AUSTRALIAN CORPORATE INSOLVENCY REFORM: THE PJC'S REPORT IS IN, SO WHAT CAN WE EXPECT NEXT?

Date: 20 July 2023

Australia Finance Alert

By: Alex Smith

After a 10-month inquiry process, on 12 July 2023 the Parliamentary Joint Committee on Corporations and Financial Services (PJC) delivered its final report on the effectiveness of Australia's corporate insolvency laws.

In this alert, we distil some of the key findings from the almost 400-page report and consider what future law reforms might look like.

A COMPLEX AND INEFFICIENT SYSTEM

The PJC's overarching observation is that Australia's corporate insolvency system is "overly complex, difficult to access, and creates unnecessary cost and confusion for both debtors and creditors"—with inefficiencies, low returns for unsecured creditors, and opportunities for restructuring lacking. The PJC also highlights the "piecemeal" nature of insolvency reform since the post-Harmer Report system was established under the *Corporate Law Reform Act 1993* (Cth).

CALL FOR AN INDEPENDENT REVIEW

The PJC recommends that a "comprehensive review" be established—most likely to be led by the Australian Law Reform Commission or the Productivity Commission—with broad expertise on case law, legislative frameworks, regulatory arrangements, international insolvency systems, and (lacking at times in previous reviews) the economic and financial imperatives of corporate insolvency. It is intended for this review to explore substantive law reform measures on a number of topics, encompassing both corporate and personal insolvency. Some of the more significant focus areas are:

- As a "top priority," examining possible amendments to insolvent trading laws to address the PJC's concern that "the current insolvent trading regime is not working effectively to prevent companies from becoming deeply insolvent before they enter formal insolvency or restructuring pathways". An alternative model may be the wrongful trading provisions that apply in the United Kingdom, under which actual knowledge or negligence would need to be shown in relation to the incursion of a debt where a company is insolvent (as opposed to the "reasonable suspicion" standard under the current laws). Other reform options may include applying monetary thresholds to individual debts and excluding certain classes of liabilities from the scope of the insolvent trading provisions;
- The approach to assetless insolvency matters. Specifically:

©2005-2026 K&L Gates LLP. All Rights Reserved.

- Liquidators' remuneration—exploring in particular the level of “public interest work” liquidators are required to undertake via mandatory investigations and reporting to ASIC. The PJC is sympathetic to industry concerns about the complexity this adds to liquidators' work, and the sustainability of a model under which liquidators incur substantial expenses for “no or limited pay”; and
- Considering the creation of a public liquidator function, possibly modelled on the United Kingdom, New Zealand, and Singapore systems. This would address longstanding concern in the industry that a substantial volume of assetless companies are simply left dormant before being eventually deregistered, given the lack of incentive for an insolvency practitioner to accept an appointment with limited prospect of their fees being paid. This in turn can fuel phoenix activity, and leave improper conduct without investigation and enforcement;

- Independence requirements. The PJC notes the importance of independence standards for insolvency practitioners, and the potential for a conflict where a person advises a company before subsequently accepting an appointment. However, the strictness of those standards will be explored as part of the proposed comprehensive review. This is an important issue, because Australia's strict independence requirements, especially for administrators, has meant that any prior involvement with a company could mean the administrator is not perceived to be independent. As a result, “pre-pack” sales in Australia have faced structural barriers, in contrast to the United Kingdom where the independence requirements are more relaxed. This removes what can be (if there are sufficient protections for creditors) a viable, flexible means to restructure a distressed business. The PJC report identifies the separation of the roles of advice and restructuring in formal appointments as a possible way forward;
- The relative priority rights of employees, liquidators, and creditors. The report suggests that a comprehensive review could look broadly at the very rationale for giving employees priority rights in an insolvency context, and why the priority attaches specifically to circulating assets; and
- The operation of the unfair preference provisions. This would be a welcome component of the comprehensive review. While the High Court's decision in *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2 clarified that the peak indebtedness rule does not have application in Australia (so that liquidators must assess the net preferential effect of a series of payments made as part of a continuing business relationship between the insolvent company and a creditor during the statutory claw-back period), there is scope to explore other simplifying measures.

LOW HANGING FRUIT: MORE IMMEDIATE REFORMS

Pending the completion of the comprehensive review, which could take a number of years, the PJC also proposes a range of immediate measures that it labels the “low hanging fruit” of corporate insolvency reform, designed to address “clear and broadly recognised failings in the current law”.

Of particular note are the PJC's recommendations:

- For the government to implement the recommendations of the November 2021 safe harbour review. This would include simplified legislative drafting on intangible concepts in the existing safe harbour provisions (such as the need for an informal workout attempt to be “reasonably likely” to achieve a “better outcome” for the company) and providing practical guidance to directors on how to progress an informal workout

©2005-2026 K&L Gates LLP. All Rights Reserved.

under the safe harbour regime without fear of personal liability. Other options for modifying the safe harbour that were canvassed in submissions to the PJC during the consultation process have been left for the comprehensive review—for example, potentially relaxing the requirements for a company to be up to date with the payment of employee entitlements, tax lodgements for directors to access safe harbour protection, and possibly extending ipso facto enforcement restrictions when the safe harbour is in effect;

- To at least expand funding for the Assetless Administration Fund (potentially as a reconstituted and broader "Public Interest Administration Fund") while the comprehensive review investigates the merits of a public liquidator function;
- For the government to immediately consult (outside the comprehensive review) on modifying the small business restructuring (SBR) and simplified liquidation processes, which have received limited uptake since they were introduced with effect on 1 January 2021. Notably, this could result in an increase in the AU$1 million in outstanding liabilities threshold, which currently limits a company's access to the SBR and simplified liquidation processes. Potentially, the scope of the SBR moratorium could also be expanded to capture a broader range of secured creditors' rights;
- For reforms to the Fair Entitlements Guarantee (FEG) scheme, to ensure it extends to all impacted employees of an insolvent entity, while preventing abuse in phoenixing arrangements. One concern raised by the PJC is where a corporate group is restructured so that employees retained in wound up entities are made redundant, shifting the burden of redundancy payouts to the FEG scheme rather than the solvent entities that remain in the group; and
- For reforms to address uncertainties in the insolvency process for trusts. This has long been an issue in the industry. The Harmer Report, completed in 1988, recommended specific legislative provisions on the insolvency of corporate trustees, including provisions on when a corporate trustee can exercise its right of indemnity over trust assets and how assets are to be distributed amongst trust and nontrust creditors. Uncertainty remains on these fundamental issues notwithstanding the High Court's decision in *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth* (2019) 268 CLR 524. That decision clarified, in obiter remarks, that proceeds from the exercise of a corporate trustee's right of exoneration may be applied only in satisfaction of trust liabilities, to which the right relates. The complexities arising where a corporate trustee acts as the trustee of multiple trusts, and in the interaction between the competing rights of creditors, however, remain unsettled.

WHAT NEXT?

We now await the government's response to the PJC's recommendations. Where corporate insolvency reform in Australia will go will take some time to crystallise, particularly with the recommended comprehensive review, which is expected to take several years to complete if undertaken.

However, possible directions for reform have at least been identified in the PJC's report, and there is the prospect of more immediate reform on matters that have impeded the efficiency of Australia's corporate insolvency system for decades.

Ultimately, the comprehensive review is necessary to articulate a coherent rationale for Australia's corporate insolvency laws and ensure the current system is fit for purpose. A similar holistic review was undertaken in

©2005-2026 K&L Gates LLP. All Rights Reserved.

Singapore from 2013 to 2017, and this led to reforms that some now regard as representing best practice insolvency laws globally. The completion of a comprehensive review in Australia, and the implementation of recommended reforms, could place Australia in a similar position.

KEY CONTACTS



ALEX SMITH
PARTNER

SYDNEY
+61.2.9513.2434
ALEX.SMITH@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.

©2005-2026 K&L Gates LLP. All Rights Reserved.