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Private & Confidential

Financial System Inquiry
GPO Box 89
Sydney NSW 2001

Submission to the Financial System Inquiry

McGrathNicol is a leading advisory firm with expertise in restructuring (both distressed and non-distressed) and insolvency. We have extensive experience derived from involvement in many of Australia's largest and most complex examples of corporate financial distress and insolvency as well as innumerable matters in the small to medium enterprise ("SME") sector.

Examples cross all industry sectors and include Centro Ltd (restructure), ABC Learning Centres (receivership), Ion Ltd (Voluntary administration), Babcock & Brown (restructure) and HIH Insurance (liquidation).

We welcome the opportunity to contribute to the work of the Financial Service Inquiry and attach our submission which addresses the questions posed under the heading External administration at 2-69.

Please do not hesitate to contact me if any further information is required.

Yours faithfully

Robyn McKern
Partner, CEO

Enclosure(s):
McGrathNicol submission

McGrathNicol

SUBMISSION TO THE FINANCIAL SYSTEM INQUIRY

MCGRATHNICOL SUBMISSION

Our submission comprises the following:

1. EXECUTIVE SUMMARY

The submission which follows sets out the basis for our key conclusions and opinions which are in summary:

- Business failure is an inevitable consequence of entrepreneurship and risk taking which is a cornerstone of capitalist economies. The measure of a stable and mature economy and its ability to attract capital to enterprise is in part a function of how efficiently and effectively it deals with this inevitable element of business failure.
- It is neither necessary nor desirable to import a regime such as the US Chapter 11. This view is based on the following:
  - We do not accept that the evidence and history of insolvency administration in Australia leads to conclusion that the current Australian insolvency regime is ineffective or materially deficient.
  - We do not believe that wholesale adoption of a Chapter 11 framework would effectively address the issues that some perceive as problematic in our current system, moreover it would bring new and different issues such as market distortion and extended fetter of creditor rights. We do not think that a debtor led process such as Chapter 11 would be culturally acceptable in Australia.
  - In addition to its other shortcomings, Chapter 11 is no solution for SME business nor any but the largest of companies in Australia due to its inherent cost structure.
- We believe that the Australian VA ("VA") regime has a great many strengths, particularly in comparison to Chapter 11. It is flexible, accessible and straightforward and it affords those worst affected by insolvency, the creditors, the opportunity to participate in the process and the comfort that the process is led by a qualified and independent expert practitioner.
- We do believe that there is scope to improve the current Australian regime. In particular we support the prohibition of ipso facto clauses to improve the effectiveness of the moratorium in voluntary administrations ("VA") and enhance post insolvency restructuring prospects.
- In principle we support the 2012 draft legislation which was developed largely in response to the 2009 Senate Inquiry into Insolvency, and particularly support those measures aimed at improving practitioner

standards. However we have reservations as to whether the legislative changes will necessarily deliver the hoped for reductions in complexity and cost of external administration. Furthermore,

- The proposed changes do not go far enough. We are of the view that a more fulsome review of Chapter 5 of the Corporations Act is warranted to improve the efficiency of external administration. Within our submission we identify and make suggestions in regard to a number of aspects of the current law which, in our view, add cost unnecessarily.
- Particular review is recommended in relation to aspects of the current law which have become unnecessarily complex, resulting in uncertainty and cost and, we would argue, no longer achieves their policy objectives. These areas concern the priority of employee entitlements and recovery of unfair preferences.

▪ In regard to considerations surrounding the funding of regulation, we are of the view that such a model should recognise that corporate insolvency is a necessary element of an efficient capital market and a reliable, regulated system benefits all participants. Hence we are of the view that if there is to be a "user pays" model to fund the regulation of the corporate insolvency sector, this cost should be borne equally by all companies which enjoy the benefits of incorporation.

2. RESPONSES

2.1 Options to amend insolvency law

The Inquiry has sought views on the costs, benefits and trade-offs of the following policy options or other alternatives:

a) No change to current arrangements.

b) Implement the 2012 proposals to reduce the complexity and cost of external administration for SMEs.

Our view, on which we expand below, is that change is required to the current insolvency laws. We support the principles behind the 2012 proposals but consider that the drafting will not necessarily result in the desired reduction in cost and complexity. We think that there are more opportunities to improve the legislation than dealt with in the 2012 proposals and would support a more comprehensive review and update of the legislation.

Option a – no change to current arrangements

McGrathNicol is of the view that changes do need to be made to the present legislative framework to reduce the complexity and cost for the benefit of stakeholders. Accordingly we would welcome such improvements and would be pleased to provide input to the process of improvement directly and through our engagement with ARITA.

Option b - Implementation of 2012 proposals

We refer to our submission to Treasury dated 8 March 2013 providing our detailed comments on the corporate law aspects of the Insolvency Law Reform Bill 2013 Exposure Draft ("ILRB ED") and enclose a copy. We confirm that the views expressed in this submission remain representative of our current views.

In summary, our position is one of support for the policy objectives behind the ILRB ED, in particular those measures which are aimed at increasing and enforcing high standards of practice. Our view is that, subject to our qualifying comments which follow, these reforms are a helpful first step in addressing many of the concerns arising from the 2009 Senate Inquiry into Insolvency.

Our qualifying comments in regard to the ILRB ED are:

▪ The overarching object of the reforms, being harmonisation between the corporate and personal insolvency regimes, has been pursued in some aspects without due regard to the significant differences between these regimes. Most of the legislative connection between the corporate and personal insolvency regimes was broken by changes to the Corporations Law in 1993 and we would submit that the features of the two regimes have moved even further apart since that time. For this reason the legal framework applicable in bankruptcy will not consistently work efficiently or effectively in corporate matters.

- As neither the draft regulations nor other consequential amendments to the Corporations Act have been released, much of the detail around how the new proposals would work in practice is not yet known and will require careful further consideration.
- We are concerned that many of the proposals do not achieve any reduction in the complexity of the current rules. Rather, in a number of areas the draft legislation involves excessive layering of controls which will increase the cost burden of compliance and will ultimately impact on the return to creditors from external administrations.

We believe more is required

Further, we are of the view that the program of reform in insolvency law (irrespective of any substantive policy shift such as that being raised through the debate regarding a US style framework) should go beyond the matters embodied in the ILRB ED and encompass a more comprehensive review of Chapter 5 of the Corporations Act. Such a review should have the objective of updating the Chapter in order to:

- Eliminate inherent inefficiencies and causes of unnecessary cost (eg in respect of meetings requirements, limits of use of electronic communications).
- Simplify the legislation in specific areas where the law should be readily capable of being understood by affected stakeholders, but where instead common law has intervened adding significant complexity, making the law inaccessible and costly to apply and, arguably compromising, policy intentions. We suggest the following areas of insolvency law are in this category and require review and simplification:
  - priority of employee entitlements - clarity is needed around the obligations imposed by s433 and particularly the effect of liquidation on the obligations of receivers. The need for law reform on this issue was identified by Justice Finkelstein in the *Incat* decision in 2004 and there has been a series of cases subsequently which demonstrate the complexity and cost now involved in resolving what should be a straight forward matters of policy and law.
  - unfair preferences. We comment further about this area of the law below.

We also note that it is a common theme that legislative change outside Chapter 5 of the Corporations Act is effected with little or no regard to its impact in the circumstances which prevail once an external administrator is appointed. As a result, external administrations are rendered more complex than necessary resulting in time and cost to understand, avoid or unravel presumably unintended consequences. Examples we would cite include: privacy law, tax law (specifically in relation to capital gains tax) and requirements to lodge annual accounts.

We would welcome a process within the development of legislation that required specific consideration of, and where appropriate provisions to cater for, the impact of such laws on companies subject to external administration.

In our opinion the reform program embodied in the ILRB ED should continue to be progressed through careful consideration of the feedback provided early last year and further consultation on release of the associated draft regulations.

In addition, notwithstanding that we favour a more comprehensive review for the regulation of external administrations, we submit that it would be regrettable to delay the implementation of ILRB ED by linking it to matters now identified as requiring review, but that are much less progressed in the law reform process.

2.2 Impact of Australia's external administration regime

The Inquiry has sought further information on the following area: Is there evidence that Australia's external administration regime causes otherwise viable businesses to fail and, if so, what could be done to address this?

Our response to this question is addressed by outlining our views in the following areas:

- The role and impact of the insolvency law framework and its impact on the cause and management of business failure:
  - comments on the Australian restructure culture, based on our experience
  - how the law operates to drive creditor and director behaviour – delayed action or pre-emptive appointment?
  - comments on safe harbour proposals
- Observations about the effectiveness of Chapter 11
- An assessment of the strengths of the current Australian regime
- An assessment of the weaknesses of the current Australian regime and suggestions for improvements

The role and impact of the insolvency law framework and its impact on the cause and management of business failure

The Inquiry has posed the question "Is there evidence that Australia's external administration regime causes otherwise viable business to fail? If so what can be done to address this?"

It is our submission that the Australian system of law in insolvency does not cause otherwise viable businesses to fail. Importantly, neither does our system support the continued operation and absorption of capital and third party credit by unviable businesses.

Achieving this systemic balance is not easy but is, in our view, the optimal policy objective.

We do not think that the current system is perfect. Indeed, in many respects it is in need of review and improvement and within this submission we have outlined our views on several of these areas and offered suggestions.

Nevertheless, our view is that, for the most part, the system delivers stakeholders the tools necessary to ensure that credit and capital is not unfairly absorbed by unviable enterprise and delivers a fair outcome to stakeholders in insolvencies where, by definition, there is not enough to go around.

More generally we would make the following comments on business failure and the insolvency system:

- Business failure is an inevitable consequence of entrepreneurship and risk taking which is a cornerstone of capitalist economies.
- The measure of a stable and mature economy and its ability to attract capital to enterprise is in part a function of how efficiently and effectively it deals with this inevitable element of business failure.
- It is a nonsense to think that every business can survive and thrive in perpetuity, regardless of how it is managed or the competitive environment in which it operates.
- The failure of a business can occur from a myriad of causes: poor management; external shock; inappropriate business model; competitive conditions; changes in government regulation and legislation; fraud. The system needs to be able to deal with the consequences of business failure no matter the cause.
- Business failure typically is tantamount to, or a precursor of, an event of insolvency (eg inability to pay debts as due, breach of a banking covenant). A formal insolvency appointment/process is a response to an event of insolvency. The Australian system provides for such responses to be initiated by the directors, the secured creditors or the unsecured creditors. We think it appropriate that a range of stakeholders is

encouraged and empowered to "call out" a company's failure or insolvency to ensure that it is dealt with efficiently and with regard to the interests of all stakeholders.

- There can be no doubt that a formal insolvency appointment crystallises the loss of goodwill which deflates both enterprise and asset value - but it is not the cause of the loss and should not be used as a convenient explanation for the value depletion that occurs prior to insolvency.
  - Rather, the business failure causes the loss: the formal insolvency appointment operates to afford transparency of the position to all stakeholders and, consequently, losses which may have been hitherto unrecognised are crystallised. Importantly, the formal appointment prevents greater loss being incurred from continuing to trade uninhibited.
  - The crystallisation effect is exacerbated by the common use of "ispo facto" clauses in supply agreements. Such clauses have the effect of enabling counterparties to cease contractual relationships in the event of a trigger – the appointment of an external administrator is a common trigger. These clauses have a deleterious effect on goodwill and restructuring options both before and during external administrations.
- However, notwithstanding the depletion of business or asset value that is crystallised on entering external administration, the corporate insolvency regime should operate to preserve, and where possible build on, the value of distressed business assets, while providing independent oversight of an equitable and orderly realisation and distribution process.
- Facilitating the recovery of value and distributing such value to the stakeholders according to their rights is one aspect of an effective insolvency system, the other is the legislative requirement for independent investigation of causes of failure and antecedent transactions. There are two limbs to this:
  - External administrators have obligations to investigate causes of failure and identify and report breaches of law to ASIC. This is aimed at ensuring inappropriate director/corporate behaviour is identified and addressed by the party capable of taking disciplinary action, generally the corporate regulator. The prospect of this type of disciplinary action ought to act as a compelling deterrent.
    - The effectiveness of the deterrent significantly depends on whether there is any consequence for reported breaches.
    - The fact that no action is taken in regard to a large proportion of reported breaches, undermines the impact of this part of the system and has the capacity to lead to a cycle of diminishing returns – creditors complain about the costs of external administration, liquidators, knowing the chances of action being taken on reported breaches are slim, minimise investigations to keep costs down; liquidators' investigations and reports of offences become more superficial and lacking in hard evidence; the capacity to act on such reports is diminished - and the cycle perpetuates.
    - In the meantime, directors/management holds little fear that actions taken in their own short term interests will give rise to any adverse consequences.
  - Liquidators also have powers to investigate and void certain antecedent transactions. Generally these are designed to enable the voiding of transactions (uncommercial transactions and unfair preferences) or recovery from directors (insolvent trading) to restore the company to the position it would have been had not those with knowledge of the company's insolvency acted in their own interests.
    - In our view, these aspects of the system are ripe for review in the context of considering whether there are elements within our system which militate against early identification of financial distress and preventative action.

Restructuring culture?

We suggest that at the heart of the question posed by the FSI are two other questions:

- Is our system is unduly biased towards incentivising stakeholders to pre-emptively appoint external administrators rather than supporting stakeholders to proactively address potential and actual business failure and work towards a solution which avoids crystallising losses at their peak? and
- Conversely, does our system militate against stakeholders recognising and acting early enough to prevent the demise into insolvency?

The fact that these two questions can be validly asked suggests to us that there is good balance in the present system.

We make the following comments in relation to these questions:

The discussion around the lack of a restructuring culture in Australia typically limits itself to considering restructuring once a company has already entered the insolvency phase and draws conclusions regarding the low rate at which such businesses are rehabilitated. This overlooks the extent to which restructuring does occur both successfully and unsuccessfully in the pre-insolvency or distressed phase.

- In our view, that insolvent business are hard to rehabilitate and the success rate is low should not be surprising.
  - Businesses which are insolvent suffer a deficit in some or all of the factors which are necessary to successful restructure or turnaround eg viable business model, supplier goodwill, customer goodwill, effective management, engaged and capable employees, financial headroom, financier confidence, effective financial systems, accurate and timely information.
- A great deal of restructuring routinely occurs in well managed businesses in order to maintain viability and avoid financial distress altogether. In our view, it is not possible to draw the conclusion that as a nation we lack a restructuring or rehabilitation culture if we limit our consideration of the phenomenon to companies which are already distressed or insolvent and ignore the extent to which companies undertake restructuring internally or with external support to avoid distress altogether.
- As practitioners, we have been involved in numerous restructuring assignments. Our experience is that more often than not the need for restructuring has been identified (by the company and/or its banker) and attempted by the company before external expertise is sought. Typically the escalation of the restructuring efforts to involve external restructuring expertise is a result of:
  - The need to obtain or restore the confidence of key stakeholders, typically financiers.
  - The potential need to utilise the tools available within the insolvency regime in which external advisers have expertise.
    - This need may take the form of identifying the "worst case" outcome as a means of persuading stakeholders to compromise their positions or it may be a need to work through the formal options (voluntary administration, receivership, formal scheme of arrangement, informal workout) to understand the relative merits and determine how to get the best outcome in the circumstances.
- Our experience is that the banking industry goes to significant lengths to assist viable businesses to overcome transient or resolvable financial distress. The banks recognise that the best outcome for the bank as much as for the customer and the broader stakeholder group (suppliers, employees) is to retain a viable, healthy customer and their first and most common response is to seek to support the customer to work their way out of distress.
  - The form of support will vary but typically involves, at the very least, time to determine and effect restructure proposals and may extend to providing additional liquidity support.

– The banks also encourage or insist upon external expertise to assist businesses and financiers to land on a common view of the realistic potential for rehabilitation and the resources necessary to achieve this outcome (time, capability, funding, markets, supply and customer goodwill…luck).

  > It is acknowledged that this support is not always welcomed by the customer and commonly, particularly in the SME sector, avoiding the cost of external advice is prioritised over the potential benefit of identification of an achievable rehabilitation plan and the risk that such a plan cannot be identified and the better outcome for all is to stem the losses by taking decisive action.

– The banks' preparedness to support a customer in difficulty will depend on the severity of the issues, whether the plans and prospects of recovery are realistic and most importantly whether there is a relationship of trust with the customer and confidence in their capacity to implement the necessary changes.

– Whilst our experience is that banks are supportive of businesses seeking to overcome financial crises, in some cases it is not in any of the stakeholders' interests to forestall or prolong inevitable failure. In these cases banks will act to prevent stakeholders from further loss. Customers will often perceive this as being pre-emptive and unnecessary.

Pre-emptive insolvency appointments and preparedness to take early remediation

Far from pre-emptively putting companies into external administration, our experience is that such action is only taken reluctantly and when all other avenues have been exhausted.

At the same time, our experience is that management and boards are highly reluctant to admit business failure or potential failure to third parties, including financiers. So, typically, the restructuring being undertaken as a company is moving into financial distress is done without external advice and without alerting third parties to the depth or urgency of the situation.

The vast majority of restructuring, both formal and informal, involving external advisors or specialist restructuring experts occurs as a result of pressure from third parties – most typically financier creditors. More often than not, by the time this pressure has arisen, been resisted and debated before finally prevailing, the options for restructuring are significantly diminished.

The causes of this reluctance to seek advice early will differ from case to case but we would suggest the following themes in the SME sector in particular

▪ The commonality of directorship and ownership and circumstances where the business debt is secured by personal assets (the family home), combines potently with the entrepreneurial ethos of optimism such that failure will not be admitted until such time where there is literally nothing else to lose.

▪ Safety nets such as the government Fair Entitlements Guarantee Scheme, combined with a lack of contemporaneous oversight to ensure compliance with the Superannuation Guarantee Charge Act, dilute the moral compulsion owner/operators may have to act at a time where there is still capacity to ensure employee entitlements are met.

▪ The cost of advice adds to the personally secured debt and adds to the financial distress.

We would also suggest that the unfair preference law inhibits third party creditors from calling out the apparent insolvency of a company.

Evidence of knowledge or suspicion of insolvency undermines suppliers' defences against a liquidator seeking to receiver an unfair preference. This in turn operates against the supplier acting in a way that might motivate the company to act sooner to address its issues.

Anecdotally, we would report that the unfair preference regime is largely despised by suppliers/creditors. Those who have been proactive and robust in seeking to recover debts owed to them and ceasing to supply when they harbour doubts about being paid– behaviours which you would think would be valued in a macro economic sense – find themselves most likely to be required to repay the amounts recovered so as to redistribute the funds (after liquidators fees and costs) to creditors who facilitated, wittingly or not, ongoing trading by a failing or insolvent company.

Whilst making an initial claim is relatively inexpensive, the defence and legal prosecution of a preference claim is inevitably costly. This puts parties under pressure to settle rather than defend and risk adverse costs. Even in successful claims, it is not unusual for a relatively high proportion of the funds recovered to be consumed by legal and liquidators' costs, with little net return to creditors. It is difficult to see how the public policy objective is met in these circumstances.

Like insolvent trading, unfair preferences can only be pursued by a liquidator and accordingly, creditor's enthusiasm for a Deed of Company Arrangement ("DOCA") may be influenced less by the overall return to creditors under each of the liquidation or DOCA alternatives and more by the fact that they will not be pursued for preferences under a DOCA.

Safe harbour options

There has been significant discussion and support over several years for the introduction of "safe harbour" provisions which aim to provide directors comfort that while they seek to restructure a company and provided they do so with good judgment and whilst reasonably holding the view that it will "all be alright in the end" they will be protected from the laws which render them personally liable for allowing a company to incur debt when there is a risk that the debt cannot be repaid ("insolvent trading").

Proponents for safe harbour provisions suggest that their absence has and does result in formal insolvency appointments being made prematurely so as to protect the directors from the risk of personal liability and that this inhibits the opportunity to restructure business. This contention does not align with our experience.

- As noted above, in the SME sector, in comparison to the prospect risk of losing business, livelihood and home, the risk of being pursued for insolvent trading causes little or no additional anxiety.
- In larger companies, where directors may have less financial, but significant reputational, skin on the line we have not experienced any greater enthusiasm to effect a formal appointment except as a last resort.
  - What does happen is that a board, mindful of the value depletion which can be perceived to follow a formal insolvency appointment will use their power to appoint a voluntary administrator as a lever to secure forbearance or compromise from other stakeholders.
  - Non owner boards may be more inclined to expend resources on external advice to ensure they are appropriately informed on the state of the company's affairs and enhance the prospects of successful restructure and to seek this advice earlier.

We note that whilst touted as a significant motivator of pre-emptive appointments or disincentive to attempt to restructure distressed companies, in fact the risk of being pursued for insolvent trading must be considered low. Few cases are prosecuted, let alone successful.

- Liquidators will only undertake civil claims where it is assessed that the outcome will deliver and improved result for creditors than not taking the action.
  - It is not uncommon for liquidators to attract criticism from creditors for taking actions of this nature and in doing so expending or risking creditors returns; equally criticism is raised against liquidators if no consequence ensues for directors where creditors feel that they have behaved inappropriately in taking credit whilst insolvent.
- The costs of mounting a civil claim, litigation risk, the risk of adverse costs, the unpredictable operation of the 'good faith' relief provisions (section 1317S), the risk of being unable to recover even if a favourable judgment is awarded, the time it takes to run a matter through the courts and the impact all this has on the timeliness and quantum of returns to creditors all conspire to limit civil action to the most egregious examples of trading whilst insolvent.
- Presumably for many of the same reasons, ASIC is not highly active in regard to criminal prosecution for insolvent trading and very few cases have proceeded in recent years.

We are therefore sceptical about the extent of the problem which safe harbour provisions are said to address and whether they would have any appreciable, positive impact. Moreover, we are concerned that a "safe harbour" would be open to abuse and permit, almost encourage, reckless or laissez faire director behaviour with little or any consequence.

Observations about the effectiveness of Chapter 11

As indicated in our earlier comments, business failure is an inevitable element of a healthy economy which seeks to foster entrepreneurialism, growth and allocates capital accordingly. It is the mark of a stable and mature economy that this inevitability is dealt with efficiently.

It is appropriate that the Australian legislators have due regard to the systems at work in other jurisdictions, as means of assessing the effectiveness of our system at a micro level (how it deals with assets and claims in insolvent entities) and a macro level (how it operates to make Australia attractive for investment).

However, too often the commentary around the US Chapter 11 framework, would have it believed that the Australian system has no redeeming features while in contrast, the application of Chapter 11 of itself transforms and saves all business with never a creditor dollar nor a job lost. This is manifestly not the case.

In our view, wholesale adoption of Chapter 11 would not be an improvement upon our current system.

For the purposes of assessing the merits of the system in the context of Australia's culture and legal system, we believe it is more constructive to critically examine some of the major principles or elements of the Chapter 11 regime which are touted as benefits.

Debtor led process

A core premise of Chapter 11 is that the board and management is not dislocated by the company entering into Chapter 11, whereas in VA the external administrator takes control.

- Whilst this is the premise which to some is attractive, in fact significant changes occur in boards and management post the commencement of Chapter 11 due to the influence of secured creditors and the different skill set required to navigate restructure.
- In Australia, VA typically follows a period of attempted restructuring which has failed in whole or part. There is a natural sense of distrust amongst those who have suffered loss for the directors who oversaw the loss and it is easier for those parties to support the company's rehabilitation if it is under the independent control of someone who is not only impartial but has the experience and skills to undertake restructuring in a distressed environment.
- We readily concede that it is usually beneficial for the company to retain the corporate knowledge of its officers and senior management if a post appointment restructure is to occur. Equally, it is not uncommon for such people to be out of their depth, exhausted by the efforts to date or have conflicts of interest which render them a liability rather than an asset to the company. Independent control can identify and deal with both these situations.

We are of the view that the transition of control of a business which has failed to an independent, skilled practitioner with clear obligations to protect the interests of creditors is far superior to the US Chapter 11 model.

Effective moratorium; ipso facto prohibitions

The Chapter 11 moratorium is bolstered by the prohibition of ipso facto clauses and our view is that adopting this alone would significantly improve the prospects of retaining or building value in a business in VA and thereby facilitate improved prospects of trading on and out of difficulty or, more likely, a going concern sale (which we consider a totally valid restructuring outcome).

Prohibition of ipso facto clauses would also, in our opinion, significantly obviate the need for "pre pack" VA or receiverships (where a sale of the business is fully negotiated pre appointment and implemented immediately on appointment so as to take advantage of the insolvency mechanisms to manage creditors whilst avoiding the impact on goodwill of attempting to trade post an appointment, hampered by the effect of ipso facto clauses).

More broadly, whilst we support the concept of more effective moratoriums, we would caution about the impact of extended moratoriums on the competitive landscape. Through the Chapter 11 mechanism, entities in Chapter 11 gain an unfair competitive advantage over competitors that have not had the benefit of a debt moratorium and creditor compromises. This can have the effect of distorting markets. The American airline industry is a prime example of the potential negative outcomes of this process with protracted dislocation caused by less successful operators resorting to Chapter 11 while placing additional competitive pressure on their well-operated competitors.

In our view the moratorium needs to be complete to be effective, exist for a period adequate to develop and implement a plan, but should not be the cornerstone of the forward business model.

Costs

Chapter 11 is a costly procedure involving as it does significant court involvement as well as the professional advice provided to various stakeholder groups which is funded by the debtor company. Whilst for large and complex matters, the costs under an Australian voluntary administration ("VA") and a US Chapter 11 may not be appreciably different; we do not believe that this would hold for the average VA.

Finally, we understand that in view of serious concerns regarding the effectiveness of the Chapter 11 regime in the US, there is a formal review being undertaken. Our view is that, with the exception of the prohibition of ipso facto clauses, the outcome of this review should fully considered before contemplating adoption of Chapter 11 principles in Australia.

An assessment of the strengths of the current voluntary administration regime

In terms of achieving the objectives stated in section 435A of the Corporations Act, voluntary administration has been at least a modest success.

In 2013-14 ASIC statistics show that of approximately 1300 voluntary administrations about 400 resulted in effectuated Deeds of Company Arrangements (DOCAs). This statistical proportion is roughly consistent over the preceding 6 years, since the implementation of the insolvency law reform package in 2007 (which provided a more streamlined process to initiate a creditors voluntary liquidation).

We reiterate that significant restructuring effort is undertaken in the pre-insolvency period by companies, with the support of banks, involving restructuring expertise and not – it is only after these efforts have failed that companies enter into VA.

Strengths of the current regime include:

- It involves a simple, low cost and fast mechanism to initiate.
- Creditors are able to participate in the process and have forums to influence the outcome
- The removal of control from management that has had oversight of the business resulting in its financial difficulties and replacing them with an independent insolvency practitioner experienced in extracting value from distressed business assets.
- The imposition of a moratorium period on landlord and creditor collection action enabling an evaluation of the business and exploration of restructuring or sale options while potentially destructive debt recovery action is precluded.
- Protection of creditors continuing to deal with the company in administration by the imposition of personal liability on the voluntary administrator.
- The reporting regime contains comprehensive disclosure requirements to ensure that of creditors are fully informed in making their decision on the preferable alternative outcome for the company's future.
- The decision making process acknowledges the predominant interest of the creditors where a company is insolvent, which we believe is consistent with the prevailing view as to the appropriate balance of interests in the Australian business sector.

- The VA regime contains an easy cost effective transition to the chosen outcome once the creditors have made their decision.
- From a substantially secured creditors' perspective, a high degree of autonomy of decision making is preserved, with the ability to initiate their own recovery action during decision period. As secured lenders are in most instances a critical stakeholder whose opinion will significantly impact on a defaulting borrowers' the future alternatives this degree of control is, in our view, appropriate.
- Other secured parties and owner of property used by the company have relief mechanisms available should they believe their position is being prejudiced by the voluntary administration process.
- Where officer misconduct is identified, the VA regime contains a mechanism for prompt reporting of officer misconduct to ASIC.

Assessment of the weaknesses of the VA regime and suggestions for enhancement

Few creative restructuring outcomes

A commonly identified concern about the voluntary administration regime is the lack of creative restructuring proposals that proceed using this mechanism; a significant majority of DOCA's provide for a simple distribution of funds to creditors in part satisfaction of their claims.

We refer to our comments above regarding why the system does not cause otherwise viable business to fail, particularly to our view that pre insolvency restructuring in Australia often takes place outside of the public view, and is known to involve sophisticated and creative solutions to navigate out of financial difficulties.

For this reason, we regard the criticisms about the lack of creative restructuring using the voluntary administration process as misguided; most entities by the time the reach the stage of entering voluntary administration have such substantive financial and operational difficulties that the options for restructuring are severely curtailed.

Further we believe that with some enhancement the voluntary administration procedure can be an effective tool for extracting value from assets and enterprise and ensuring that all or part of the business can be preserved and operated under the control of a new owner, with all of the attendant benefits to interested parties and the economy generally.

Ipso facto clauses

One substantive concern we have with the voluntary administration regime is that although it prevents proceedings from being commenced against the company while it is in place, it does not preclude a party to a contract with the company from terminating solely on the basis of entering into an external administration (exercise of an ipso facto clause).

Loss of supply and customer arrangements as a result of such clauses can significantly undermine the prospects of the business continuing as a going concern leaving little option but to cease trade and employment and seek to sell the assets on a break up (fire sale) basis. We would support amendment to the law which would prevent such value diminishing conduct.

In our view this change would significantly improve the prospects of restructuring through a return to profitability and refinancing or through a sale of the business operations without unacceptable erosion of the rights of creditors.

Costs of voluntary administration

Another pervading concern about voluntary administration is the cost of the process and its impact on returns to stakeholders. In our view, many of the factors contributing to escalation of costs as well as a number of the perceived shortcomings of the voluntary administration regime could be rectified by relatively straightforward legislative amendments, which we have outlined at a high level in the table below:

Weakness of the current VA regime	Suggested improvements
Relatively short duration of the moratorium period The moratorium period is arguably too short for many companies to enable: ▪ the assessment of the current position ▪ receipt and evaluation of proposals for DOCA's ▪ investigation of what a hypothetical liquidation might generate for the purpose of making a comparison of the available alternatives Under the current system the administrator must make a court application to extend the moratorium period – this involves time and cost.	Include options to automatically extend the moratorium period for longer than the current 45 days, perhaps to 90 days, provided certain criteria are met and creditors are given notice of the basis for extension. Relevant threshold criteria might include stabilisation of business operations, if the administrator is running a sale campaign and complexity of the investigation required to produce the s 439A report.
High level of extension applications The frequency of Court applications need to seek the intervention of the Court is higher than the proponents of the process originally foresaw. Harmer stated that the need to apply to the Court for assistance during the voluntary administration process should be exceptional. However, we would estimate that a large proportion of voluntary administrations (especially those companies that operate larger businesses) require applications to the court (with the attendant cost consequences) to approve an extension of the convening period or a funding arrangement for the trading period.	Only require Court applications to extend the convening period in cases where the new longer maximum period recommended above is exceeded.
Costs of holding the first meeting of creditors We would question whether the costs involved in calling the first meeting of creditors, which is usually poorly attended, warrant the outcomes this meeting seeks to achieve.	Consider making the first meeting optional. Within 5 days of appointment a short form report to creditors outlining the administrators' immediate plans and setting expectations for the conduct of the administration and the basis upon which fees will be determined should be issued (published to the entity and the administrators' website) and advise of their right to nominate to form a committee of creditors. Creditors should be notified of the availability of this report and their right to notify the administrator in the first 7 days if they wish to nominate a replacement administrator. In cases where a request is made then a meeting must be convened but not otherwise. A mechanism for forming a committee of creditors through use of electronic communication could be developed, avoiding the need for a physical meeting to

Weakness of the current VA regime	Suggested improvements
	be held.
Meetings generally Meetings are costly to convene and are not particularly effective forums.	The requirements for formal meetings should be reviewed and more flexible options made available. Resolutions, including fee resolutions should be capable of effecting by obtaining executed special proxies, as opposed to requiring attendance at a meeting (in line with the requirements in personal bankruptcy).
Communication costs Mechanisms for convening meetings and communicating with creditors generally are costly and do not take advantage of more cost effective technologically advance mechanisms of communication.	Revision of the electronic communication rules to recognise that email is now the main method of business communication. Allow publication of reports on websites rather than issuing lengthy reports to creditors by post.
Complexity of creditor reporting requirements Lack of clarity around reporting requirements, plus regulator feedback about the mandatory features has lead in many cases to the production of very long, complex and costly S439A reports.	Issue clear and explicit guidelines about the standard framework of reports, with a greater emphasis on streamlined communications and audience appropriate information. Differentiate the content requirements between cases where there is a genuine decision to be made between a DOCA and liquidation and those where liquidation is the only viable alternative and minimise the reporting requirements of the latter.
Unnecessary member reporting requirements Financial Reporting obligations (audited reports to members under Part 2M.3 of the Corporations Act) continue to apply for large proprietary companies and an application for relief from reporting obligations adds to costs incurred with, we suggest, no benefit to any interested party.	Issue a Class Order removing this requirement automatically for all insolvent companies in external administration.
One size does not fit all The voluntary administration regime applies in the same manner to insolvent or near insolvent companies regardless of the turnover, level of debt, number of creditors or extent of operations and assets held. The issue of costs interfering with the successful outcome of the administration is often more significant where the company's operations and asset levels are limited and opportunities to access credit more restricted.	Consider introducing threshold criteria around key financial data such as the level of debt and assets to determine the preferable type of voluntary administration that should apply. For those businesses falling below the cut off thresholds a more streamlined voluntary administration process could be introduced. We understand ARITA is developing proposals to streamline the VA process for SME and micro businesses.

Weakness of the current VA regime	Suggested improvements
Reporting requirements (not limited to the VA):	
▪ the Reports as to Affairs form required to be completed by directors (and managing controllers) is in a very confusing and unhelpful format	The Reports as to Affairs requires complete revision if it is to be a useful tool for the capture of key information at the commencement of an external administration.
▪ the form 524 receipts and payments does not give transparent disclosure and the requirements of the provisions to account are not clear.	The objectives of the Form 524 require review and clarification and the format should be revised to align and take into account the costs of compliance.
▪ Section 422, 438D and 533 reports of director misconduct are the same for receivership, voluntary administration and liquidation when there is good reason for there to be differences.	The reporting of director misconduct should be tailored to each form of external administration, taking into account the role of the appointee in each, the time available to report and who bears the costs of reporting.

McGrathNicol appreciates the opportunity to make this submission to the Financial Services Inquiry, please direct any questions to Robyn McKern rmckern@mcgrathnicol.com

APPENDIX - Insolvency Law Reform Bill 2013

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CORPORATE RECOVERY

8 March 2013

The Manager
Corporate Governance and Reporting Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
Parkes ACT 2600

Attention: Mr Aaron Jenkinson
Email: insolvency@treasury.gov.au

Dear Mr Jenkinson

Insolvency Law Reform Bill 2013- Exposure Draft

McGrathNicol is a national practice of 31 partners, 19 of whom are registered liquidators; in addition, two of our senior employees are also registered liquidators. The majority of our registered liquidators are members of the Insolvency Practitioners Association of Australia (IPA). Our insolvency practice is confined to corporate engagements typically the larger, more complex 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 also welcome the opportunity to make a submission in regard to the proposed amendments to the *Corporations Act 2001* (the Act) detailed in the Insolvency Law Reform Bill 2013.

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 as our firm does not practice in personal 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:

Harmonisation

In general terms we have no objection to the harmonisation of the corporate and personal insolvency regimes and recognise that this may have potential advantages for regulators, creditors and practitioners who conduct both corporate and personal insolvency practices.

However, a number of our detailed submissions concern the results of the attempt to harmonise the regimes without due regard to the significant and substantive differences between corporate and personal insolvency.

Insolvent companies typically involve a far greater number and value of creditors than personal insolvencies and are far more likely to be trading enterprises and employers. The harmonisation approach appears to have taken the view that processes and requirements that work well in bankruptcy can be applied, without modification, to corporate insolvency. There are certainly aspects

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in which this premise holds, but there are several where it does not and, in our view, harmonisation in these aspects will unnecessarily add cost and confusion.

In the absence of detail regarding any proposed consequential changes in the law in relation to receiverships, aspects of the proposed Uniform Insolvency Practice Rules will have the effect of undermining the harmonisation that presently exists between the different types of corporate insolvency. We submit that this outcome is potentially likely to cause greater confusion among creditors than the mischief that is sought to be remedied by the harmonisation of the corporate and personal insolvency regimes.

Complexity

Taken in isolation, most, if not all, of the changes proposed appear reasonable and well targeted on issues which have been identified, through the Senate Inquiry and subsequent consultations, as in need of reform. However, in our view, collectively the amendments risk excessive layering of controls and processes and result in undue complexity.

We submit that there is a need to consider the collective impact of the amendments and consider opportunities to simplify and rely on over-arching controls or common mechanisms to achieve the core objectives, and minimise the cost burden of compliance which is ultimately borne by creditors.

Insolvency Practitioners Association ("IPA")

In the course of reviewing the proposed amendments and developing our submission we have liaised with the IPA. We support the general comments raised by the IPA in its submission insofar as they concern corporate insolvency law and practice.

Regulations and consequential amendments

As you would know, the proposed Uniform Insolvency Practice Rules point towards a great deal of the detail being dealt with by regulations which have not been released for comment. This fetters our ability to fully understand the proposals and provide constructive input in regard to how the regulations are likely to play out in practice.

In addition, it would seem that consequential amendments will be required to the Act in order to implement the new Uniform Insolvency Practice Rules. Again in the absence of the detail in this regard we are unable to provide constructive feedback into the process to assist in ensuring there are no unintended consequence in practice.

We would welcome the opportunity for consultation on these aspects of the law reform in due course.

If you have any queries or comments in regard to our submission, please contact me or Rosemary Winser on 08 8468 3701.

Yours faithfully

Robyn McKern
Partner, CEO

Detailed comments and submissions in relation to Schedule 1- Uniform Insolvency Practice Rules

Part 2 – Registration and Discipline of Insolvency Practitioners

Section	McGrathNicol commentary
Division 8 – Registering Liquidators 8-10 – 8-85	The timeframe for obtaining registration is significantly longer under the proposed amendments than the current regime administered by ASIC. Six months plus 45 business days is an undue gap between the submission of an application and registration based on our experience that the current average timeframe is approximately 8 weeks. We submit that as registration is a critical business tool a period of 7.5 months represents an excessive delay and undermines the policy goal of encouraging a robust and competitive insolvency market and also opens up the risk that the data upon which the application is assessed falls out of date during the assessment period. As we have raised in previous submissions in relation to reform proposals, the new registration process must entail recognition of skills obtained through undertaking restructuring, receiverships and advisory work such as independent business reviews. These skills are directly relevant to voluntary administrations, deeds of company arrangements and liquidations and experience gained in these matters equips practitioners to search for solutions which seek to preserve economic value and employment.
Division 12 - Annual Liquidator returns 12-5	It would be useful to understand the expected format of the approved form. On the assumption that it will cover similar content to the triennial registration renewal form, we suggest that the forms be combined with each third annual return serving as the registration renewal to avoid unnecessary duplication.
Division 16 – Disciplinary and other action 16-15 Registered liquidator to correct inaccuracies	We submit that the window for ASIC's review/amendment of lodged documents be limited to 12 months, so documents are not indefinitely subject to review/amendment.
16-55 ASIC may convene a [disciplinary] committee	Nominees to the committee should be persons who are no longer practising (in insolvency), to avoid the potential for conflict of interest. If this is not feasible, the liquidator under review by the committee must able to object to nominees on the basis of conflict, such objections to be subject to the reasonable review of the IPA and ASIC (noting that 18-10(3) indicates that the Minister's power to appoint a member will most likely be delegated to ASIC).

__Part 3 – General Rules Relating to External Administration__

Section	McGrathNicol commentary
Division 22 – Remuneration and other benefits received by EAs 22-10 EA's remuneration	The default remuneration amount of $5500 appears to represent a minimum fee for a first appointed external administrator (EA). This part of the amendment implies that a second appointed EA has no entitlement to the default remuneration amount and this may act as a disincentive for a proposed replacement (second) administrator to consent to act. The amount should be provided for expressly inclusive or exclusive of GST.
22-15 Remuneration determinations	The removal of the current power of a Committee of Inspection (CoI) (and presumably a creditors' committee in a VA or DoCA), to determine the remuneration of an EA has potential to create a very cumbersome process for dealing with remuneration determinations, especially on appointments with large numbers and classes of creditors. Our experience is that committees provide a more workable body than a general meeting for the EA to communicate with, and meetings may be convened much more readily and cost effectively. As committee members will generally be bound by a confidentiality deed, the EA is able to provide a more complete account of commercially sensitive matters to the committee. Committee members are likely to have more insight into the EA's dealings than the general body of creditors and are therefore better placed to assess remuneration requests. Under the amendments, if creditors do not delegate to the committee the power to determine the EA's remuneration, the remuneration determination process is likely to incur increased costs. We submit that the automatic power of a duly elected committee to fix the EA's remuneration should remain.
22-35 EAs must disclosure of employment etc of related entities	In practice, very many practitioners operate their businesses through structures which involve service entities which provide staff to the practitioner. Whilst generally we are supportive of prior disclosure of the proposed employment or engagement of a related entity, it would be wholly impractical and of little utility to make disclosure of this sort of operating structure in advance. Accordingly, there should be an exception for the EA's firm and any service entity employing staff, alternatively the section should be drafted to better target the mischief which it seeks to address.

Section	McGrathNicol commentary
22-45 EAs must not accept extra benefits etc	This amendment appears broad and absent the regulations which may better define “extra benefits” it is difficult to comment on an informed basis. We would be concerned if, in the final drafting, this clause prohibited: + payments in advance or indemnities provided by third parties as security for costs or remuneration to be incurred. + reasonable entertainment or technical presentations provided by service providers (eg law firms, insurance brokers)
22-50 EAs must not give up remuneration	Clarification of this proposed amendment is required as it is unclear what ‘give up’ means in this context. We are concerned that it is open to the interpretation that the very common form of practice, being a profit-sharing partnership where the EA’s remuneration is paid to that partnership, might offend this proposed provision.
22-55 EAs must not purchase any assets of the company	We submit that this restriction should be modified in line with, the COPP and APES 330, which allow the EA, his partners, his associates, his staff and their close or immediate family to acquire assets from a retail operation under administration of the EA, where those assets are available to the general public for sale and where no special treatment or preference over and above that granted to the public is given. Absent this modification, there is high risk that this amendment could be unintentionally breached by a family member of the EA of his/her staff who are unaware of the appointment.
Division 24 – Funds handling 24-10 Opening and paying money into administration account	The proposed amendment to open a single bank account within 5 business days of appointment appears to be required regardless of whether there are, or are likely to be, funds to bank in relation to the external administration. As most banks will levy account maintenance fees whether or not there are any transactions in the account, it would be an unnecessary burden for the EA to have to cover these costs personally. We also see no basis for the requirement that a single account be opened – it may well be more appropriate from a logistics, risk management and investment return perspective to open multiple accounts. We submit that the requirement be amended to require a bank account be opened for the external administration within 5 business days of <u>becoming aware</u> that funds are likely to be received by the EA in relation to the company. In relation to the paying in of monies, there should also be a recognised exemption where it would prejudice a recovery by banking a cheque tendered in offer of settlement of a dispute.

Section	McGrathNicol commentary
24-15 Consequences for failure to pay money into administration account	In the context of corporate insolvency, $50 is a very low threshold amount, we submit $250 would be more appropriate. Payment of penalty interest to the Commonwealth provides no compensation to the stakeholders in the administration estate for any loss of interest earned on the funds had they been banked earlier and we query the value of this provision. A criminal penalty seems extreme as a remedy for a breach of this provision.
24-20 Paying money out of administration account	We advise that for high volume matters the use of the electronic signature of the EA on bulk cheque payments (eg, dividend payments to creditors) is common and efficient. We would be concerned if the language of this provision precluded this practice.
24-35 Receipts for payments into and out of an administration account	We are opposed to the new requirement that the EA obtain a receipt for a payment made out of the administration bank account. The provision contains is no threshold limit for the amount of a payment requiring a receipt and no exceptions. Whilst the requirement is limited to cases where it is "practicable" to obtain the receipt – 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? We submit that this amendment is impractical and burdensome and we question its utility 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. 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.
24-40 Handling securities	The use of the term 'securities' here does not seem to be consistent with the definition in the Act (debentures, shares, units, interests in an MIS) and it requires clarification. A criminal penalty seems extreme as a remedy for a breach of this provision.
Division 26 - Information 26-10 Annual administration return	We have strong concerns regarding the impracticality and lack of effectiveness of this proposed amendment. In our opinion it will diminish the quality of information available for creditors in that: + the frequency with which information is available is halved; + timing issues will mean that there may be lengthy delays in disclosing any substantive information about the transactions in an external administration. For example an appointment in early July

Section	McGrathNicol commentary
	will not be required to submit a report until 25 July the following year, this may be seen as a loophole capable of manipulation. + external administrations with high levels of transactions will have reports which are approximately double the current length, making them more difficult for creditors/interested parties to interpret. The result of this proposed amendment would seem to undermine, rather than promote, the stated goal of providing greater transparency around the conduct of external administrations. In addition, we are of the view that for practitioners who undertake insolvency matters exclusively, there are serious workflow consequences involved in seeking to concentrate the reporting on all matters to a 5 week period. Presently, this reporting (under the Form 524 regime) is spread throughout the year based on 6 monthly intervals from the appointment dates, which are random. This is a system which works and which provides a regular flow of information to ASIC and creditors (albeit we believe that the form and the content of the Form 524 leaves much to be desired in terms of its utility in providing useful information to both these stakeholders). We recognise that bankruptcy trustees operate under a regime akin to that proposed. However, we submit that the number of appointments held concurrently by a corporate insolvency practice and the volume of data and transactions involved in corporate insolvency compared to bankruptcy renders invalid the assumption that it is sensible to impose the bankruptcy regime on corporate insolvency practices. We would be pleased to assist in working towards a solution which better addresses the stakeholder interest in obtaining timely and useful reporting in a manner which can be reasonably accommodated by practitioners. The starting point for this is gaining clarity on the stakeholders involved and their information needs.
26-15 Books of external administration	This amendment expands the rights of creditors and members to inspect the files of an external administration well beyond the current rights in section 486. EAs should have the power to deny access to commercially confidential information and documents subject to legal professional privilege. With regard to the proposed requirement that the EA ‘ensure that the books are kept in the EA’s office’ we suggest that this may be impractical both in cases where there is an operating business under the EA’s control (where efficiency would dictate that books recording the transactions of the EA be held on site) and where there is a very significant quantum of records. As an alternative, we submit that the provisions should require the EA to maintain control, rather than physical possession, of the books as defined in 26-15. This would still enable the requirement of allowing reasonable access to creditors requesting inspection to be accommodated.

Section	McGrathNicol commentary
26-25 – 26-35 Audit of administration books-ASIC/the Court	It is unclear what level of priority is to be afforded these audit costs but we submit they should not have a priority over the EA's fees and costs. In addition, the position with regard to these expenses in the case of an assetless administration requires clarification
Division 26D – Giving Information etc to creditors and others 26-50 – 26-59	We are accepting of the principle that reasonable requests from creditors for information should be satisfied. However, it is difficult to comment on the effectiveness of this qualification until the test for reasonableness in the regulations is available for review. We submit that "reasonableness" should be a matter for the EA to determine and that, as a minimum, the EA is entitled to take into account the cost of complying, the use to which the information is anticipated to be put, commercial confidentiality and privacy concerns, the impact on the administration of complying, the funds available, the parties to whom the information is to be provided. The draft provisions are silent as to who bears the cost of providing information and to whom information must be distributed, which we regard as a deficiency. If the cost is to be borne by the administration, this goes back to a question of reasonableness of the request which may be impacted by such factors as: + the time costs of responding to the request + the costs relative to the available assets of the administration + the size of the creditor's claim relative to the overall value of creditors + whether the creditor seeking information is a related party, a potential purchaser, an ongoing supplier, or involved in litigation with the company or EA.
Division 26D - Giving Information etc to creditors and others 26-60	We recognise that giving creditors, members or committees of inspection the ability (even if limited) to replace or modify by resolution specific requirements imposed by regulations may offer practical benefits, but it would be useful to understand which regulations it is contemplated may be modified in order to determine the appropriate way to respond to this proposal. We note that the draft Bill does not: + deal with nuisance or vexatious requests + address the costs and potential delays to the progression of the administration + provide for how reports must be distributed (to all creditors or just the requesting parties?) + establish who is responsible for setting the topics the report must address The regulations will need to address these issues. Any regime proposed by the Committee should be subject to the reasonableness test as determined by the EA with ASIC as the final arbiter for what is reasonable, should this be in dispute.

Section	McGrathNicol commentary
Division 26E – Other requests for information 26-65	We query where this proposed amendment may lead. For example, does this pave the way for requests for information from DWEER under the Fair Entitlements Guarantee Act by the Commonwealth without payment? We submit that an express provision should be made providing for the party requesting this information to bear the costs of so providing.
Division 26R – EA may be compelled to comply with requests for information 26-70 – 26-80	In principle we would have no objection to this process, on the assumption that EA will not be compelled to comply with unreasonable requests; ASIC being the arbiter of "reasonableness" based on the factors which we outline above and trust will be included in the regulations.
Division 28 – Meetings 28-5 – 28-40	In general terms we are concerned that this new mechanism creates an overly complex process for convening meetings. This does not seem to be a harmonised provision as the rules applying in bankruptcy do not contain this level of complexity. We suggest that this amendment should be drafted in similar terms to the provisions dealing with the provision of information to creditors covered in Division 26 above. That is, reasonable requests for meetings should be accepted, with the regulations providing express criteria around determining reasonableness, including issues such as: those noted above in regard to the provision of information; the relative number and value of the requesting creditor's claims; and, security for costs being provided in cases where the request comes from a significant minority. As with Division 26, ASIC could be empowered to compel the holding of a meeting where it considers it reasonable. In every case, the meeting request must detail the agenda for the meeting and any proposed resolutions.
Division 30 – Committees of Inspection 30-10 – 30-35	This proposed amendment introduces additional complexity into the process of appointing a CoI which, in the absence of detail of regulations and consequential amendments to the current law, are difficult to assess. As it stands, it is unclear how it will work. Will creditors who may be on the Committee by statutory right be identified before or after the creditors resolve to have a committee and the number of people to be on that committee? Is it intended perhaps that those who have a statutory right join the committee are in addition to the number agreed by the creditors? Would those who have a statutory right initially put themselves up for election and, if unsuccessful on that basis, exercise their statutory right to join? The answers to these questions has implications for the appropriateness of the requirement to hold 50% of employee entitlements to participate on the CoI. On its face this requirement is very high for larger appointments because it would be impractical to obtain. We also note that a percentage of value criteria for membership also creates practical difficulties when there has been a

Section	McGrathNicol commentary
	limited response from creditors in submitting proofs of debt in response to the notice of meeting. It is inappropriate in our opinion to give supervisory responsibilities to the CoI. CoI members are not impartial and may be unrepresentative depending upon the level of interest in participating. Language such as 'giving a direction' should not be used as it creates an expectation that such direction will be complied with. The obligations of the EA's should be limited to taking into account the express wishes of the CoI. Giving creditors or CoIs the ability to replace or modify by resolution specific requirements imposed by regulations should be limited to procedural matters such as reporting frequency only. We are opposed to the proposal for the CoI to obtain specialist advice/assistance unless the EA is involved in providing the instructions, is given a copy of the advice and better arrangements are provided for meeting the costs of such advice. At present the cost is said to be an 'expense of the administration' but it is unclear what level of priority this will be afforded and what will happen if there are no available funds.

Chapter 3 – Regulator Powers and Miscellaneous Amendments

Section	McGrathNicol commentary
32-15 Court may inquire on application of creditors etc. 32-20A Meetings to ascertain wishes of creditors or contributories	The amendments need to be extended to address how the costs in relation to the application and inquiry are to be met.
32-22 & 32-23 Appointment of reviewing liquidator by ASIC, the Court or creditors	We submit that an EA under review should have the right to object to a proposed reviewing liquidator on the basis of conflict of interest, such objections to be subject to the reasonable review of ASIC. We recommend that 'expenses' be defined for the purposes of this provision. Expenses such as trading expenses in an administration may be subject to commercial confidentiality and the EA under review must have the ability to object (to ASIC) over disclosure (through a reviewing liquidator's report) of confidential information. The amendment should include provisions for a liquidator under review to be protected from reviews (as required by creditors resolution) which appear vexatious and/or which impose inordinate delay on the approval of fees. We submit that any regulations providing for an extension of the review period beyond the previous 6 months should be issued as a draft for comment prior to implementation.

Section	McGrathNicol commentary
32-24 Review	We submit that any definition of 'properly accrued' should be aligned with the IPA's guidance on remuneration for work that was necessary and properly performed.
32-27 Regulations about reviews	We submit that the proposed regulations be issued as an exposure draft for comment. The amendment does not include adequate detail as to the process and this should be subject to industry feedback as to practicalities before this new provision is implemented. We have noted (at 32-22 of our submission) that there should be a reasonable process for objecting (on the basis of conflict) to the appointment of proposed reviewing liquidators.
42-4 EAs to have regard to directions given by creditors or contributories	In our view language such as 'give directions to the EA' should not be used as it creates an expectation that such direction will be complied with. The obligations of the EA's should be limited to taking into account the express wishes of the creditors and contributories. Also we would favour the abolition of the use of the term 'contributory' and suggest it would bring Chapter 5 in line with other areas of the Act to refer only to 'members'.