstruction qualification or license.

The difficulty is highlighted in the following examples:

- A pre-insolvency advisor who has a Bachelor of Business but has no other qualifications or registrations is engaged to advise an individual on their personal debt problems. The advisor provides the debtor with pamphlets published by the Australian Financial Security Authority setting out standard information on bankruptcy, Part IX and Part X arrangements. The advisor forms the straightforward view that the debtor can't pay their debts in full. The advisor proceeds to negotiate a series of informal arrangements with the debtor's creditors as an alternative to one of the Bankruptcy Act options. This advice relates to insolvency and debt negotiation. Should an insolvency and reconstruction licensing regime require this advice to be regulated?
    - Would the answer differ if the advisor did not provide any of the AFSA publications and was only retained to attempt to negotiate debt payment arrangements?
    - Would the answer differ if the advisor gave written advice that the debtor should engage a Debt Administrator to discuss a Part IX arrangement?

- A Chartered Accountant is engaged to prepare a company's financial statements. In the course of preparing the financial statements, the accountant determines that the company may be in financial distress caused by excessive costs (such as rent). The accountant recommends to the director that a negotiated termination of the current lease and a downsizing to cheaper premises will improve the company's financial position. This appears on its face to be straightforward and simple advice which is within the accountant's area of expertise. This advice relates to solvency and to 'restructuring' in the common understanding of those terms. Should an insolvency and reconstruction licensing regime require this advice to be regulated?
    - Would the answer differ if the Chartered Accountant had allowed their membership of CA to lapse and was currently not a member of any professional association?
- A lawyer who has practised in criminal law and is an accredited criminal law specialist has never handled an insolvency matter. One of her clients is facing certain charges. As part of the engagement, the lawyer recommends that the client transfer various assets to family members as part of an asset planning regime. The client later goes bankrupt and the transfers are all attacked by the bankruptcy trustee. The lawyer gave 'insolvency and reconstruction' advice. Should our insolvency and reconstruction licensing regime require this advice to be separately regulated?

The list of difficult scenarios is long and will present challenges to those responsible for considering and crafting any licensing regime.

Alternatives or Adjunctive Solutions

Separately to the question of a licensing regime, we have considered a number of adjuncts or alternatives to help to disrupt phoenix activity. We have listed those alternatives and provide explanations where warranted:

- The relaxation of the independence requirements that apply to insolvency practitioners. The ARITA Code (amongst other provisions) sets out the scope of advice that an insolvency practitioner can provide before they will be prohibited from accepting a subsequent formal appointment. In those instances, the insolvency practitioner is constrained from providing full and frank advice about lawful restructuring efforts an entity might undertake for fear of compromising their actual or perceived independence. The relaxation of the independence requirements would allow some of the best trained and most qualified insolvency professionals to intervene to help businesses and individuals in financial distress in a more effective way.
- The introduction of a Director Identification Number. This has been considered in detail in previous submissions by numerous parties and we don't propose to repeat that learned commentary.
- A requirement for a director to receive a core level of education before being permitted to be a director.
- Creating the environment whereby business operators and individuals are better educated about the options available to them, the help that can be sought, the quality of the advice and advisors that operators and individuals should insist upon (i.e. only seeking the assistance of ARITA members for example) etc. This should in part demystify and destigmatise insolvency advice to encourage people to act sooner.
- The establishment of a central register of known phoenix advisors. For example, liquidators are required to report potential contraventions of the Corporations Act 2001 to ASIC (in the form of the EX01). This form could be easily amended to include an obligation on the liquidator to report the names of external advisors who appear to the liquidator to have been involved in the provision of improper or unlawful phoenix (and other) advice.

- Better education to the business community about the definition of phoenix conduct and an explanation of what is and is not acceptable behaviour.

Question K Are there any other legislative amendments that should be made to combat illegal phoenix activity?

In response, we make the following recommendations:

Definition of Illegal Phoenix Activity

- We recommend the introduction of a statutory definition of 'illegal phoenix activity'. This will provide clear statutory guidance as to what conduct is and is not appropriate and should assist advisors in understanding the parameters of acceptable behaviour. This will also allow the expansion of existing provisions to include a 'phoenix offence'.

Expansion of Liquidator's Powers of Investigation

- As liquidators, we are at the coalface of investigating illegal phoenix activity and attempting to recover compensation. In many respects, our role serves a significant public benefit when we investigate wrongful conduct and report it to ASIC or identify misconduct and recover compensation for aggrieved parties.
- A liquidator has a much smaller tool chest of investigative powers than a registered bankruptcy trustee. We see no sensible reason for these differences to exist.
- By service of a Notice issued pursuant to section 77A of the Bankruptcy Act 1966 (BA), a bankruptcy trustee can require the production of documents of an associated entity of the bankrupt in the possession of a third party (i.e. an accountant, director etc). No such power exists in the Corporations Act for a liquidator. It should clearly do so.
- At the request of a registered trustee, the Official Receiver can issue notices pursuant to s.77C of the BA which will:
    - Compel a third party to produce documents relevant to the bankrupt's examinable affairs to the Official Receiver.
    - Compel a third party with information about the bankrupt's examinable affairs to attend a compulsory interview before the Official Receiver. This interview is conducted by the trustee, evidence is given on oath and the interview is recorded and can be used in evidence in proceedings.
- The s77C Notice is a powerful tool. It is an offence to fail to comply with a s77C Notice without reasonable excuse. It is a powerful tool which we use extensively as bankruptcy trustees to obtain evidence of wrongful conduct or help us obtain evidence to pursue claims.
- A liquidator has no such power. The only way a liquidator can achieve a similar outcome is to conduct expensive and time-consuming public examinations pursuant to sections 596A and 596B of the Corporations Act. The absence of a similar power to the s77C Notice provisions is a glaring hole in the liquidator's armoury. This should be remedied.
- The absence of these powers for liquidators has significant ramifications for the integrity of the corporate insolvency system.
    - Phoenix advisors who understand the corporate insolvency system know that a liquidator's only real power of investigation is the public examination process.
    - They will also be aware of the prohibitive cost of conducting public examinations and the strong likelihood that liquidators will not conduct public examinations without creditor funding or assets available in the liquidated company.

  - Consequently, a phoenix advisor may be willing to 'take the gamble' that a phoenix transaction can be implemented and will not be investigated or pursued by a liquidator with limited resources.
  - It is much less likely that a liquidator such as us will be appointed that has the resources, skills and experience to investigate phoenix behaviour at our own expense and without creditor funding.
- The introduction of these simple additions to a liquidator's powers of investigation will achieve the following:
  - Liquidators will be able to conduct better and faster investigation of corporate failures, including phoenix behaviour.
  - Liquidators will not be prevented from investigating illegal or wrongful behaviour because they are unable to fund the legal costs of public examinations.

Review of Existing Participation Offences

- We recommend that the existing regime to hold those knowingly involved in contravention of the Corporations Act be reviewed to broaden and strengthen the circumstances in which those involved in wrongdoing will be captured.
- This might mean that a liquidator (or ASIC) could have concurrent action against advisors for losses occasioned by wrongful conduct.

Incentives to Engage Registered Advisors

- We recommend that potential reforms consider whether incentives can be offered to directors to engage appropriately qualified/registered advisors as opposed to unregistered/unqualified advisors.
- Such incentives might be similar to safe harbor type legislation, where directors are relieved (in whole or part) of personal responsibility if they have acted in accordance with the advice of appropriately qualified/registered advisors.