



Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

**INQUIRY INTO BUSINESS SETUP,
TRANSFER AND CLOSURE**

DR W MUNDY, Presiding Commissioner
MS M CILENTO, Commissioner

TRANSCRIPT OF PROCEEDINGS

**AT PRODUCTIVITY COMMISSION, MELBOURNE
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DR MUNDY: Good morning, ladies and gentlemen. My name is Dr Warren Mundy and I am the Presiding Commissioner on this inquiry into business setup, transfer and closure. With me is my colleague, Commissioner Cilento.

Before going any further, we would like to pay our respects to the elders, past and present, the Wurundjeri people, on whose traditional lands we meet today and to the traditional owners and elders of all indigenous groups in Australia who have continuously occupied this continent for over 40,000 years.

The Commission received Terms of Reference from the Treasurer of Australia on 20 November 2014, pursuant to Parts 3 and 4 of the Productivity Commission Act, to conduct a public inquiry. These proceedings, which are being held today and next Tuesday in Sydney, are conducted in accordance with the relevant provisions of the Act. Whilst witnesses are not required to give an oath, any information which is false or misleading that is given to the Commission in these proceedings, if it is found to be false and misleading, can lead to a period of imprisonment of no greater than six months. We have never had to use those provisions of the Act, but we are supposed to tell you.

We like to conduct our proceedings in a relatively informal way but we are required to keep records of those proceedings, so the proceedings will be recorded. Because we are recording proceedings, we don't tend to indulge participation from the floor, although at the end of each day it is our practice to provide an opportunity for anyone who has been present here to make a short and brief statement if they weren't on the witness list, or use that as an opportunity perhaps to clarify the evidence that they have given us.

We tend to structure these discussions by the witness making a brief opening statement and then we will just essentially have a dialogue between ourselves and the witness. So without any further ado, could you please state your name and the capacity in which you appear and perhaps just give us a brief opening introduction.

ASSOCIATE PROFESSOR ANDERSON: Thank you very much, Dr Mundy. My name is Associate Professor Helen Anderson of Melbourne Law School. I am currently part of a team of four academics considering illegal phoenix activity. We have Australian Research Council funding to look into this problem and we are in the second of three years of this project. Our initial parts of the project were investigating the meaning of phoenix activity and at the moment we are trying to quantify phoenix activity, its enforcement, its incidents and its cost. We are not yet at the stage of making firm recommendations which, of course, is something that the Productivity Commission would be particularly interested in hearing. Nonetheless, we do have some preliminary views on that. I could go on for quite some time about illegal phoenix activity and the damage that it causes but I think our submission probably covered that. I am happy to answer any questions about that.

DR MUNDY: Thank you, Professor, and thank you for your submission and providing us with some notes for today. Commissioner, do you want to start?

MS CILENTO: I guess my sort of opening question would be how big a problem do you think it is in Australia. There's a wide range of estimates that get spoken about frequently but it's pretty hard to pin down. So if there's anything that you can sort of add in terms of the research that you have undertaken that gives us a sense of even which end of the

spectrum of estimates that are out there, that would be useful. Also, one of the things that's difficult to get a handle on is the extent to which it's occurring here, compared with other jurisdictions. Is it more or less of a problem in Australia? That might be a useful place to start.

ASSOCIATE PROFESSOR ANDERSON: Okay, happy to do that. As I think my submission pointed out, illegal phoenix activity in its very nature is concerned with the intentions of the directors in placing their company into liquidation or allowing it to become dormant and transferring assets perhaps or transferring your business across to a new entity. We can estimate or know how many companies are created each year, which gives us some other figures. We can know how many are shut down. We can know how many are dormant and deregistered, things like that. But what we can't ever really reliably know is how many of those were done with those improper intentions.

The PricewaterhouseCoopers figures that are used were, in my opinion - and I have made this clear to PwC - based on erroneous assumptions, and is the problem as big as that? Possibly, possibly not, but those figures are not, in my opinion, rock solid. I am not sure how widely this is known but the ATO is looking at commissioning some further research into the size of the problem.

However, one thing I can say is that if you - I put out a blog piece recently and was flooded with answers of people saying this is happening all over the place. So to the extent that it becomes drawn to ASIC's attention, it looks like a small trickle. I suspect it is much greater than that. I think that way too much time is spent on the "how big" problem. I think it is definitely big enough to warrant government intervention and some solutions. I think it can be time and money wasted obsessing about how big it is, particularly where the point of that is to then be able to work out - well, if we do x, we can then exactly determine how effective that measure was. I don't think this is the sort of area of the law that is susceptible to those sorts of quantification exercises. It's big enough.

DR MUNDY: The Commission recently did a piece on access to civil justice.

ASSOCIATE PROFESSOR ANDERSON: Yes.

DR MUNDY: We don't know how big our legal need is but we know it's big enough to worry about it. The PwC figures that you just mentioned, they're not flushing to the front of my mind at the moment. Are they, in your opinion, over estimates or under estimates?

ASSOCIATE PROFESSOR ANDERSON: I don't know. Certainly anything that is between I think 1.9 billion to 3.2 billion, which I think was their range, it's a nice margin of error. I couldn't say reliably. It could be.

MS CILENTO: Just following on from this point about - I mean obviously those are big numbers, your argument about it's enough of a problem, at least anecdotally, to suggest that the government needs to intervene. Why do you think there's been so little by way of sort of prosecution and sort of I guess firming up cases or evidence of that to date?

ASSOCIATE PROFESSOR ANDERSON: Well, I think that there is a general sense that the essential parts of a company, the limited liability of shareholders, et cetera, we don't

want to meddle with that because we don't want to throw the baby out with the bathwater. We don't want to discourage people from being entrepreneurs, where a great deal of closing down one business and starting another could be legitimate business rescue, which is absolutely wonderful for the economy. A business owner who's learnt their lesson starts again, succeeds the second time, jobs are saved possibly, jobs are created, et cetera. So I think there's that great sensitivity around those fundamental aspects of corporate law. We don't want to upset that.

I think that the other point is that we go to this vexed question of whether there should be a phoenix offence. I don't think there should be. I think there are plenty of laws. I think that, therefore, what enforcement there is could well not be identified as phoenix enforcement. It could be directors' duty breaches. It could be a director penalty notice by the ATO. There is probably a good deal of enforcement in the phoenix context that is not identified as phoenix enforcement, and that's really one of the aims of our quantification report, to actually point that out. Disqualification of directors for being involved in multiple failed companies. Again, we don't know for a fact that they're phoenix companies. We are just saying that they're inept serial entrepreneurs that we want to get rid of.

I think that we spend too much time thinking that we have to identify phoenix, prosecute phoenix, quantify phoenix. Now I don't think that's the case. I think we need to take a step back. It's a handy word, but I think we need to focus on the whole process of businesses closing down and making sure that we detect illegal behaviour in that context. It could be that the directors simply rip off the assets and transfer it to themselves. No new company is created. That's every bit as much a fraud on the creditors as starting a new business. So I think we need to step back from phoenix and I think we need to think about that.

MS CILENTO: What has to happen in that front then, in terms of better detection of illegal activity? I know or my recollection is that your response to the suggestion that we could streamline was around making sure that there was proper investigation.

ASSOCIATE PROFESSOR ANDERSON: Yes, absolutely.

MS CILENTO: Can you just flush that out: what do you think needs to happen? How onerous is that in the context of the system as it exists now? I guess one reaction to it is it's almost a presumption that there is illegal activity there and that we need to investigate for that in every circumstance. What sort of a burden does that pose on the system, do you think?

ASSOCIATE PROFESSOR ANDERSON: Well, it depends what you mean by the system. I think if we're talking about on private liquidators, it's a huge burden because by definition these are assetless or very small liquidations. I feel very strongly that liquidators are quite unfairly tasked with this investigate and report obligation, where they may not get paid. If you're talking about the system in the sense of the liquidators being required to do a great deal of investigation, then I think that is a huge burden. I think we need to make sure that there is funding for liquidators, even at those very early stages.

In my dot points I mentioned that perhaps a government liquidator - I haven't really given that thorough thought, but I do think that it's unfair to expect liquidators to be doing this semi-governmental policing role without proper funding. The AAF, while it's well

intentioned and has recently been expanded in 2012, still doesn't go far enough in my opinion.

Is there a presumption that there is illegal behaviour in most liquidations? The liquidators I have spoken to, by and large, said "Yes, of course there is illegal behaviour. There's insolvent trading. People hang in there too long", things like that, not necessarily phoenix activity though.

DR MUNDY: The evidence that we have received during the course of this inquiry is that relatively few of the reports that are prepared by liquidators and passed on result in subsequent action by ASIC.

ASSOCIATE PROFESSOR ANDERSON: Yes.

DR MUNDY: Very few directors have been struck off. It seems to us on face value that a very substantial regulatory burden has been placed on the profession and, where there are assets, the creditors.

ASSOCIATE PROFESSOR ANDERSON: Absolutely.

DR MUNDY: For no good public purpose. Would that be your view?

ASSOCIATE PROFESSOR ANDERSON: Absolutely, because you actually do have the hard statistics on that. So of the 10,000, 12,000 liquidations there could be reports of suspected misconduct in three-quarters of those. It could be that ASIC thinks that over-reporting. ASIC, I think looks - it goes through a machine. It doesn't get processed by humans. Depending on a range of factors, I think one in 10 of the reports gets asked for further information. About one in 10, or two in 10 of those, gets some further follow up. So we're talking about two per cent of the reports of misconduct getting follow up.

DR MUNDY: You mentioned before this notion of a government liquidator, which I don't think is that far perhaps in principle away from where we are, but where do you think the funding, if there was going to be some sort of scheme by which to investigate properly, these assetless, or essentially assetless liquidations? Do you have any views on where the funding for that should come from?

ASSOCIATE PROFESSOR ANDERSON: Yes, and I think your own report mentioned a levy on business company re-registrations. I think that's a great idea because it is actually in the interests of companies to ensure that fraudulent operators are removed. I think that anything that can be done to do that overall benefits business because as I and many others have pointed out, it's bad for honest traders to have to compete against fraudulent operators.

DR MUNDY: Coming back to the issue of phoenix activity for a moment, we made a recommendation with respect to creating a directors' identification that struck us passably strange. It was easier to become a director than it was to open a bank account.

ASSOCIATE PROFESSOR ANDERSON: Absolutely.

DR MUNDY: How do you think that that would - if the government was minded to accept that recommendation, how would that impact on phoenix activity?

ASSOCIATE PROFESSOR ANDERSON: I think it would do lots of beneficial things, the director identification number. For one thing, in the mind of a director, he's traceable. At the moment phoenix succeeds, in my opinion, because the benefits outweigh the risks. Anything that can shift the balance back might cause some people to think twice. It certainly would get rid of fictitious operators. It might get rid of dummy directors where it is quite obvious that a certain person is managing the business but someone else is a director, possibly a pensioner, possibly an accountant that might be a director of a hundred companies. It's quite obviously a substitute director.

I think that it would have a huge benefit in allowing ASIC to gather intelligence. The ATO, Australian Crime Commission, all sorts of federal police, I have spoken to people from there and they all think it's a great idea. Pretty much everyone I have spoken to said we give away the privilege of incorporation way too cheaply and easily.

I do think that not only the director identification number but the process of incorporation should be more detailed in terms of the intelligence gathered, in terms of this director with this DIN has been associated with 10 or 15 previous companies. That is really valuable intelligence for ASIC, so if they do get a liquidator report involving this person with their DIN stated, immediately they can detect that this guy has been associated with all these other companies, so I think it would be enormously useful.

DR MUNDY: You just mentioned there the circumstance where an accountant might be a director of a very large number of companies. Does that in your mind raise questions about the capability of any person who's a director of that number of companies discharging their general duty as a director to each company?

ASSOCIATE PROFESSOR ANDERSON: Absolutely, yes. I noticed the other day and I forgot to answer the second part of your question about the quantification of phoenix overseas. Again, I think the answer is I have no idea and neither do they because it's not tracked. Ireland, you can't be a director of more than 25 companies, for example. Australia doesn't have any limit. I think probably we ought to have a limit and I think it should be considerably less than 25 because if you actually look at the duties of directors, to discharge them properly, you can't possibly do that with 25 active companies.

DR MUNDY: We should probably declare at this stage that Commissioner Cilento and I are both company directors.

ASSOCIATE PROFESSOR ANDERSON: But I bet not of 25.

MS CILENTO: Not of 25, indeed.

DR MUNDY: No. I am effectively a director of one company but a director of seven because of the nature of the corporate structure. Presumably we have a circumstance where you'd have some carve outs for complex related entities.

ASSOCIATE PROFESSOR ANDERSON: But if you are the director of the holding company, are you also saying that you are the director of all seven subsidiaries?

DR MUNDY: No, I am a director of a subset of the seven subsidiaries, as are a number of my colleagues for tax reasons.

ASSOCIATE PROFESSOR ANDERSON: Yes, but I do think then that you go back to the basic law which says that you owe a duty to each company of which you are a director. You do have an obligation to discharge your duties properly in relation to separate entities. So I don't think there should be a carve out; I think you have to do your job properly in relation to every company of which you are a director.

MS CILENTO: Just when you think about some of the more complex structures, and one of the issues that has been raised with us is whether or not having a director identification number would actually impede the establishment of those companies and more complex structures. I am guessing you think not.

ASSOCIATE PROFESSOR ANDERSON: I mean seriously it's a matter of proving your ID, possibly having your photograph taken and citing a number. I mean you have to put all sorts of details on all sorts of forms. If you are associated with big, complex entities, for heaven's sake, I mean there's a lot of paperwork involved. I wouldn't have thought that would be too onerous.

MS CILENTO: Do you know - my own sort of research on phoenix in other countries, you know, it's really hard to get a handle on. I guess, you know, one of the things I have been interested in is whether there are different approaches in other jurisdictions and whether or not something like a director identification number is something that exists in other jurisdictions.

ASSOCIATE PROFESSOR ANDERSON: Yes, India has one. Mind you, India also has a huge number of other identification numbers. I think Hong Kong has personal identification numbers for anyone over 11. There's different levels of tolerance in different countries about identification numbers and whether it involves breaches of privacy. It's an area we're looking into and I had a little look at the Australia Card stuff. Now, I think this would definitely avoid the objections to the Australia Card. This is just like a driver's licence or a passport. You want to do a specific activity, you have to qualify by proving your identification.

DR MUNDY: Just back on the limitation, you mentioned Ireland has a country that limits the number of a companies a person can be a director of.

ASSOCIATE PROFESSOR ANDERSON: Yes.

DR MUNDY: Are you are aware of any research - you can send us an email, but any research or anywhere where those sorts of laws might be documented?

ASSOCIATE PROFESSOR ANDERSON: No, I don't, so I will have to let you know on that one.

DR MUNDY: Okay. That would be fine.

MS CILENTO: In the dot points that you sent through, one of the things that you sort of focused on as well was pre-insolvency advisers. I am interested if there's anything that you can speak to about what particularly you're saying in terms of how we can increase visibility of their activities, how you can have a better process in terms of tracking asset redistributions prior to insolvency.

ASSOCIATE PROFESSOR ANDERSON: Yes, I am very happy to. This seems to be a new scourge and I do think that it fits in with all of the other pieces of the picture. Where you have liquidators, a great deal of attention has been paid by ASIC and the public to liquidators and their duties and their codes of conduct. My sense is that the vast majority of liquidators do do the right thing and that's not simply because there's a reach of people in the room. That is definitely my sense. I'm just putting that out there.

My sense is that you have ASIC picking off a few cases. You have liquidators, who are private sector professionals, having to pay their own rent and fulfil their duties if they take on a case. You have insolvent businesses, people trading. They go to a liquidator who tells them, "Look, you have been insolvent trading. You have been doing this. You have been doing that. I am going to fill out a form. I am going to tell ASIC." These people, from anecdotally, what I have heard, they scuttle out of the office so quickly you can't see them for dust because they have already spoken to a pre-insolvency adviser who said, "Leave it to me. I will make sure this problem goes away by 9 o'clock tomorrow morning for a relatively cheap price". The director pays it out of their own pocket. The company is absolutely stripped to the bone. The liquidators don't take it on. They can't afford to take it on. The company remains dormant and is then eventually deregistered by ASIC. So roughly 100,000 companies deregistered a year for failure to fill out forms and pay fees.

It is the absolute black hole. Who knows how big the pre-insolvency problem is, but anecdotally, from liquidators, I am hearing that they're getting more and more clients who say, "I have been sent to you to liquidate the company". The liquidator is doing the right thing asking these questions and the person says, "No, no. I have been told that ASIC and the ATO are unlikely to trouble me because I am small beer. I am just going to leave." I don't think a lot of these business people are too bright. The pre-insolvency advisers give them the information they need to sidestep the law. That's my thought.

DR MUNDY: Do you have a sense of the character of these sorts of businesses? Are they typically relatively small, family-owned operators?

ASSOCIATE PROFESSOR ANDERSON: Phoenix businesses, you mean, or the pre-insolvency?

DR MUNDY: The ones that you're talking about in relation to the business.

ASSOCIATE PROFESSOR ANDERSON: Small business, yes, small family-owned business, possibly retail, not necessarily set up to fail. I mean I think that's a whole separate category of phoenix where you might have trolley collection business, personal services, all sorts of things set up to fail. I think there's an awful lot of small businesses set up to succeed that fall by the wayside. Phoenix is not a problem, generally speaking, with large

companies. They have far too much to lose in terms of reputation. This is a shadowy business. I think, in essence, the best thing we can do is shine a light on it.

DR MUNDY: Just focusing on this pre-insolvency conduct, so I think what you're saying is that the bulk of these companies are companies which were set up for legitimate reasons and they run into trouble.

ASSOCIATE PROFESSOR ANDERSON: Yes.

DR MUNDY: They get the bejesus scared out of them when they're shown the law with respect to insolvent trading. Someone says "I can get you out of jail for five grand".

ASSOCIATE PROFESSOR ANDERSON: Yes.

DR MUNDY: I'm out of jail the next day, rather than it being a systemic form of fraud.

ASSOCIATE PROFESSOR ANDERSON: Yes, that's my sense and they advertise quite openly. You can Google them.

MS CILENTO: It's interesting because I think there's an interesting question there about how best to tackle it.

ASSOCIATE PROFESSOR ANDERSON: It's not easy.

DR MUNDY: On the one hand, we would like people who think they are trading insolvent or are worried about the solvency of their business to go and seek professional advice. Then on the other hand they're getting advice from these people, who maybe their primary intent of the advice is to defraud the creditors or at least to evade the law, which is what the processes are set down for.

ASSOCIATE PROFESSOR ANDERSON: Yes.

DR MUNDY: Would licensing these pre-insolvency practitioners help?

ASSOCIATE PROFESSOR ANDERSON: I think it would but I don't know how you stop the people without a licence operating. I mean how would you police it. I mean I believe if they're brought in to the ARITA fold that would be highly beneficial but how do you actually stop someone hanging out their shingle, saying I can give you some advice.

DR MUNDY: The same way we stop people calling themselves lawyers, but it creates a degree of regulatory burden. Again, we don't want to stop I guess a legitimate professional accountant, who might not be an insolvency practitioner, giving advice to a client which might be entirely reasonable and robust advice.

ASSOCIATE PROFESSOR ANDERSON: I think that's where the blurry lines between what is a legitimate business rescue and what is a phoenix, that's where the problems arise because even these pre-insolvency people, if you hauled them up before this Commission, they would say, "Look, I gave perfectly legal advice."

MS CILENTO: What do you think the best solution is?

ASSOCIATE PROFESSOR ANDERSON: I think things like the DIN are going to be useful for deliberate phoenix. These accidental phoenix, these people that try to do the right thing, I think we need better funding for liquidators to be able to work out which ones are worthy of ASIC's time. I think ASIC needs to bring far more actions. I think there needs to be more publicity.

I think that where you're talking about people creating multiple successive failed companies, I think there probably needs to be some sort of sliding scale of difficulty, perhaps like in Ireland where someone with multiple failed companies has to put up a bond, a personal bond. It just focuses the mind nicely, "Should I get a job or should I try with another business".

I think that there is no single answer. I think there will be multiple things, increased enforcement, increased resourcing, some prevention measures, better detection. I think trade unions, for example, are a very valuable source of information. Perhaps there needs to be better communication channels between things like trade unions, who often know when workers are not getting paid.

Superannuation funds, they need to have better channels of information perhaps to the ATO about non receipt of super payments, things like that. I think the solution is probably going to be lots of very small changes, rather than one big change.

DR MUNDY: I mean in various points you've mentioned a number of Commonwealth agencies that are active in enforcement in this space. Is it your view that, I guess, ASIC, the ATO and the Crime Commission may be the three probably are reasonably well coordinated in this regard, that they're not falling over each other, that things are correctly pressed?

ASSOCIATE PROFESSOR ANDERSON: I don't think they're falling over each other. I think that agencies such as the ATO, the Fair Work Ombudsman, agencies like that, refer things to ASIC. ASIC needs to be properly resourced to accept those referrals. I don't think there's any sort of jealousies or power grabs or anything like that. On the contrary, I think it is that ASIC has the expertise and needs the resources to use it.

Agencies definitely need to be encouraged to report things and they could be encouraged to do that by ASIC perhaps giving these some more feedback on referrals.

DR MUNDY: Just coming back to phoenix companies, I think our discussion so far has really been around relatively small companies that just get passed on.

ASSOCIATE PROFESSOR ANDERSON: Yes.

DR MUNDY: Are you aware of instances where there has been a corporate holding structure and the associated entities have been closed, open, closed, open, closed?

ASSOCIATE PROFESSOR ANDERSON: Absolutely, yes. That is what Treasury calls sophisticated phoenix activity and the labour hire company. There's no transfer of assets to detect, so that's very tricky and possibly the employees are transferred. There was a case

brought by the Fair Work Ombudsman against a guy called Ramsay and he had a series of abattoirs and he was trying to avoid all sorts of debts and industrial instruments, things like that so, yes, it's well accepted.

DR MUNDY: We understand that New Zealand and Ireland have enabled the holding company to effectively be got at for this sort of activity.

ASSOCIATE PROFESSOR ANDERSON: They do have laws. They're not used very often though. They're called contribution orders but, of course, the important thing to remember is that you have to bear in mind the creditors of the solvent companies as well. It's all very well to pierce the corporate veil and get at the assets of the solvent parent or related companies, but they also have their creditors. I don't know that it's just a matter of saying we should just order contribution orders willy-nilly. I think those laws are well worth investigating but it's not just a clear case of it would work.

DR MUNDY: You say they are not used very often. Is that because of exactly the sort of reasons that you explained?

ASSOCIATE PROFESSOR ANDERSON: It could be. It's not as though there's lots of cases brought and the Judge says no because in each case it's not an automatic thing.

DR MUNDY: Yes.

ASSOCIATE PROFESSOR ANDERSON: The Judge has to say it's just an equitable or whatever the test is. It's not as though lots of cases are brought and the Courts are saying no. It's just that the cases aren't brought. It's very hard to know why the cases aren't brought.

Mind you, just while I think of it, it could be - and this is something you hear from liquidators - the evidence of enforcement is a very small amount of enforcement. A lot of deals are done prior to proceedings being issued.

DR MUNDY: Yes.

ASSOCIATE PROFESSOR ANDERSON: The holding company may well have kicked in a big chunk of change just to make this go away.

DR MUNDY: Yes, make the matter go away so it never gets reported and the law doesn't get developed either.

MS CILENTO: At the risk of kicking this around a little bit further, the issue of dormant companies seems to be a particularly challenging one, if there's not a formal role of liquidators.

ASSOCIATE PROFESSOR ANDERSON: Absolutely.

MS CILENTO: It would seem that what you're suggesting is that that's just got to be more resourcing for ASIC to go in and have a look at a few more of those.

ASSOCIATE PROFESSOR ANDERSON: Yes. I think, particularly if you did have the tracking of directors, if there are - because we also say the 100,000 figure includes the total number of deregistrations. It includes the 10,000 or whatever that went into external administration. It also includes all those voluntarily deregistered successful businesses that someone has retired. So who knows how many are deregistered for failure to return their forms. ASIC doesn't now publish that statistic. Even assuming it was 50,000, that's a fair number, I think the director identification number or some other system could well identify where you've got the same people associated with multiple dormant companies. Let's start there and work our way down. So if someone has been - there's 10 dormant companies and then those with five and things like that, they just have walked away and no creditor has sought their winding up.

MS CILENTO: Yes.

DR MUNDY: It could be as simple as the director has passed away.

ASSOCIATE PROFESSOR ANDERSON: It could be lots of quite legitimate reasons but until we have a look, we won't know.

MS CILENTO: What additional data would you like to see ASIC publishing?

ASSOCIATE PROFESSOR ANDERSON: Well, I would like every single regulator to at least ask the question, not is there a breach of a phoenix offence but do you expect that this offence was committed in the phoenix context. I think we need a great deal more when liquidators report. When people phone up a hotline, I think that question should be asked, just to give us a sense of how big is this problem because at the moment it's impossible to know.

MS CILENTO: Yes.

DR MUNDY: Thank you very much for everything, Professor. That's been particularly helpful.

ASSOCIATE PROFESSOR ANDERSON: Thank you very much for giving me the opportunity.

DR MUNDY: Thank you.

MS CILENTO: Thanks for your time.

DR MUNDY: Our next witness is not here yet. Maybe he is. We might just adjourn these proceedings for a few minutes and then we will start again.

ADJOURNED

[10.40 am]

RESUMED

[10.49 am]

DR MUNDY: We will reconvene these proceedings and I would ask the next witness to state their name and the capacity in which they appear and then perhaps make a brief opening statement.

MR ZWIER: My name is Leon Zwier. I am a partner of the law firm Arnold Bloch Leibler. I am a partner who has worked in corporate reconstruction for a period, embarrassingly, greater than 30 years.

DR MUNDY: You don't look that old.

MR ZWIER: Thank you. In that capacity, I thought it would be useful to provide some of my observations and the benefit of my experiences, having worked through the corporate structure for larger corporate reconstructions, both formally and informally.

DR MUNDY: Thank you for that. We would just like to place on the record both our appreciation of the written material you have provided us and also the engagement you've had with both ourselves and also with our staff. Was there anything else you wanted to say by opening?

MR ZWIER: No, that's fine. I think you've had the benefit of the submission, I have had the benefit of some of the comments you have made in relation to it. I have indicated, I think through your staff, that I was really intending to no more than briefly touch upon those matters. I don't intend to amplify in an opening statement. I am happy to take any questions in relation to the position that we have taken.

DR MUNDY: Can I perhaps start with the issue of rebranding and some suggestions you have made about the objects and the purpose of the relevant parts of the Act. I guess, without wanting to be flippant, I have been trying to rack my brain as to what voluntary administration could be called. What would we rebrand it to? Do you have any thoughts on that?

MR ZWIER: Certainly I have from time to time thought that referring to a particular chapter or voluntary restructuring or something which connotes restructuring or rehabilitation might be an appropriate way to deal with it. I have often wondered about the word "voluntary" because in a sense the process is quite prescribed in the Act, but really it's really the restructuring part of the Act. It is corporate rehabilitation that it's intended to deal with.

DR MUNDY: In the notes that you very helpfully provided us with, you make the observation that - meaning the objects or the part, "So it's not available to insolvent companies", which I think is something we're in agreement on and only for distressed companies in the future. Then you went on:

Being clearly the purpose of maximising the chance of a company's employees being preserved.

Are you suggesting there that the Act should have an object or a purpose that would be about the maintenance of the employment levels in the company at the time? I guess what

my concern would be is creating a circumstance where there was a statutory purpose that might involve the maintenance of employment levels in a company which are inefficiently high for the business, particularly for the business going forward.

MR ZWIER: It might be poorly expressed. What's intended is to have regard to employment as an issue and part of the object is to have regard to employment going forward but I don't favour large-scale employment of people which is not viable. I mean it's got to be efficient but it's something that can be considered. I know from recent experiences in a large corporate reorganisation which I am working on in Europe at the moment, it's a big issue. It's a big issue in Europe the role that employees play in corporate restructuring.

MS CILENTO: One of the issues that's been raised with us is the challenge of defining solvent and insolvent and that fine line when a company is in distress or the questions about viability long term are there. Have you got any observations to make on that and how that might be done or what gives people a bit more confidence that we can actually bring people forward enough.

MR ZWIER: You're right. It is the most vexed question for practitioners because the first question we're all asked when we get brought in to a boardroom is, "Is the company solvent?" Every lawyer runs a million miles and gives a description of a law and then says, "Really it's a question of fact and judgment for the board, a commercial call".

Again, the insolvency practitioners generally on the other side of the profession are met with the same kind of difficulty. I mean there are indicia of insolvency that I think could be spelt out a little better and the authorities stipulate what they are. They're indicia, indicia only, but they're not ultimately determinative. Then you've got the overlay of being able to renegotiate your terms and conditions with key creditors and therefore it might change one way or another.

The German model which I am dealing with is very strict at the moment and that deals with your state of mind as a director. I think at the last meeting I had, they said if you're 50.1 per cent sure that you're okay, you can keep trading. I did point out to them it was probably 50.01. They said, "Ja". Then we debated whether if you slipped to 48.9 what your obligations were and they said that they keep records of people's thinking.

I think indicia of insolvency would be helpful.

MS CILENTO: Yes.

MR ZWIER: I certainly think that if there is going to be a safe harbour brought in and you bring in practitioners as part of the safe harbour protections, that's going to assist because, again, the reputable insolvency practitioner that goes in will have some say about it and will direct the board in some respects on that issue.

Again, it goes to questions of viability, profitability, cashflow and terms and conditions.

DR MUNDY: Is that really the point in that insolvency really is a question of a point in time judgment, whereas the question is the viability of the firm. The firm might be

profoundly viable and its capital structure might be woefully inadequate and that might lead to a circumstance of insolvency, which a restructure in its capital would solve and the business could continue. So particularly for access to restructuring type provisions, is insolvency in fact the right sort of notion or is a notion of business viability, although I appreciate the difficulties of providing a statutory declaration of such a thing.

MR ZWIER: It's both and I think in our submission we talked about business viability and having an independent insolvency practitioner saying, "This business is viable", because I don't favour the idea of restructuring it, trying to save businesses that are not, in the long term, viable.

DR MUNDY: No.

MR ZWIER: Someone has to make a judgment call about viability. In smaller organisations where the directors are also owners, they're subjective and they can never see the difference and you've got a problem because it might represent a life work or many years of personal focus. To come to the realisation that it's futile, is a hard realisation to come to.

The UK practitioners that I am working with on corporate reconstruction at the moment say a big part of a plan of reorganisation that they do is someone independently says, "This is a viable business worth saving". Then you move to the other side of it which is cashflow and solvency, but viability is different.

I don't advocate saving businesses that in the long term are not viable, so I think viability is an issue and I think solvency is another issue. I guess that we all loosely talk about the twilight zone of solvency or insolvency as being the point at which directors need protection. The real problem for directors is, of course, they're judged with perfect hindsight, even though the Courts go out of its way to say that they don't but it must influence outcomes.

DR MUNDY: Would you see the solvency being a trigger for considering viability or would you see the question of "We're concerned about our viability if we're the directors of the company" being the threshold issue?

MR ZWIER: I think a good board should be looking at viability all the time, not triggered just by solvency, because a smart board will be looking at the business model and saying, "Is this a viable business model for short, medium and longer time?" That should be considered all the time. Of course, when you run into cashflow difficulties and solvency is threatened, then it sharpens the focus and causes people to probably examine that issue with more rigour, but it's something which good boards should be looking at all the time.

MS CILENTO: Yes, but you're right though. It's when the cashflow bites that's when you have to decide how strongly you believe in the viability of the business and the cost associated with the restructure to get your cashflows back on track.

MR ZWIER: Absolutely. It brings it into sharp focus, but I certainly think that boards need assistance for that period and they need assistance where they don't have the Sword of

Damocles being the insolvent trading provision issue hanging over their head because it creates impossible conflict for the board.

DR MUNDY: Are there any cases particularly in Australia, documented cases, recorded cases in the Courts, where the solvency question has ridden over the top of viability that we could have a look at. So cases where a company has been viable but because of the way the law of insolvency works, the company has gone to the wall.

MR ZWIER: Well, I suppose if you look back historically to Ansett, it's clear that Australia was capable of sustaining two viable airlines competing with one another and Virgin and others have filled that space. Solvency and a whole lot of business problems with Ansett caused its collapse and its major dislocation, but clearly there was room for two airlines, or more airlines than two, in Australia. It was the solvency that tipped Ansett over. It might have been too big and it should have gone through a restructuring. Of course, the insolvency triggered a myriad of problems, not the least of which the crystallisation of \$760 million worth of employee entitlements that would have been avoided on a going concern. That's one clear example.

I am not close to HIH, other than having acted for its CEO, but again I have often wondered why HIH went through a liquidation process when it would have been a much smarter thing to do with an insurance company of that size to find a way to restructure it, because insurance companies are long-term viable entities. There might have been problems on the way through with that particular company but look at the massive dislocation created by the failure of HIH. Insurance companies are viable.

MS CILENTO: Leon, you're a strong advocate around ipso facto. One of the issues that has been put to us or raised with us is whether or not it creates unintended consequences in terms of the terms of contracts when they're struck.

MR ZWIER: There's always going to be that tension in relation to it, and let's put the law into its proper context. If you look at law historically, it's about protecting property interests of the middle and upper classes. That's where it all came from. That's why banks get such protection and property gets such protection, equitable interests get protection. The insolvency laws are about balancing competing interests.

It seems to me that if you have a viable business and you've got counterparties who entered into an agreement with the company at the time that it was viable and solvent, it's unfair for them to be able to terminate the contract because of the mere fact of insolvency, if the restructuring creates a viable, solvent entity at the end of the restructuring process.

Again, in the real world in which we operate, of course, and using leases of premises, leaving aside relief and forfeiture and all sorts of principles, if you just use that, think of leases of land, if a landlord is in a position where the land is more valuable with no lease on it, then you know which way the landlord in that situation will go. If it's line ball then by and large it's workable. If it's out of the money then, of course, it's in a different place. But from the company's perspective and, you know, trying to let historically brash - you know, 120 leases, you try and preserve that as a going concern and restructure it and save it. It just seems that giving every landlord the ability to terminate the leases and kill off that entity in circumstances where the only default is the actual insolvency, but by the time it's

restructured it's going to be solvent, it just seems to me it tips the balance the wrong way and ipso facto projection puts it the right way.

MS CILENTO: Do you have any knowledge of evidence overseas where people have either sought to amend the terms of contracts initially knowing that there's a moratorium of ipso facto or where they've structured the contract in a way that still allows them to get around that?

MR ZWIER: Not that I can think of, but advisers are practical and smart and people will often find ways to work things to their advantage. But, no, I look at it from the perspective of the broader issue which is why should a party who has the benefit of a termination clause based purely upon insolvency, dealing with a viable business with a whole lot of employees and people affected by it, why should it have that ability to terminate it in those circumstances.

DR MUNDY: Presumably though - I just want to check, if the company enters some sort of insolvency restructuring process, your expectation would be it would still be required to perform in all other ways under the terms and condition of the contract.

MR ZWIER: Absolutely.

DR MUNDY: It's really just that they don't get out. The creditors or the other party to the contract can be assured they're still going to get paid for the goods and services they provide and if there is a default in that regard, then there's no reason not for the contract to be terminated.

MR ZWIER: Absolutely right. In other words, if you expect to hold them to the lease, you've got to abide strictly by the terms of the lease and pay the rent and pay the outgoings and make good the property. You've got to comply with all the other terms and conditions. I am saying in the limited circumstance where a termination right exists solely because of the insolvency of the company, in those circumstances there should be a window of opportunity to enable the company to restructure itself and hold that lease, but they've got to abide strictly by the terms of it.

DR MUNDY: Yes, okay. So I don't think there's much ground - I don't think there's any difference between what we're recommending.

MR ZWIER: No.

DR MUNDY: You raised in the notes that you gave us the issue of disclaiming of onerous contracts. I once had an issue with the disowning of disclaimers with a contract with an airline liquidation. Do you just want to expand a bit on that issue because I am interested in, I guess, the symmetry between ipso facto and disclaimer of onerous contracts.

MR ZWIER: Again, let's assume for present purposes the company has entered into a terrible take-or-pay agreement, a terrible take-or-pay agreement, it cannot possibly be viable if that agreement continues. It's actually onerous because what it requires is someone to - it compels the company to basically sell all of its goods for less than the cost of production. A

business can't be viable in those circumstances. It's onerous. In a liquidation context, it might be that you could terminate it.

Involuntary administration, you could build in to a DOCA a power to terminate and convert it into a damages claim and then compromise the damages claim in theory, but there might be an argument about power. If you only have the disclaimer provisions in liquidation, what it encourages is companies to go into administration, tip in a liquidation, disclaim the onerous property, have the liquidator then form the view the company is viable, put it back into administration and then reorganise it that way. So what I am saying is that really they've got to be consistent. The power that you've got to fix up a company in liquidation has got to be the same.

Again, I think in recent discussions I had about one of the problems in Africa in some of the diamond deals that were done were so favourable to the people buying the diamonds, it's very hard for one particular African country to actually make a lot of money out of the diamonds. The contract is onerous. But taking that into a smaller context, a company having a bad deal might want to get rid of it.

I think of the Willmot case. We went to the High Court on that point and the High Court said the power can be exercised in that way.

DR MUNDY: All you're really saying is to stop process manipulation. You could effectively construct the situation by going in and out of liquidation but the law would be tidier.

MR ZWIER: I wouldn't use the word "manipulation". I would say that the proper analysis of the different regimes would mean that you could legitimately go through that process.

MS CILENTO: Yes.

MR ZWIER: Manipulation is pejorative. That's why I don't like it.

MS CILENTO: If I am understanding what you're saying is that the contract is so onerous that if you can't restructure it you're going to end up liquidating anyway. So you liquidate and by virtue of liquidating you actually then deal with the contract which then allows you to be viable.

DR MUNDY: But for the onerous contract the company is viable.

MR ZWIER: It's viable.

DR MUNDY: I think there's been some discussion about take-or-pay around small coal mines in Queensland for funding them. I mean it creates incentive issues around the viability of take-or-pay contracts though for infrastructure development, doesn't it?

MR ZWIER: Yes, and again the other side of the coin is it creates uncertainty too because someone will say, "Well, that's all very well while the company is viable but we have to think about what's going to happen if it's not viable", particularly if it's critical on the other

side from the counterparties point of view, to make sure that it has certainty of supply. You know, there are all sorts of issues.

MS CILENTO: Presumably there's requirements around proof of the contract being uneconomic. It would be similar to a sort of force majeure situation, wouldn't it?

MR ZWIER: Absolutely, and ultimately it's got to be determined by Courts. Again, I think in our submission we talked about having a panel, like the takeovers panel for insolvency. A lot of these issue are really commercial issues and one of the problems that we have, of course, is if you draw Judges who aren't commercial in nature, and of course Judges are a cross section of society in many respects and they have different expertise. It's very hard for them if they've not been exposed to some of those commercial issues to determine it.

Again, I think in our submission I said the panel wouldn't have judicial power but, of course, its existence would allow a Judge to refer to the panel effectively for an expert report which might assist a Judge determine it. The Judge might say, "Well look, I've had an insolvency practitioner, an insolvency lawyer and someone from business review all of this. They're satisfied that it's an onerous contract. They're satisfied that the business won't be viable if it continues and a Court could adopt it. It would provide assistance for the determination of those kinds of issues."

DR MUNDY: We will move to the specialist panel in just a moment but I just wanted to clarify. So onerous really is to be interpreted as "but for this the business will fail" or rather "but for this the business would be viable", rather than, "This contract is a bit of the money. It's inconvenient".

MR ZWIER: It's got to be - - -

DR MUNDY: Really bad.

MS CILENTO: Yes.

MR ZWIER: Onerous captures the intention of that provision. It can't just be at the margin.

DR MUNDY: Yes, and the jurisprudence around that is robust?

MR ZWIER: It's robust.

MS CILENTO: It goes to the long-term viability presumably.

MR ZWIER: Yes.

MS CILENTO: And a range of other parameters around the significance of the contract to the business and all of those types of things, I would have thought.

MR ZWIER: They're all the issues that the Courts would have to deal with in the context of that. There's a mechanism to protect the rights of the counterparty. The counterparty will go there and argue that the termination shouldn't be cavilled and disclaimed.

DR MUNDY: Perhaps moving on to the specialist panel, I guess my first question probably is around how would it actually work. You've just talked to a situation where a Judge might refer a matter. Often effectively the panel has the form of being an expert witness and some jurisdictions have hot tanking arrangements for experts and all that. It's an issue that the Commission has examined at some depth. I am minded and I would never suggest that the Courts were in competition for business because that would be wrong of me, but these matters are held in multiple Courts. How would we give effect to this? Presumably by amendments to the Corporations Act, rather than waiting for Court rules to catch up with it?

MR ZWIER: I just think that, within the context of the Corporations Act, maybe establish a panel kind of provision analogous to the takeovers panel where the only thing the panel can do is determine unacceptable circumstances in relation to a transaction or take referrals from a superior Court or any Court.

DR MUNDY: Any Court that's got jurisdiction with respect to these sort of matters, the option would be open to the Judge just to refer matters back off and that advice would have the standing of being an expert witness's report.

MR ZWIER: The panel could, of itself, determine voting issues, unacceptable circumstances surrounding voting, like the takeovers panel, analogously without a judicial power because it doesn't have it.

DR MUNDY: Yes.

MR ZWIER: But that's how it would work. I actually think, and I say this without disclosing confidences, that some superior Court Judges would favour it because they would regard it as being a far more efficient way to deal with some of these issues.

DR MUNDY: Well its experts belong to the Crown, rather than experts that belong to the parties, so you avoid the bias issues inherited to presented experts, I guess.

MR ZWIER: You will bring together people who've got experience and understanding of the law and understanding of the issues and the problems to help determine some of the problems. I can tell you, as an advocate in the Courts - I am disclosing secrets here, what I always do is I always begin by articulating the commercial problem and the commercial solution without reference to the law at all. Then I move to the black letter of the law to explain how within the black letter of the law the direction could be made or the Court could deal with the problem. I try and spend time to advocate about the commercial reality of it. Of course, Judges react differently to it. Some Judges will engage on that aspect and the better commercial Judges help manage the process. I can recall one or two Judges saying, "I don't think you can do it that way but I think you can do that way". Obviously I don't care how we do it, it's a deal.

What I am saying is when you have a dearth of commercial Judges available for these things, we might have a fatality of a corporation in circumstances that could have been avoided by having that kind of panel available and that expertise.

DR MUNDY: I guess one of the things that we're always worried about is additional cost, but presumably there would be cost savings arising as presumably litigate - you would expect that in the bulk of cases litigation would proceed more expeditiously. I guess I am looking for the cost savings in this.

MR ZWIER: Again, my model is the takeovers panel. It's all done on written submissions. There's no requirement to abide strictly by the Rules of Evidence.

DR MUNDY: Yes.

MR ZWIER: Everyone has prescribed numbers of pages to put in. They have a very tight time limit. So, you know, you need something in within 24, 48 hours. Again, if the panel imposes tight timelines, no matter how creative we lawyers can be, we can't create more hours out of 48 hours in 48. We might have a few more bodies on it and again, it abbreviates the process. It's still supervised in a sense but it's quicker. If you have lay people putting in those kind of submissions, you cut lawyers out, you cut practitioners out, which I don't think necessarily is a bad thing on some of these commercial issues.

DR MUNDY: You will be aware that we have made some recommendations about cutting down the small matters and almost trying to find some sort of administrative, rather than judicial, process to deal with them. If the government was minded to deal with those issues and we're really talking about Courts getting expert advice, what's left is Courts getting expert advice on major matters. Is that the sense of what's left in it?

MR ZWIER: That's right. Again, we see lots of inefficiencies in the system, particularly around management of business schemes. The parties come out and we do argue every point and every issue and everything. People with collateral interests, greenmailers - I mean take for example corporate restructuring.

I don't know if you understand what I mean by the greenmail issue and how it plays out in practice. That is someone's got the ability to block the restructure which makes good economic sense for everyone and maximises the returns but the negative rights exceed the positive rights. The big global question is how do you value the negative right. What is a negative right worth? Is a negative right worth the cost of the damage you do on the way through, on a multiple of it, a percentage of it.

Everyone in those restructuring negotiations are playing chicken with one another. It would be great if we could refer some of that stuff off to some panel while the company survives through to try and force that issue to be resolved.

DR MUNDY: Where am I up to? Schemes of arrangement. The data that we have from ASIC, if I am reading it correctly, suggests that there were 25 scheme administrators appointed in fiscal year 2010 but since that time there has been 11 in the subsequent five years. Do you have any insights into this? Have they gone out of vogue? People were excited about them for a while and they've proved to be unwieldy?

MR ZWIER: First of all, in the world in which I operate, schemes of arrangement are absolutely essential. That is, schemes of arrangement are regarded as non-pejorative and a restructuring device out of an insolvency, away from an insolvency environment. So that when you are trying to restructure a company and avoid the stigma of a voluntary administration or a DOCA or receivership, it's schemes of arrangement that are very attractive. The hedge funds globally are aware of schemes. They are aware of them in the UK. They're aware of them in Australia, Commonwealth countries. They are aware of them in Canada. Schemes play a key role.

Again, to give you a practical insight into the way restructuring works, and I have given you the kind of greenmail side of it. Invariably it's the development of five or six competing plans. Plan A is consensual. Plan B is light touch, no scheme of arrangement as part of B. Third will be light touch, voluntary administration of an entity at the top but not the operating entities, change of control down there. D might be a receivership, coupled with - and you get down - and the last one, it's always a freefall insolvency.

Schemes play a big part in all of that. The reasons schemes play a big part is that a scheme of arrangement means unanimous consent. Every finance document which says you need unanimous consent of the senior lenders to do the following, scheme of arrangement converts that 75/50, if you have a scheme at that level. That means you can actually restructure with a syndicate of lenders or hedge funds who have bought some of the debt, on the 75/50 basis and that forms the catalyst to the negotiation because if you get your requisite majorities through, that's how you get things done.

Again, classically, when you're restructuring a company through a scheme there will be an implementation agreement. Nine Entertainment there was no implementation agreement. It was done based upon good faith negotiations between practitioners. I represented the lenders. We were always above the 75/50 threshold, so we knew the scheme was going to get supported on the way through but from the company's perspective, it needed to know that it was going to get supported, because had the numbers gone the other way, it tips into insolvency.

I am just saying schemes are really important for large reconstructions. They don't have the stigma but they play no role for smaller corporations because they're expensive. You know, you've got to go to Court twice, people can object, a lot of hearings, so we don't see a lot of them. For big problems, they are very important. That's why I think in my submission I said we should have a moratorium provision for schemes because one of the big problems is when we're leading up to the scheme being propounded, invariably the greenmailers will come out and say, "We're going to vote against. We're never going to support it. It's dead in the water. You're finished."

Well, what does the Board do? The best illustration of that issue is Centro. If you look at Centro, the Centro schemes are a series of cross-condition schemes. The Centro schemes require different classes to support it. I think three of the four classes said they were going to kill it. The board had the courage of its conviction to form the view honestly, saying, "When push comes to shove, they will behave in an economically rational way and therefore they won't tip it over."

Let me tell you, it was high risk for them. I want to see a moratorium with scheme so that you actually have no one being able to demand immediate payment until the Court deals with the scheme to take some of that pressure off.

MS CILENTO: I don't have any questions on that.

DR MUNDY: Just briefly coming back to the litigation question. It's an area that I guess has been of interest to us for a while and the Commissioners. We understand that the Federal Courts established a practice area in corporate law which is going to cover insolvency. Do you think this will improve the process of getting matters through the Federal Court? Have, to your knowledge, any of the Supreme Courts gone down a similar path?

MR ZWIER: I did not understand that the Federal Court was going to set up. I didn't understand that. I didn't understand the Federal Court would set up a specialist insolvency division.

DR MUNDY: No, it's described as a Commercial & Corporations National Practice Area.

MR ZWIER: That's right. It's beyond this.

DR MUNDY: Yes.

MR ZWIER: I say that because I was very keen to make it narrower. That is my own view was to say we ought to have some specialist insolvency Judges who are narrower than general corporate and commercial and I know the Court's strongly of the view that it should be picked up within that rubric. The answer to that is yes and it's important because the Federal Court, for example, has a number of industrial relations appointees to the Court who have not been exposed to the complexities of corporate restructuring. Whilst they're capable, smart, intelligent and good looking, those Judges have not had that - lest they should read this - they have not had the same experience. They've not had the same experience, so it's better to have it.

My own experience of the State Supreme Courts is that I don't think they've dealt with the bigger jobs as efficiently as the Federal Court because the Federal Court has allocated Judges on a docket system to one case. Again, I am saying what I have previously said which was in the corporate administration I think I began with Robson J. I think I did Croft J hearing. I think I did Judd J, Pagone J, Davies J, and on each one of those hearings in relation to Timbercorp, I had to re-educate a Judge on where we were up to all the way through. By contrast in the Federal Court under the docket system, a Judge would have been allocated the matter.

For example, and this is a live one, I am working on the NewSat problems which is the publicly listed satellite entity that's got problems. At the first appearance I did in the Federal Court before Beach J, I asked for him to manage those issues going forward and he has agreed to do so. So any NewSat applications I've got one Judge who's familiar with the background, who will take me all the way through.

MS CILENTO: Sorry, I did have a question coming back to the schemes. If we actually make progress in terms of rebranding the voluntary administration side of things and it becomes more a restructuring and a rehabilitation, what impact do you think that will have on the use of schemes? Will it diminish the need for them?

MR ZWIER: No, because voluntary administration, by whatever name you call it, you know, rehabilitation, whatever it is, it's determined by a majority of all creditors. Schemes allow you to move into classes. For example, in Nine, we were dealing with the tier of secured creditors only. The trade creditors were paid a hundred cents in the dollar. It didn't really affect them. Rather than having votes involving everyone, why dislocate all of your creditors when you're only really trying to get through amendments of the conversion of debt to equity. Schemes will still play a part. You could do it through voluntary administration as well but it might be neater to do it through a scheme, rather than have all your creditors called together and have all them in the one place.

DR MUNDY: In effect, schemes might actually enable - I don't want to use the word "preferential" because I know that has particular meanings, but it may actually enable a more favourable outcome for small creditors, as you described with Nine and them getting a hundred cents in the dollar, reduce the public opposition by the fact the small guys have got their money and the banks are left with the job of working through the real detail of the corporate restructuring. By getting rid of the small guys effectively, because they're happy, you don't end up with a circumstance where they're slowing and muddying the waters. Is that part of the attraction?

MR ZWIER: Yes, and again you don't treat ipso facto problems through the scheme. The other thing too, and again I am probably revealing some of my thought process about complex restructuring, is if you had an onerous contract you might even want to propound a scheme of a very limited group because there might be embarrassment for someone to oppose the scheme on the basis that they would then be responsible for an iconic entity failing if the scheme didn't get up, whereas administration is broader.

DR MUNDY: What you're basically saying is, "I will take the 90 cents in the dollar, thanks very much, and I won't push the thing over because I don't want to wear the consequences."

MS CILENTO: It's the question of just making sure that this issue about the moratorium isn't dealt with, the need for a moratorium on the creditors isn't dealt with if we actually get the VA side right.

MR ZWIER: In fairness to your position, because you won't be as familiar with the provisions as we are, I did speak to a Canadian judge on this issue recently at one of the INSOL events and asked him how they deal with that problem in Canada. He said the Courts in Canada take the view under their general powers, the equivalent of section 411 powers, they could make an order restraining anyone from moving against the company pending the outcome of a scheme, which really provoked me into thinking we should put it into the statute, rather than make it discretionary.

Again, if you draw the wrong Judge who is disinclined to make the order, then you might discover the scheme fails because one creditor moves too quickly and makes the company

insolvent. I think it's a tweak, but it's worthwhile doing because it will allow people to deal with parts of the business, rather than the whole of the business with all the creditors.

DR MUNDY: I am just mindful of the time but we did make some observations about safe-harbour arrangements. Did you have any views on those?

MR ZWIER: I read them but to be honest I read them a while back. I've been very busy the last few days on some unrelated things. Could you refresh on what your observations were?

DR MUNDY: Basically the notion was to create a period by which the company could enter into a circumstance where the directors would be temporarily waived of their obligations to not trade whilst insolvent, subject to them having acquired competent, professional advisers to help them work through the issues. That's broad structure.

MR ZWIER: I wholeheartedly support that kind of approach to restructuring because directors need it because they're in an impossible position of conflict of our laws as they presently stand and they need that protection. Again, in the real world what can happen is you might have a series of lenders who are getting ready for the failure of the corporation, with all their books and records on one side being prepared and the directors with their books and records saying, "Look, we think we're going to get a deal done". That disconnect between the two sides, if ever there's an argument about it, a Judge is going to look at this side and say, "How could anyone possibly on the other side have formed the view that it was going to be okay". I think they need the benefit of that safe harbour to deal with those things.

DR MUNDY: Are their safeguards needed, timeframes, that sort of thing?

MR ZWIER: The reason for my hesitation is I am ambivalent because I often think without timeframes people will just let things meander and timeframes can help. So long as the sunset date can be extended, I don't have a problem with timeframes, but I don't want a sudden death because of the greenmail effect, where someone might be put under undue pressure.

DR MUNDY: Presumably though you might want to have a circumstance where the timeframe is extended by a Court rather than some sort of - or even as an administrative process.

MR ZWIER: Correct, an administrative process.

DR MUNDY: Empower ASIC to do it so there's an objective external process which is in control of it.

MR ZWIER: I certainly think that it does need some timeframes around it because it also causes people to make decisions and some people are reluctant to make decisions and so timeframes cause people to make decisions.

DR MUNDY: Are you done?

MS CILENTO: Yes.

DR MUNDY: Just to assist our staff in the administration of this inquiry, are we able to expect a submission from you on the draft report?

MR ZWIER: I will cause it to be filed.

DR MUNDY: We're grateful of your assistance, Mr Zwier. Thank you.

MS CILENTO: Thank you for that.

DR MUNDY: He's up the back.

MR ZWIER: Thank you.

DR MUNDY: Thanks, Leon, and thanks for your assistance, as I said, through the course of the inquiry. We do really appreciate it. We will have the next witness when Mr Zwier has vacated this bench.

MS CILENTO: It's good to see we've got all seats occupied.

MR WINTER: I think that might have been strategically arranged actually beforehand.

DR MUNDY: Could each of you state your names and the positions that you hold and the capacity in which you appear, just so when it comes to transcribe, if everyone has a speak the transcriber will have some vague hope of working out who said what. We will start from wherever you want.

MR WINTER: I am John Winter. I am the chief executive officer of the Australian Restructuring Insolvency and Turnaround Association.

MS FERRIER: Narelle Ferrier, technical and standards director for ARITA, Australian Restructuring Insolvency and Turnaround Association.

MS ARNOLD: I am not going to say the name in full, but it's Kim Arnold. I am the technical and education director at ARITA.

MR MURRAY: Michael Murray, the legal director at ARITA.

DR MUNDY: Thank you very much and we would just like to place on record the very strong support that ARITA has given to the Commission in relation to this part of the inquiry. We are very grateful of it. With that, Mr Winter, would you like to make any introductory comments?

MR WINTER: Thank you, Dr Mundy, I would. Can I start out by also acknowledging the great work of the Productivity Commission. We were delighted to see the draft report and we were more than delighted with the extremely cooperative way that we have been able to work with you on the investigations work that you have done so far.

We would also like to say that we think the substance of this inquiry is particularly important and, as I am sure you have come to appreciate, the last time we had any major review done of the corporate shutdown model was probably dating back to '92 with the Harmer Inquiry that led to the establishment of the voluntary administration regime. The market has changed quite dramatically since then. We have obviously moved from an environment where organisations were much more bricks and mortar focused towards an environment now where we see a deeper focus on the service sector and virtual businesses. Indeed, the sources of finance have changed dramatically over that period of time and increased in their complexity.

By way of some overarching comments, we do think that there is a deep inadequacy in terms of the community understanding of around what solvency is. We do think that that stretches to many accountants and financial advisers in the market and that it does provide for challenging situations, where organisations are beginning to face financial distress. We were talking this morning amongst ourselves around an analogy. If you look at healthcare, the fact that in many cases organisations are either calling an undertaker or are at that point of needing accident and emergency, rather than going for a regular health check-up and having a good understanding of what makes their business viable or not.

We would also say that Australia though has a fundamentally good insolvency regime and we have the benefit of strong international links. We spend a lot of time looking at how other regimes operate and we do think that Australia stands up well to scrutiny. There's certainly some areas of improvement and indeed we have shared with you our platform for recovery document and our policies that have arisen for that. We do think that there are some opportunities for improvement that we have already shared with you.

We do have some specific comments around some of the recommendations. I don't know, Dr Mundy, if you would like for us to do questions with you first and they may cover them or if you would like us to raise those particular issues.

DR MUNDY: We do have the benefit of the note that you sent to us so maybe we can just deal with them by way of questions as we go.

MS CILENTO: Sure.

DR MUNDY: That's probably easier. Did you want to start, Commissioner?

MS CILENTO: You've thrown me straight into it. Let me start with ipso facto. You expressed some concerns about that being abused. Do you mind just talking us through those.

MR WINTER: Kim, do you want to?

MS ARNOLD: Yes. Can I take a step back before we look at ipso facto and look at safe harbour because some of the discussion in the draft paper was around linking ipso facto moratorium into this safe harbour concept as well.

MS CILENTO: Yes, sure.

MS ARNOLD: I think we need to go back to what is safe harbour and what ARITA sees as safe harbour. Certainly from our reading of the draft report, it was indicating that your vision of safe harbour was more like a new insolvency regime. Certainly with ARITA, we've been discussing the concept of safe harbour for a very long time and trying to promote this idea of safe harbour and we see it more as a defence for directors in the event that their restructuring attempts were unsuccessful and the company ended up in liquidation.

If a liquidator felt that there was insolvent trading and attempted to take action against the directors for insolvent trading, the directors would then use the defence of safe harbour to defend any insolvent trading action. So safe harbour, in of itself, is not actually a regime like voluntary administration or liquidation. It's a defence.

We don't see this having a time period or anything because it's a behaviour, a course of behaviour that enables the directors to defend against any subsequent insolvent trading action in the event that the restructuring failed and it ended up in liquidation. If they successfully restructured informally, good. If they ended up restructuring through voluntary administration, good. If it ended up in liquidation and the liquidator took insolvent trading action, they would be able to say, "We complied with all the guidelines around the safe harbour defence and therefore there's no insolvent trading action because we have a valid defence."

That has always been our vision for safe harbour and so I think it was important to get that out there before we then talk about ipso facto, because we see ipso facto as something that's a right of an independent, external administrator, who can make an informed decision about whether that contract is in the best interests of the company's restructure.

We see that because there's personal liability attached to most external administrations. When an external administrator makes a decision, he or she is making that decision based on weighing up all the risks and benefits for the company's restructure, versus the risk of them having to bear that cost personally.

Whereas, if you're talking about ipso facto outside of an external administration, who is going to bear the cost if in the decision to continue with the contractor, the company can't pay or meet their obligations. You know, if a decision is going to continue in the contract and not allow for its termination, who is going to be responsible for guaranteeing the obligations are going to be carried through with.

DR MUNDY: I think this may well be a point of misunderstanding. Our view on ipso facto is that for a company or an administrator to avail themselves of access to this, they must perform under all other terms and conditions of the contract.

MS ARNOLD: Yes.

DR MUNDY: I guess it begs the question then, our point I think is that in the event of an insolvency event and we will broadly define them as any sort of event constructed under the Corporations Act, is that that mere fact is not sufficient to terminate a contract.

MS ARNOLD: Yes.

DR MUNDY: There must be a breach of other. So the issue of who guarantees performance is no different to the previous situation, is that unless there are guarantees required in the contract as and of itself, then I guess our view is that there is no need - as long as the contract is being performed with, then - - -

MS ARNOLD: Yes. I suppose our point was that in the event that the contract wasn't performed with, it may be too late. Certainly when we read the draft report, the impression we got was that consideration was being given to ipso facto within a safe harbour period.

DR MUNDY: Yes.

MS ARNOLD: That's why I wanted that discussion about safe harbour being a defence rather than we seeing it as a set period, to come up front because if a contract - say an administrator is appointed. They decide to continue with the contract and then for whatever reason things didn't quite go as well as planned, one of the things about Australian insolvency administrations is that the practitioner and voluntary administrator does have personal liability, which I think gives confidence to creditors when they're dealing with the external administrator, which obviously if you're talking about a safe harbour period, would not necessarily be the case. Well it won't because you don't have - - -

DR MUNDY: Yes, but the directors can make that choice.

MS ARNOLD: They can.

DR MUNDY: They can appoint the administrator. They don't have to go into safe harbour if they do not wish.

MS ARNOLD: No, we understand but we would raise concerns that creditors would be reluctant to trade with a company if they had publicly announced or publicly claimed a safe harbour period, versus a defence available in the event of subsequent failure.

DR MUNDY: Yes.

MS ARNOLD: Creditors, I would suggest, would be cautious about continuing to trade with a company where they know there is financial distress.

DR MUNDY: And indeed they probably exhibit similar behaviours to what they do when they have to deal with a company that's in administration. The reality is that creditors don't always see the personal obligations of the administrator at the end of the day.

MS FERRIER: The extension of that as well is if there was a public announcement of a safe harbour state is what implication that would have for secured creditors as well and what would happen to the company's value.

DR MUNDY: Yes.

MS CILENTO: I mean I guess what we're trying to get at is this whole point of trying to create a system that encourages restructuring sooner and giving directors the confidence that

they're able to do that in a way where there is a defence, provided that they behave appropriately in terms of - - -

MR WINTER: I think that sooner part is the critical phrase that we're looking for. So if you're looking at restructuring to happen far earlier in the financial distress timeline and spectrum, hopefully that intervention is coming before a point of formal insolvency. So, in many ways, the safe harbour becomes the protection in saying, "Look, I've taken all the advice. I've taken all the proper steps to protect me from a retrograde action around something. I crossed" - as you were talking about earlier, when does formal insolvency actually occur, how you would find it, et cetera. If you're working towards a good restructuring process where you don't actually cross the line, you might even come close to it, safe harbour at least gives you that retrospective look at saying, "We did all the right things up to here." Whether or not we cross that technical term kind of becomes irrelevant around that.

DR MUNDY: In principle, you could have crossed it and then crossed it back again.

MR WINTER: Correct.

MS ARNOLD: Well, when you're in the twilight zone, arguable throughout, you know, a period of time you can cross it multiple times as you endeavour to restructure.

MS CILENTO: I guess, without wanting to be pedantic about this, if we create a system where it's a known defence and you create a period of restructuring, isn't it going to have the same impact anyway?

MS ARNOLD: It's about whether you're doing it through a series of behaviour that isn't public, versus the public knowing. Certainly there could be ASX disclosure requirements, ongoing disclosure requirements, around it, even as we describe it, but if you're lodging notice formally advising ASIC and things like that, it's a public state that could affect confidence in business.

MS CILENTO: If we were envisaging a restructuring period, a formal restructuring period, that hopefully is brought forward from the inevitability of insolvency, if you're a listed company that would have to be notified to- - -

MS ARNOLD: Yes, we're not talking about removing the continuous disclosure requirements. What we're saying is, if you're an unlisted company, then - what's going on at the moment is companies are restructuring now so it's happening. The concern is that it's not as freely able to happen or that directors are concerned because they see that there's a risk of insolvent trading because their company is in that twilight zone. So what we're saying is let's encourage informal restructuring to happen, let's empower directors to do it by giving them a defence. So it's happening at the moment but there's concerns about exposure to insolvent trading.

We're saying let that continue to happen, as it is now, but give directors a valid defence. If they comply with those safe-harbour guidelines, in the event of it being unsuccessful, they will have protection because they've done the right things as they've attempted to restructure. One of the keys, I think, that makes a lot of restructuring successful is the

highly confidential and private nature of it, so it may be something that's done with the support of their secured creditors, but their normal trade creditors might not even know, they probably won't even know, that it has happened, and it's that confidentiality and privacy that enables it to happen without destruction of value.

DR MUNDY: Let's just tease out the characteristics of this defence. Our proposition is that the directors - I think it would carry over in our mind, anyway, if we were to change our view, but the directors would need to be advised by an appropriately qualified person who may or may not be a member of ARITA, but a person appropriately acknowledged by law.

I guess my first question would be: how proximate does the advice need to be? If I'm going to rely upon the defence, how proximate does the advice have to be for me to be able to use or, at least, what does it need to relate to? Because, if I've been a director and I've got advice about something five years ago and the world has moved on, the mere fact that I've been advised I don't think necessarily gets me there.

MS FERRIER: I think it would need to be a series of behaviour and certainly, if we're looking at this from a defence, the restructure has obviously gone bad because we're talking about it going into liquidation. So you would expect to see a whole series of actions leading up to the appointment of the liquidator to be able to say, "We took all the necessary steps. When we realised that had failed, then it tipped into insolvency."

DR MUNDY: Presumably, the adviser would have a duty to the Court to make clear what they had been doing?

MR MURRAY: Yes, I'm not sure about that. One answer to that is there is an existing defence to insolvent trading and other similar liabilities in respect of reliance on competent financial advice. When that issue comes before the Court, it comes down to, often, a matter of fact as to the sort of issues you're talking about - the relevance of that advice to the issue that the company confronted. Whether the company itself disclosed all the information that it had to disclose to the advisers, that sort of issue. I think the wording is sort of there already in the law in terms of how it might be adapted for this particular instance.

In terms of responsibility of the Court, it would be just a matter of, I think at the appropriate time, if it came to that, that there would be evidence before the Court as to what advice was taken and that Court would make that assessment as to whether that was proper advice or adequate at the time.

DR MUNDY: We've heard a bit about pre-insolvency advisers, both today and in other contexts, during the course of this inquiry. Presumably, an appropriate form of registration would deal with the less than suitable people who do appear to be giving some pre-insolvency advice.

MR WINTER: I'm not sure that registration is necessarily the panacea for that. The term pre-insolvency adviser has become pejorative in that sense. If you look at the work that some of the very high-end management consultancy firms do, you could arguably suggest that that's pre-insolvency work; they're taking organisations who are in some level of financial distress or needing to be repositioned, and they're providing very sophisticated advice which may be analogous to that. We're not suggesting for a second that that's

inappropriate, in fact, we're suggesting it's good and proper. There's a question more around the intent of the type of advice.

DR MUNDY: It may well be that it's good and proper but the question is: is it adequate for the public policy person to rely upon a 25-year-old consultant from McKinsey.

MS CILENTO: Not naming any particular firms.

DR MUNDY: I would have relied on a 32-year-old consultant but this is my point: we can't be satisfied as a matter of public policy as to individuals employed by an expensive firm; we can be satisfied by professional practitioners appropriately registered by a respected, either statutory or professional, body. It's like being a lawyer.

MR WINTER: Absolutely. We would tend to agree with that; I don't think it's necessarily exclusive to - - -

DR MUNDY: I'm not saying that those other people shouldn't be precluded but, rather, the public has an entitlement, I would have thought, to rely upon a process of law.

MS CILENTO: Professionals would have certain responsibilities that extend beyond their commercial relationship.

MR WINTER: Absolutely.

DR MUNDY: Your profession is peculiar in that and, to some extent, you do have duties to the Court; you're employed by Courts to do certain - it makes you quite different to a certified public accountant.

MS ARNOLD: Certainly in our formal capacity, it's exactly right.

MR WINTER: To go to the heart of your question around should the advice be proximate, I think it necessarily has to be proximate. It probably extends to a test of reasonableness as to how you identify that because we would probably suggest that it also needs to be able to demonstrate relevance, it needs to be able to demonstrate competence, which touches on your point, but it probably also needs to be continuous across the process as well to ensure that, if circumstances change, that the right advice is being taken. If there is that element of trust being exhibited this protection - and one of the things that we advocate around our safe-harbour model is that, if that's going to happen, there should be possibly a lower bar for the ability to prosecute people who do not meet their director's responsibilities than if they weren't already in that protection.

MS CILENTO: I guess I am interested in how - we're looking at this in the perspective of trying to encourage restructuring but to sort of pick up a bit on some of Leon's points, within a period of time, so that this doesn't become something where - the issues around insolvency and economic viability, if those two issues are blurred, there is twilight zones around all of this, you don't want a situation where people feel that they've got this defence to fall back on if they've got - continually engaging advisers who are coming in, I mean, it just goes on and on. We are trying to link the two in a meaningful way.

MS ARNOLD: I think your risks, I would suggest, are lower the larger a business gets because you're going to have creditors who are more sophisticated, more informed and less likely to be messed around with than if they're not being paid. Whatever restructuring is going on is going to have to be having creditors paid because eventually, if you're not paying them, somebody is going to go, "Enough is enough." Plus, if you're not being able to pay your creditors, your defence is getting pretty shaky because obviously you're not paying creditors, and it's pushing out and it's pushing out; what are your chances of you making decisions that are actually going to result in this restructuring if you can't pay any of your creditors.

So I think the risk is lower if you - because if you're not paying your creditors and you're not dealing with them, then somebody will take action against you. Just because you're doing this restructuring and you're relying on a safe harbour as a director, that doesn't prevent a creditor from taking action to wind you up or bank to - presumably the bank will be involved with the restructuring, but let's go with an unsecured trade creditor here. There's nothing to stop them taking action, and there shouldn't be anything to stop them taking action because, if the company is not dealing appropriately with their creditors, then the creditors should have a right to cause a formal appointment to happen.

DR MUNDY: Particularly with larger companies but also given the Commonwealth's interest in FEG, how would you feel about a circumstance where if the adviser in place who's got to be a suitable, qualified person was required to have a duty to report to ASIC that the company was trading insolvent, if the adviser formed the view that the company was trading insolvent, obviously he or she should advise the directors but, at the same time, advise effectively the Crown.

MS ARNOLD: I suppose, if you're going to do that, I think you have to give scope for directors to take some sort of action. You would have to enable not only the adviser to give them advice, but you'd have to give them a reasonable time - I don't know off the top of my head how long that would be - to actually either appoint an administrator, go through a scheme, which we discussed earlier, you know, if it's a very, very large company and were a strong supporter of what Leon said around moratoriums for schemes, we think that schemes have a real chance to be something, our Chapter 11, Australia's Chapter 11, for very large corporate restructuring.

Now I've lost my train of thought, completely.

MS FERRIER: You were talking about reporting to ASIC if the company became insolvent.

MS ARNOLD: Yes, you'd have to give time for them to take action. If they get the advice and they go, "Okay," and they call a board meeting and decide to appoint a voluntary administrator, then that's the appropriate course of action because they've got advice, they've gone, "Okay, we've reached a critical point, we've been told we're insolvent. Our adviser is very concerned about our position and we have to make a call." Then they should be given time to deal with it.

But solvency, this is one thing we've come back to and the thing concerns us a lot about the comments about solvency/insolvency around voluntary administration, as well as it's a very, very difficult concept - - -

DR MUNDY: The issue might be more that the company's advice that the business is unviable, rather than it's technically insolvent.

MS ARNOLD: Yes.

DR MUNDY: I guess the question for me is, if you're going to have a circumstance whereby this process is endorsed in legislation and is a label to operate in private, and I accept there might be good reasons for that. Then at some point, particularly as, in a large company, the Commonwealth underwrites the employment obligations of the company, the Commonwealth has an economic and financial interest in this matter and a wider interest in the system issues. We saw what happened when a major airline collapsed in this country; it had major system impacts on the national economy.

The Commonwealth, presumably, has a stake in this like the secured creditors; in fact, it is a secured creditor or it's providing the guarantee. It's in fact underwriting the company at least as far as its employment obligations go. It may well be that strict solvency isn't the issue that needs to be advised and it may well be that the obligation is to report but ASIC is restrained from action. But ASIC then at least knows it's got to get on to the job because, as much as the directors are entitled to some notice of it needs to act, ASIC, I think, is also entitled to some notice that it might need to act, particularly in a broader context.

MS ARNOLD: I think you'd have to take that and think about it more, because it's not something - - -

MR MURRAY: Could I just say something there. It's not unlike a business judgment rule and the business judgment rule might be exercised any day of the week by directors and it's subsequently a defence, as we're suggesting here. That's not necessarily, sort of an event announced or to promote, it comes up as the need may require later on. That's what we're saying about this period here, that you're in this circumstance. It may well be that the significance of it never eventuates because the company never enters into liquidation. So the idea of notifying ASIC, I think, is just being raised now; I think you'd have to think about that but I don't myself see, off the top of my head, that's a - - -

DR MUNDY: We can see the safe harbour is a form of proposal so, therefore, there is notification and our proposal is that there should be notification. I'm trying to work through how this private arrangement might exist, bearing in mind there's significant community concern about the conduct of these sorts of matters, particularly, for example, in the building industry. So what I'm trying to find is a process which is both economically efficient and publically acceptable.

MS ARNOLD: That would probably have to come back to a licensing or registration process, because otherwise how do you control the behaviour of advisers when the will of advisers is unlimited?

DR MUNDY: But we have statutory licensing arrangements that recognise the membership

of professional bodies. So we wouldn't need to set up a new regulator for this I wouldn't have thought.

MR MURRAY: Could I just go back to a point, if I may, right at the beginning. We would say of any company as soon as it's established and operates in business it should have proper governance and, in particular, proper financial governance. We would say of a company that it should have ongoing obviously recordkeeping, external advisers that might monitor its performance and so on, if only for its business improvement, but also if it were to enter a state of decline.

Because one issue in insolvency is that the directors are expected to reasonably anticipate or know if their company is entering into an insolvency. So what we're looking at here in this safe harbour arrangement is that ultimate promotion of good corporate financial monitoring of a business as it goes along. So it's sort of overall is what I'm saying is it contributes overall to good corporate governance. So the insolvency aspect of it is sort of just where things might become difficult and you can rely on that if you've already set the processes in place, the structures in place, in the company that allow you to see that.

There will inevitably be insolvencies. But we would say that – let's say the best sort of insolvency is of a company that at least knows its problems and is able to recognise them, do what it may in respect of trying to address them. It may well not be able to, but that's that initial threshold that we try to promote in terms of - - -

MS CILENTO: I guess the interesting point is that when you're humming along nicely presumably you feel like all your governance structures are all appropriate and all of the assumptions you make around future cash flows and all those sorts of things are solid. When you get to the point where it's looking a little bit ambiguous, having someone else come in and kick the tyres and say, "Actually, your assumptions around this in this environment aren't reliable," or they're not consistent with best practice in the industry or - - -

MR MURRAY: If I may draw on John Winter's analogy earlier about health. It's not unlike an individual. You might be feeling healthy but, nevertheless, it's wise to have an annual check-up to detect things that you yourself are unable to see. In that respect, it's always good to have an external person there giving some oversight as to how your business is operating. And that's what we're trying to encourage, I think, in this whole scenario.

MR WINTER: We do think it's – there's a presumption that accountants fulfil that role in the marketplace; and that's not necessarily true either. Certainly two-thirds of our members are accountants. So there's a clear competency there. But if you're dealing with the proverbial corner store and they're talking to their tax adviser or their tax accountant, they're not necessarily giving them good advice around solvency or business strategy, et cetera. That tends to become one of the sticking points.

MR MURRAY: My understanding anecdotally from people ringing me in financial distress is when I suggest they might see what their accountant thinks about their circumstances is either they don't have an ongoing accounting relationship or they're not able to get advice about the issue at all and that's why they've come to our organisation.

DR MUNDY: The accountant is really providing books or keeping a tax service.

MR MURRAY: I mean, I'm not an accountant myself, but what I might call compliance, which I think sums up - - -

DR MUNDY: Helping them fill in the forms.

MR MURRAY: Whereas it's less so business advisory, as I understand it.

DR MUNDY: Can we perhaps move on to – we had some evidence from Prof Anderson earlier which you were here for around about the issues of phoenix activity. I know ARITA supports our propositions in respect to director identification numbers. Was there anything else that you wanted to add, in particular how we can – how perhaps we could assist scholars like Prof Anderson and indeed ASIC and ourselves in identifying the extent of these sorts of activities and whether there's anything that the profession could do to help unpack some of this data?

MR WINTER: Look, I think there's certainly a challenge around collection of data. We've long advocated, as have most of the insolvency academics, for better access to data. Australia is one of a few areas in the world where access to ASIC data actually costs money when you're trying to do these studies. I know that many academics have struggled with that as a constraint for getting good analysis to be done in and around this space.

The challenge is, as the observation was made by Prof Anderson earlier, that you tend not to see a lot of these things. They are kept outside the formal arrangement. So the question is, how would you actually hold them up to the light of day? It's only the most dramatic examples that often come to light or the most brazen examples perhaps is probably a better way to describe it.

I think your draft report certainly uncovers this. We think that with very few exceptions businesses are not set up with failure in mind. There's obviously cases in property development, I would suggest in the more speculative areas of internet and IT organisations where that is very much in mind. But for the great majority, people set out to succeed in business, not to fail. For that reason, we think it doesn't become an overwhelming thing. But certainly firsthand we've all seen the more egregious examples in property development, et cetera.

DR MUNDY: Just teasing out this set up with failure in mind, is that a legitimate intention to set up to fail or, rather, that this is a highly speculative venture and therefore to cover the legitimate risk exposures of the principals – and this could well be the case for an internet business – that the business is set up with legitimate purpose and reasonable intent but there is a substantial risk that's being mitigated.

MS CILENTO: And usually a risk, I would have thought, that far exceeds – if it eventuates, far exceeds the balance sheet of the underlying business.

MR WINTER: If you look at the property development example, because it is a highly speculative endeavour, or historically it used to be highly speculative, maybe less so these days, there was an intent to manage the extent of recourse, and particularly when it comes to

the way that financial products are structured around these to try and minimise your full recourse spending.

There is always an anticipation of success. They're not entering it to fail from the outset. So your point is absolutely valid. But they are definitely hedging their bets in terms of their ability to go back into the market quickly without carrying, as you were pointing out, the burden of that debt forward or the burden of the failure forward.

MS ARNOLD: But there's definitely businesses that are set up to avoid particular their tax responsibilities.

DR MUNDY: Would your view or would it be a reasonable view that the general anti-avoidance provisions of the Tax Act are adequate for those purposes?

MS ARNOLD: I think it would be fair to say that our view is that prosecutions in insolvencies are difficult generally because there's poor to no books and records, which make it very difficult for a liquidator who suspects poor behaviour to actually reach the level of proof required by ASIC to even consider a matter further. They want us to have evidence, obviously. So if you destroy the books and records or you don't have books and records or there was a fire or they went missing, it makes it very difficult for a liquidator to prove what they suspect.

So then they suspect assets have been transferred. They may not even be able to quantify the amount of tax debt because they haven't reported, they haven't got books and records. So it's very difficult to prove it, which means it's not going to be prosecuted by ASIC.

MS CILENTO: How common is that?

MR WINTER: The percentages are disclosed in ASIC reports in terms of the causes of business failure. So inadequate books and records – and I'm sorry I don't have the statistic off the top, but it is one of the few pieces of published data from ASIC in terms of liquidator reports.

DR MUNDY: Presumably the prosecutorial challenges faced by ASIC would be similarly faced by the ATO if it sought to bring action under the Tax Act.

MR WINTER: Absolutely. This is the problematic end of the pre-insolvency advice, because that is exactly the type of advice that's given to businesses. If you manage your assets in this way, if you manage your books and records in this way, then most of it is going to go away because there won't be the capacity for the investigative work to be done and you'll have gone outside any periods of review.

DR MUNDY: Presumably with safe harbour and things like that, the people who are going to avail themselves of safe harbour provisions are not typically going to be the people who have set out to act in an inappropriate way.

MR WINTER: Exactly.

MS ARNOLD: One of the protections of safe harbour that we're putting forward, one of the fundamentals of it, is demonstrating that you've got the proper financial records in which to make decisions. So if you're claiming safe harbour, then you're going to have to show the liquidator that you had proper books and records on which you based your decisions and your adviser is able to assess. You can't have safe harbour if you were making your decisions based on which way the wind was blowing.

MR MURRAY: That was my point earlier about us trying to promote that good financial governance. But of course that might necessarily only appeal to those who are minded to pursue good corporate governance.

MS CILENTO: Possibly.

DR MUNDY: People who are setting out to do bad things are probably going to do bad things.

MR MURRAY: That's the reality. If I may say as well, we're talking about this in the context of insolvency and insolvency occurring. That bad corporate governance and tax evasion might – if you're just using that term broadly – well be occurring of course in any corporate structure out there without any insolvency intervening at all. Likewise, the compliance by the company with its corporate obligations might well not be at any given time attended to.

Could I just make one point about the director identity number? Could I just put that positively, if I may? And I respect Associate Prof Anderson's idea of this, it's a very good one. But I would have thought once a director gets a director identity number it's sort of a facilitatory device that allows the director thereby to rely on that number for the purposes of any further dealings that they have in terms of setting up new companies. You don't have to reprove yourself or reprove your identity or you can track yourself.

Again, that might only appeal to those who want that sort of compliance, but, nevertheless, I think it has a very positive aspect in terms of how directors operate.

MR WINTER: But it may also certainly clean up some of the ways that those records are kept as to who is directors – to share a personal experience on this, we recently had a printout of who our past and current directors were of our own organisation. Through a simple recordkeeping error at ASIC's end, there was a director who reappeared on the list. And he'd be horrified if he found out he was still a director because he's off in very senior roles elsewhere.

As a company director myself, I would hope that I could get a proper report that says, "Well, here is where I am listed as a director," because for all I know I can be being added to other organisations without my knowledge.

MS CILENTO: That is a strong argument, I think, in terms of a world where identity theft is increasingly - - -

MR WINTER: Absolutely. We do make light of the fact – Michael's frequent comment is it's harder to actually get a video out of a video store than it is to become a director of an

organisation.

MS ARNOLD: Can I just comment too with regards to this prosecutions issue on companies in liquidation is that – and the failure to provide books and records – I don't think this is helped by the fact that when ASIC does take action for failure to provide books and records or failure to provide RATA, the penalties are pitiful. So if you are really doing the wrong thing and you genuinely are trying to hide stuff from a liquidator, you are better to take it on the chin and take the penalty than you are to provide the information. The penalties are so small that they're not a deterrent to that poor behaviour.

MS CILENTO: What happens – I mean, do you know of examples where perhaps that's been the case and then people are able to then set up business again? Is it any deterrent to - -

MS ARNOLD: Well, unless they're banned, there's no deterrent. They can go and set up whatever business company that they like. My understanding is it's not a straightforward process for ASIC to get director banning even when a director has been involved with two or more corporate failures paying less than 50 cents in the dollar. It's not necessarily a straightforward process. It's subject to appeal to the Administrative Appeals Tribunal.

So it's not just a straightforward process. Maybe it shouldn't be. But maybe we can get to a certain number of failures that it should be easier to get somebody banned to have some time out to think about it. Maybe deterrence penalties that are imposed for non-compliance with good corporate governance, i.e. keeping books and records, submitting your RATA to the liquidator, the penalty should be enough that they actually encourage compliance.

DR MUNDY: Are the penalties imposed by ASIC as an administrative action or are they - -

MS ARNOLD: No, through the court.

DR MUNDY: And they're presumably restricted to a maximum number of penalty units.

MS ARNOLD: I would have to look at that.

MR MURRAY: There is some academic analysis of that I could direct you to, if you wished, later at the Institute of Criminology.

MS CILENTO: Just going back to if you have pre-position sales, which we've sort of been talking about indirectly, I think you in your notes suggested that there were – there's scope for the law to be improved to make it easier to pursue those related party transactions.

MS FERRIER: Yes, I think when we're talking about pre-position sales, I think there's sort of two categories; and we set this out in our notes. So we're talking about sales that are negotiated and effected prior to the formal appointment and then ones that can be negotiated but effected after the appointment. As it currently stands, category 1, they happen at the moment and there's powers to investigate those and consider whether they need to be overturned. They can be difficult to pursue. Again, it comes down to books and records and having that sufficient evidence, because you do need to obviously take it through the

courts. So whether there's scope – and we haven't thought about the intricacies of how you could improve it, but certainly mechanisms to make the pursuit of in-commercial transactions director related or related party transactions easier to pursue and recover.

MS ARNOLD: But then in relation to scenario 2, it may well be that a carve out could be provided for unrelated transactions. I can't remember if that was the suggestion from your report or there was an inference in your report to that. We would support that to enable those pre-position sales to happen, as long as it's used with an unrelated party. We would have concerns about any concessions being given to related party sales. It would seem that they need scrutiny and they should be subject to independent review before they're effectuated. We see that a lot of – we get a lot of feedback at the moment saying sales have to happen really quickly because the business loses its value. Well, if we bring in ipso facto as well, then there's that ipso facto protection of the business during the period that the administrator could review the transaction or the sale to related party.

The related party is well aware of the business' financial difficulties. They're involved with the business anyway. So we see that there's ability to have a bit more flexibility in there if ipso facto come in. I think it's fair that we should point out that we see a lot of – most of these recommendations are heavily linked to each other and that the success of one is dependent upon the implementation of another. And this is an example of that. Being able to create or maintain that review or scrutiny of those related party transactions will still enable these sales to occur if ipso facto a moratorium happens - - -

MS CILENTO: Presumably if they're on something like commercial terms, then it's fairly straightforward anyway.

MS ARNOLD: Exactly. But there's still that scrutiny that can happen.

MS FERRIER: The issue with scenario 2 with that is, if a sale has been negotiated beforehand by an independent party independent to the appointee, as it stands at the moment, there's obligations on the liquidator or the voluntary administrator to make sure that a proper process has been gone through. Case law at the moment indicates that the administrator or liquidator needs to make sure that they've advertised and done all their process to get fair market value. So there's no ability to rely on that pre-appointment work and effect a sale quickly. So that's where the carve-out comes in.

DR MUNDY: Because I guess the concern that's been expressed is – and I think it's been expressed on a number of occasions and it's the sort of thing that's in the public domain – is that the directors line up a transaction prior to the appointment of an administrator, they appoint the administrator and off the administrator goes. I'm wondering whether – and I guess that begs the question ultimately is about the conduct of the administrator or anyone else. So, therefore, a third party – I'm wondering in cases where the court's appointed an administrator we could perhaps rely upon the administrator to do things in that circumstance because there would be no presumption of a pre-existing relationship with the directors who did the appointment.

I'm just mindful of the fact that we've got this person – I mean, if everything is going well, the administrator should do the job and knock the thing over if it's not appropriate. But there is this potential of a relationship of agency between the directors and the administrator

if things are going wrong, which doesn't exist, I think, if the court appoints the administrator.

MS ARNOLD: At the moment voluntary administrators aren't appointed by the court; they are envisioned to be a restructuring tool of the directors. I think you're right, I think it's the conduct of the administrator. That comes back down to the actions of the regulator and us as the professional body when we have obviously a disciplinary process. ASIC has a complaints process and disciplinary process as well. That comes down to ensuring professions' high standard - - -

MS FERRIER: Ensuring our independent standards are upheld. One thing we did note in our overview as well is putting a positive obligation on reporting on these transactions as well. At the moment it's certainly best practice that you would report on any sale. But actually legislating that it's a requirement when you're reporting to creditors that you have to cover the sale.

DR MUNDY: Just coming back to legislation and back to this issue of books and records, I mean, there are other areas of Commonwealth law where the absence of certain documents creates a presumption of certain types of behaviour. I think there's provisions in the refugee and migration legislation. Would there be merit, do you think, in creating presumptions in the Corporations Act for the failure - - -

MS FERRIER: There is some limiters already. So you can rely on a lack of books and records as a presumption of insolvency in limited circumstances.

DR MUNDY: Would there be merit in widening those circumstances?

MS FERRIER: A lot of the limitations are to do with protecting third parties; so third party creditors.

MS ARNOLD: But potentially in relation to related party transactions, we can give you a summary of what those presumptions are.

DR MUNDY: And if you thought that there was any public policy merit in expanding them as effectively a per se anti-avoidance device, that might be something we could bring our minds to.

MS ARNOLD: Can I just mention something about court appointments too? I think that – remember we're talking about the aid as a restructuring tool here. I think it's important that the practitioner that's appointed in these circumstances should have the experience and the resources to actually do the job. Like I know there's – in the streamline liquidation talking about next cab off the rank, which we have shown preliminary support for, that's quite different between that very small non-trading businesses – so it doesn't really matter who does them. As soon as you start talking about a business that's viable – because we're saying the VA's viability is the key. So you're talking about a VA. There is a business because it's trying to be sold and it's going to be sold through the VA. But then you come down to this thing of how big is the business, what industry is it in, does the practitioner who's been appointed have the resources available to do it? So that means that's where the free market should come in and the right - - -

MS CILENTO: The resources and the knowledge without the conflict.

MS ARNOLD: Yes. I mean, how do you achieve that is the perennial problem. That's where you come down to insolvency practitioners are professionals. We have a code of conduct we follow. One would hope that as professionals – and we believe the majority of our profession does the right thing.

MS FERRIER: And we do have the oversight of the court. We can go to the court.

DR MUNDY: But I think you raised an important question is the capacity of the professional firm to do the work. The vast bulk of lawyers are honest. They don't all appear in the High Court. There's a question – it is inevitable that professions specialise and that some are better than others.

MS ARNOLD: Some are much, much bigger. But a lot of our members are in very small firms.

DR MUNDY: I think that is one of the reasons why we were contemplating that ASIC would keep a list of people who could be effectively authorised to do safe – even if you put – a bit like someone being a senior counsel. There was some professional beyond being a professional but being of - - -

MS FERRIER: If you were going to rely on their advice, then they had to have certain criteria that had been - - -

DR MUNDY: I don't have a hard and fast view on this, but it's about creating exactly that point. You may have members who are suburban accountants who you don't want being involved in – now, the likelihood of them turning up is quite low because the director is probably not going to avail himself of that risk. But I think it is an interesting – particularly from this question of the community credibility of such an arrangement.

MS CILENTO: And depending on how cynical you want to be, they might turn up.

MS FERRIER: Because they would envisage that it would never get to the point where they had to - - -

MS CILENTO: Or because the directors will have a particular view about the relationship.

DR MUNDY: The thing about having a list of people who are relatively large and suitable is it creates a morale hazard for them. Getting struck off that list would not be pretty. It would be damaging to business reputation.

MS FERRIER: We can consider in – like obviously we've got our framework around safe harbour. But we can consider that concept in that framework.

DR MUNDY: Because it's just a classic not all lawyers are the same. Not all medical practitioners are the same. Just coming back briefly to ipso facto, the ipso facto exemptions are growingly accommodated, particularly in Europe. I'm happy for you to take this on

notice. But we would be interested in any overseas experience or practice that you might be aware of where people have effectively tried to contract around ipso facto provisions to put themselves in a similar position.

MS FERRIER: We have discussed this and we weren't aware of any specific scenarios. But I guess we agree with Mr Zwier on this, that advisers are going to give their clients the best advice they can. So it's feasible that I'll call them workarounds would be developed. From our perspective, you could include requirements or a provision where if you were trying to avoid the intent you can go off to court to have that overturned or the ability to effect it restricted.

DR MUNDY: It's a bit like we ban speeding but people still do but it stops a good deal of speed.

MS ARNOLD: There's no doubt good professional advisers are creative. They try to think of ways to serve their clients and in situations where it's the client wanting an effective ipso facto arrangement, then they will endeavour to deliver that. That's not necessarily a bad thing. Creativity in professional advice is a good thing.

DR MUNDY: But law is increasingly littered with general anti-avoidance provisions and that's probably going to get us most of the way.

MR MURRAY: I think we could look at that for you and come back with any research.

DR MUNDY: Concerns have been raised with us that people just contract around it so what's the point. I think that's a poor argument in legal policy. But the law should say what people should do at least. But any advice you'd be able to give us, particularly on overseas experience, would be helpful. We had a bit of an engagement with Mr Zwier about this whole notion of really is VA – is the issue about VA really about solvency or is it really about viability of the company going forward. I think we're probably all in a quite similar – it's only viable companies that should be in VA and the question is protecting the directors from insolvency while they get their stuff together. If we were to go down such a path, do you have any thoughts on how we might – defining insolvency is a vexed question. I suspect defining viability is going to be a more vexed question. Do you have any thoughts of how we might structure that?

MS ARNOLD: Yes, we have been talking about it a lot and I think we probably need to talk about it some more. One of the things that we did see though is that – you'd be familiar with Mark Wellard's work around voluntary administrations and DOCAs. One of the things he highlighted was these quasi-liquidation DOCAs. We see that a viability test will remove those because if you don't have a business, you're not viable. So it immediately discounts out a large number of entities using the voluntary administration process. If a decision is made to limit voluntary administration simply to restructuring – and that obviously is a decision that the Productivity Commission has to make – but we think voluntary administration should only be for restructuring. If that's the decision, then making viability a test automatically cuts out a huge number of companies and DOCAs that are simply using voluntary administration as opposed to liquidation.

MS FERRIER: Including those that have done a sale of business beforehand because there

would be no business that you're trying to restructure.

MS CILENTO: I suspect in some ways you can cover it off with a list of topics that need to be addressed related to viability that go to sales.

MR MURRAY: I don't think the word is used in a legal sense. It's a term of art like insolvency is.

DR MUNDY: And maybe if we gave some statutory guidance we could just leave it to the wisdom of the court.

MR MURRAY: But I'm certainly happy to have a look at that.

DR MUNDY: I think it's one of those things where you can, at least by defining it, make really clear the things you don't want in it. That may be - - -

MS FERRIER: But there are simple things that – do you have a business, that's useful. Having customers is also handy.

MR WINTER: But there is also a question when it comes to viability around risk appetite. That then again comes to how various organisations are structured from their outset. To one person the viability of a business based on its risk analysis may be far different to another person's view of its viability because the risks undertaken sits at the other end of the spectrum.

DR MUNDY: But against that I think we need to overlay what the relevant overlay of risk in some part is the preparedness of the Crown to avail these people of that. So it's the public policy risk appetite that is - - -

MS ARNOLD: But then, of course, there's an opportunity for creditors to vote. So notwithstanding, if a decision is made yes, there's a business, yes, there's a possibility of it being viable, the director has put up a DOCA, ultimately it comes down to the creditors saying, "Yes, we're prepared to give you another go. We think there's a business that we want to continue to trade with." Then there's the question there about weight of related party voting, how should – can the votes be manipulated? There's a whole pile of issues around that. But, ultimately, it is the creditors who get the final say. I suppose what we're saying is only companies with businesses should have an opportunity of putting up a proposal for voting.

DR MUNDY: But I guess that leads us to Mr Zwier's views about the merits of schemes as opposed to – do you have any views on – I mean, it seems to us from the way that schemes have – I accept the argument in principles schemes are highly desirable, but they don't – like many things, they might be desirable but not popular.

MR WINTER: It doesn't mean to say that they don't fulfil an incredibly important purpose. Some of the discussion that we've had with various policymakers around, as I call it, the Hollywood view of chapter 11, you know, is this panacea, we think that if – it might be a useful term for us to have these schemes of arrangement. But we only use them two or three times a year. It's a top end solution for the big business turnarounds. That's most

people's view of chapter 11, actually, in the Australian context. They don't see that, even in their best view, of that applying to the corner store that needs to change its business model. It is a top end solution. I think for us schemes do fit that sort of mould.

DR MUNDY: It's good to have them but we shouldn't be worried that they're not getting used.

MR WINTER: Exactly, because when they work they work incredibly well.

MS ARNOLD: I think that's the key. We have suggested some changes to schemes in our thought leadership paper that we would see make them more effective, one of those being moratorium – and Leon raised this as well – that one of the issues is that deeds have VAs to enable the process to be worked up; schemes don't. So you don't have this precursor administration in place like you do with a deed. So what schemes need is that precursor to enable that workup period to happen and the scheme to be put forward and the process to go forward. That would also have the ipso facto protection at that time to enable that moratorium and that workup for the scheme to happen.

DR MUNDY: Would the introduction of moratorium, do you think, impact the behaviour of creditors?

MS ARNOLD: It would have to be a formal process like voluntary administrations are to deed. They would have to have a similar, more formal appointed moratorium - - -

DR MUNDY: So the flag would need to go up saying, "We are now in a moratorium period for the creation of the scheme."

MS ARNOLD: Yes. It wouldn't be a safe harbour; it would be actually a formal moratorium in place just like VAs are for DOCAs. It would be a similar thing.

DR MUNDY: Would your view that we should afford the directors during that period protection from insolvent trade?

MR WINTER: Yes, if they're meeting all the same criteria in terms of taking advice, et cetera.

DR MUNDY: Because then it seems it's not particularly far away from what we envisage is the safe harbour provision.

MS ARNOLD: Yes, but it's leading into a scheme. So you have a formal process and it is of a set timeframe and it's like a VA - - -

MS CILENTO: So the protection for directors then basically is if it falls over for some reason.

DR MUNDY: And the protection that's afforded by the court.

MR WINTER: Yes, the court overlooks the scheme.

DR MUNDY: And the court's oversight would start from the beginning of the moratorium.

MS ARNOLD: Yes. I mean, because what's happening at the moment is schemes – obviously there's some schemes that we've heard of from Leon where there's been schemes done with small parts of the creditor pool. But then you've got other situations where HIH did the scheme, but it did perhaps do a liquidation first to do a scheme because it was in a lot of financial difficulty. So one could argue that if there was a moratorium period, they would have been – rather than having to go through the (indistinct) and then the scheme, they may have been able to do the moratorium and then the scheme and then things might have ended up completely different.

DR MUNDY: This is what Leon seems to refer to, going into liquidation so you can hop out again.

MS ARNOLD: Yes. But you need that protection that liquidation gives you because you can't keep - - -

DR MUNDY: Yes, and they were there to gain access to the protection of a liquidator.

MS CILENTO: Your thought leadership paper has been published?

MS ARNOLD: Yes.

MS CILENTO: Have you had anyone come back and say that there's a concern that that will change the terms of the initial credit contract, that it will increase the cost of credit or anything like that?

MS FERRIER: No. We went through a member consultation period in developing that as well. So we've certainly got lenders as part of our membership group as well.

DR MUNDY: So you had no feedback from the major lenders saying, "This is going to change the way we behave."

MR WINTER: Not around that, no. But, again, I think it's because you're talking about a solution which has a limited usage and in those areas – you're talking about highly informed lenders around highly informed organisations. So you almost have that perfect information swap or the capacity for it.

MS CILENTO: Which would suggest that there's possibly not a lot of scope for streamlining it?

MS FERRIER: Just that moratorium – to remove that duplication, the concurrent appointment requirement, which is effectively a stumbling block – but in our discussions we've even talked about the court involvement in schemes and we have talked about schemes panels. But I think it was Kim that pointed out if you're at the end of the market that is going to utilise schemes, even the cost of going through a court process isn't going to prohibit you.

MS ARNOLD: Because you're so big, it's a minor cost in the whole process really. But

we do see a scope potentially for a panel. The only thing that concerns us about a panel is the fact that, as you point out, schemes aren't likely used. So can that justify the cost of setting up something specifically for schemes? And that's where we - - -

MS CILENTO: Would Leon's panel, which is more broadly envisaged, is that something that that panel could perform? What do you think about the panel idea more broadly?

MS ARNOLD: Potentially, but when you're talking about schemes for very large corporates, you're talking about some very particular skills, which mightn't be the same skills as somebody dealing with a request in a different smaller forum.

DR MUNDY: I think the notion is essentially to have a – well, it almost becomes a list of court-acknowledged expert witnesses that they'll - - -

MS CILENTO: Commercially.

DR MUNDY: Yes. And with the industry expertise.

MS FERRIER: The problem you face there is if you're talking about a big scheme – and I'll refer back to Centro which is a example that Leon raised – is you're going to have a lot of those big players and those experts in the market involved in some way anyway.

MS ARNOLD: They'd be advisers to one of the parties - - -

MS CILENTO: Possibly earning more than they would get remunerated by the panel.

DR MUNDY: Well, almost certainly what someone's going to pay them for Pete's work, I can tell you.

MS ARNOLD: That is a (indistinct) that's right.

MS FERRIER: Yes, because we don't have the big market in Australia.

DR MUNDY: But there is capacity for those sorts of panels to have people from overseas. There are capacity for those sorts of panels to have retired practitioners.

MS CILENTO: Do you see merit in that broader concept of the panel? And do you think it's something that's just going to add additional cost to the system or is it something that would actually facilitate?

MS FERRIER: Do you mean in terms of schemes or just generally?

MS CILENTO: Generally.

MS FERRIER: I think generally – sorry, John, I was about to - - -

MR WINTER: I was just going to say that's not something we've socialised across the membership per se to get specific feedback on. It's something we'd be very interested to find out reactions - - -

MS CILENTO: Do you get feedback from the membership about the complexity of the legal system and legal process? Is it something that members complain about?

MS FERRIER: It probably comes down to accountant members versus lawyer members.

MR MURRAY: One of the essences of the role of a liquidator is that they've got access to the court in respect of seeking directions in respect of difficult issues. That's a benefit. Practitioners have to also go to the court at times to get approval for extensions of time or to authorise certain actions. Again, that's something that is beneficial in the sense that it protects the liquidator in respect of making those decisions. But at the same time that costs money. Two ways of addressing that are to leave that sole discretion to the liquidator. In other words, you don't have to go to court to approve a contract of more than three months, which is one of the approvals they require. The other option is to have something lesser than a court involvement, something like a panel. But, ultimately, it is a process that is positive and, to some extent, you've got to bear the costs of whatever process you use to avail yourself of court assistance or panel assistance.

DR MUNDY: I'm mindful of the time. There's just one – and I'm happy for you to take this on notice because it's entirely a question constructed for that purpose. I understand that there's been some recent reforms in the administration of insolvency matters in the Supreme Court of New South Wales. I was just interested in – just to assist in the processes. I'm sure this is true because a senior judge of the court told me so; and he was quite proud of them. I'm just interested if ARITA has any views about the effectiveness of individual courts, what their processes look like, because they're all different.

MS CILENTO: Could you put that on the public record as well?

MS FERRIER: Yes, we'll take that on notice.

DR MUNDY: Or at least what appears to work well, what appears not to. We will always happily take evidence in confidence.

MR MURRAY: I thought you mentioned earlier that the Chief Justice of the Federal Court had spoken in respect of the new arrangements that they have there, or it might have been - -
-

DR MUNDY: No, the Chief Justice of New South Wales spoke – in the Supreme Court in Sydney.

MR MURRAY: Well, the Chief Justice of the Federal Court has made arrangements in that court for specialist panels.

DR MUNDY: Yes, that's right.

MR MURRAY: I think Mr Zwier might have mentioned that. I have heard of talk of the chief justice the other evening speaking about that and I did look at their website information. Paraphrasing very much as to what I understand it is, it's not – the expertise therefore – it's focused on expertise rather than registry. In other words, there's a group of

judges. That's what I understand is happening in the Federal Court.

DR MUNDY: My understanding of the Supreme Court of New South Wales is that it's more a registry activity than a – because they don't have a docket system in New South Wales. So how they would run a specialist list is a bit beyond me.

MR MURRAY: Well, what they do have is what they call a corporations list in equity, which has been the case for quite some time. You do find – and I'm speaking from observation rather than appearance – is you tend to get the same series of judges specialising in that particular area.

DR MUNDY: That's true.

MS CILENTO: Can I ask one more quick question?

DR MUNDY: Yes. I'm getting hungry.

MS CILENTO: Totally different topic. But you supported the recommendation that we made about the Commonwealth Government becoming more active in chasing down employee entitlements. I'm just wondering whether you think there are any barriers that exist at the moment to that actually happening or is it just the appetite for it?

MR WINTER: If I could have first crack at this and then I'm sure there'll be some other views. It's a widely expressed view across practitioners that it is somewhat disheartening when Commonwealth Government agencies do not take a more proactive role as a creditor. Indeed, I think it's fair to say we would think there's a moral obligation for them to do so. We do know from recent meetings with the ATO, for example, that around their role they're looking to take a far more positive approach, and particularly around payment of right amount on right time, no unfair advantage to non-payers, given the competitive advantage they have by racking up effectively through lending by not paying their debt.

On the other side, we see the activity that FEG are undertaking where they're seeing spikes in their business level while we're seeing drop-offs in corporate insolvencies in the market. So the moral hazard issues that are arising there are significant and of concern. One of the things that we're doing with both ATO and with FEG is to try and help along the process of becoming more educated in how they can act in their rights and obligations within an insolvency framework so that they're better able to discharge their public responsibilities in that regard. We see it as a positive development if any Commonwealth Government agency in that regard is taking a more active role.

MS ARNOLD: I suppose one of the hurdles may well be knowledge and expertise within the government agency to drive those fundings. Because it's not a matter of just providing the money and expecting it to happen. They actually have to become actively involved in the process. The Department of Employment has previously run a pilot program a number of years ago which was extremely successful, but they had a very – they had a dedicated resource who was very focused on it and was very involved in the process with the practitioners. They ran a few big actions and had some significant success. We see that as fundamental to – we think the tax office should be involved as well.

It's fundamental as part of their showing that you can't get away with avoiding your obligations, just like you can't get away with avoiding your employee entitlements and moving your assets away and rely on the government to pick up your obligations, just like you can't get away from your tax obligations. Part of that is having them fund liquidators because we've just had discussions about how liquidators do all these investigations with no funding. They struggle to get books and records. They struggle to get writers. I mean, we see the worse. There's no doubt about it.

Liquidators see the worse of director behaviour. That may give us a tainted view of what directors are like. But you won't encourage better behaviour if you don't enforce the laws that are there. Often we say the laws are there, but they are really hard for us to do anything about, or when we do get some action the penalties are so small it doesn't deter anything.

MR WINTER: That's exactly the problem. It's the lack of market signals around you will be hunted down if you do break the rules in this regard. That's what encourages that pre-insolvency adviser space that's exactly how they arbitrage the opportunity.

DR MUNDY: I know that you are intending to make a further submission. Could you cover that issue of incentives, both in terms of penalties and others, for us? If you could also perhaps provide us any information you can on the record in relation to the costs of small liquidations.

MR WINTER: We're in the process – we have somebody who's engaged to actually do that quantitative work.

DR MUNDY: The other thing I think which we haven't got time to tease out today is with some precision what could be streamlined to facilitate small liquidations and how we might, in doing that, make sure that we don't inadvertently create an out for phoenix obligations.

MR WINTER: Indeed, we will.

DR MUNDY: Thank you very much for your attendance and the support that you've provided to date. These hearings are adjourned until half past 1.

ADJOURNED

[1248]

RESUMED

[1335]

DR MUNDY: I reconvene these proceedings of the Commission. We'll now have the next witness. Could you please state your name and the capacity in which you appear?

MS STYLIANOU: My name is Vicky Stylianou. I'm with the Institute of Public Accountants and I'm the executive general manager of advocacy and technical.

DR MUNDY: Thanks, Vicky. If you'd like to make a brief opening statement and then

we'll ask you some questions.

MS STYLIANOU: Thank you, and thank you for the opportunity to come to the hearing today. The Institute of Public Accountants, which I'll call the IPA, has made a submission to the inquiry. We've looked at the draft report. We haven't looked at all 480 pages of it. But we are planning to make a further submission and I believe the deadline is 3 July. But just in response to a few of the things we've looked at in the draft report, I think overall, in general, most of the things that are relevant to us and that we've looked at in our submission initially we're pretty much in agreement with.

I suppose for us one of the main areas that we would be looking at a little bit more closely is around access to finance. I should say also that the IPA – our submission and the IPA in general, we look at policy very much from the perspective of small business SMEs. That's because about three-quarters of our members are in that space. So everything I say and everything that we submit is very much from the perspective of small business and SMEs. When we look at access to finance, we look at it from that perspective.

I think for us it's not just a case of whether or not small business SMEs can get finance, but it's also a case of the quality of that finance and the terms on which they get the finance. Even though I note that the draft report talks about there might be a funding gap but generally, it seems to us, that the draft report doesn't really think that there's a big issue there to be addressed. That, I think, for us, is probably the main part at which we might sort of diverge from the draft report. So I'm happy to talk about that a little bit more.

But, otherwise, overall, in terms of some of the other areas like regulation, innovation, we're more or less in agreement. So I can address those a little bit more as well. But, as I say, the main area that we've looked at is around access to finance. We think for us the main – I suppose just to sort of break it down even more is that we believe that small businesses and SMEs, especially those in the growth phase, should be able to access finance at a reasonable cost and of reasonable quality without, for example, having to resort to credit cards and risking their residence.

I note that there's been a lot of movement in this area. For example, we're now looking at crowd funding and I know there's draft legislation coming on that. There's a lot of other different types of finance that are sort of even coming to the Australian market. But I don't know if that's going to be enough. So what we've looked at is – and we've got a lot of evidence and we've looked at a lot of it – is whether that's going to be sufficient. You can't really say whether or not into the future that's going to be sufficient. But we think there's certainly a case for government intervention. Probably in our further submission that will be the main area we look at. Thank you.

MS CILENTO: Vicky, just on that, you do get conflicting feedback on this issue around access to finance. There's a lot of data that points to the fact that the vast majority of businesses do seem able to access finance, granted a fair bit of that is secured against various assets, including homes and the like. I think it would be useful for us, whether now or in your subsequent submission, to actually provide evidence of where you see that access to finance shortfall and the types of businesses, to the extent that you can describe them, that are finding that particularly challenging. There does seem to be a consistent theme for us, from what we've heard to date, that businesses which have a reasonable business case and a

reasonably well-articulated business case, on the whole, seem to be able to access finance.

MS STYLIANOU: We think that it really is a case of breaking it down, whether you're talking about particular sectors, particular sizes, also start-ups, whether you're talking about innovative start-ups, for example, that might have greater problems than more established businesses. We also look at what's called the discourage lending factor. We know that there's those who do apply for finance and we can look at those and assess those. But we think there's also a case to be made – and we've got some evidence that we can point to – of those that don't apply or are discouraged from applying. Also, even in terms of the data, whether you look at it including those who do access credit cards or do access sort of the residential loans.

So we think that there's certainly a lot more to be looked at once you keep breaking it down. I suppose also our concern is around those that might be called innovative start-ups, not necessarily always around technology, but quite often that's the case. If you put it together with sort of the innovation agenda where we do say that we need to encourage innovation – and I know the government has got its innovation strategy agenda. But when you put those together with the innovation site and the start-ups and small businesses that are trying to access reasonable finance in that space, then there seems to be a gap.

MS CILENTO: There's an interesting split even amongst the sort of more innovative businesses as well. I'd be interested in the sort of feedback you're getting from the businesses that you've engaged with. I mean, my take on what we've heard from the sort of start-up innovative entrepreneurial businesses is there only seems to be two camps. Everyone's keen for more money.

MS STYLIANOU: Yes.

MS CILENTO: But there's sort of different arguments and suggestions put forward. There seems to be one camp which is suggesting that it's unrealistic almost for innovative businesses to necessarily have fully worked up business models and they are by definition blue sky businesses and that the financial system as it exists is ill-equipped to do the due diligence on them and to fund them accordingly.

There's another camp which acknowledges the challenges and the blue sky nature but, nonetheless, still argues that having to go through these rigorous processes, having to define a business model, having to actually look at and define a source of value creation actually is not a bad thing. If that's what's required to get funding, then that's a precursor to success in the end anyway. So what are you hearing in terms of that sort of spectrum of where people's experience is and what their expectations are?

MS STYLIANOU: What we're hearing is that in Australia definitely in terms of accessing bank finance that's not an issue. But a lot of the businesses that are quite innovative that don't have that track record may or may not have that worked up model. It really depends on what it is that they're trying to bring to market. So what we're hearing is that – and this is based also on sort of our membership as well and some of the research that's been done through Deakin University as part of our partnership – is that there's still a gap. Because I think in Australia there's not a well-developed market around venture capital and business angels, that there isn't that fallback position, whereas in other jurisdictions like the US/UK,

there's a lot more of that sort of other finance market.

Certainly in terms of Australia, it seems to be a preference for debt finance rather than equity finance. But certainly what we're hearing is that there are issues. And I know we've looked at some of the research as well. There does definitely seem to be two sides of it. But I think it also depends on how far you drill down and what sort of businesses you look at. But certainly in terms of some of the tech start-ups what we're hearing is that there are still problems trying to get finance. That's why it seems that some of them – and there's a lot of anecdotal evidence on this as well – are going to places like the US and the UK where there seems to be that more mature market around venture capital and business angels and the like.

MS CILENTO: Is that a problem if they're accessing VC out of the US, which often comes with expertise as well?

MS STYLIANOU: Not necessarily from that perspective. But it also depends on whether we as a nation are losing that innovation or that business or that commerciality.

DR MUNDY: So the issue is not financing it, it's the issue of where the business is located. It's the same argument that could be used for supporting the car industry, for example.

MS STYLIANOU: Yes. I suppose the argument is if they go to the US to access their finance, does that mean they stay in the US? Does that mean that the benefit of that business and the commercialisation comes back?

DR MUNDY: Lots of infrastructure companies in Australia borrow lots of money in the US private placement market. I haven't seen Melbourne Airport moving to the US.

MS STYLIANOU: Yes, but they might come back here. But some of those very small ones may not come back here. For example, in the UK because of the Fintech industry that's really, really sort of starting up and really generating a lot of business and interest in London, there's data that shows a lot of the French companies or the French tech start-ups – and we're talking about the small companies that are likely to stay overseas – have moved to the UK. So what we're hearing is that that's a bit of an issue.

MS CILENTO: Infrastructure VC arguments or for taxation?

MS STYLIANOU: Accessing finance. It's all sorts of stuff, but also there are some very useful sort of tax incentives in the UK. They've got their patent box so that if you – there's a lower tax rate on income that is generated from certain patented products. That's done deliberately to try and attract sort of more business. At the moment, with especially things like Fintech, there's hubs that have sprung up all over the world, including now in Sydney – Chalk and Stone or Stone and Chalk, whatever it is – Stone and Chalk has sprung up in Sydney.

So there's all these hubs all over the world that have sprung up trying to attract all these sort of high-tech start-ups. I suppose the argument for Australia is that if we can't compete in that market – and certainly finance is a big part of it – then those highly innovative businesses will move to wherever they can get whatever it is that they need, whether it's

expertise, tax incentives, whatever. And finance I think is part of that mix.

DR MUNDY: But in a lot of ways I mean this is – there is a long literature about the location of businesses dating from north or 1950. Really a lot of what you see here is well, where would you expect to find the Fintech sector? Well, probably in the city of London, probably in New York. I suspect if we bothered to look where these Fintech businesses are in the US we'd find they're in New York and Chicago.

MS STYLIANOU: Yes, there are.

DR MUNDY: So there are natural economic reasons in large jurisdictions which have these tax – now, these Fintech businesses aren't moving to Birmingham in the UK. They're locating in London. I suspect there's a few of them clustered around the life insurance industry in Edinburgh. So the mere fact that they're going is where they should arguably be. But I guess – I mean, what we've been hearing is we have heard very little, very, very little, from start-up businesses and those who invest in them about tax, other than in relation to employee share schemes.

But I guess the question – and it boils down to this: is that what's the policy solution? You suggest some sort of a credit guarantee scheme. This isn't credit, of course, is it? It's equity.

MS STYLIANOU: There's different types of schemes.

DR MUNDY: Let's talk about equity because I don't think any reasonable person would argue that high-tech start-up businesses should be solely debt funded. So I guess the question is, if the not equity has been allocated to these businesses by the private sector, why do you think the government would be a better judge and manager of risk? Or is it just the old the government can diversify every risk in the economy, so it should pull it on to the consolidated revenue?

MS STYLIANOU: We point to very much overseas experience. Australia is one of the few developed countries in the world that doesn't have such a system. I think the fact that in Australia we don't have a mature VC market or a mature BA market that there seems to be even more reason – more of a gap, if you like, for something like a partial credit guarantee scheme to be introduced. I mean, there is evidence – and we'll put it into our submission – that government guarantee schemes have had positive effects in other countries. So we're saying that in the absence of – and let's even look at let's say tax incentives, R&D tax incentives. Are they adequate in Australia? We'd say no.

But if you put it all together we'd say that there is definitely a need to have one. There is evidence that we can point to overseas where they have been successful. We're saying okay, we recognise the fact that in Australia we may not have the right conditions, the government might not be in a position to have the sort of scheme – elaborate sort of scheme that we'd like. But we're saying we should consider it, at least on a partial basis. We do note that the Labor Party, the Australian Labor Party, has put that forward as one of their policies.

DR MUNDY: I should declare at this point that I'm a member of the Australian Labor

Party. I guess in coming back to us on the evidence that you cite, our view of the evidence is that it's inconclusive. We make that point very clear. So it would be helpful to us not only for you to further expand on the merit of the evidence that you cite but the inadequacies, if any, of the evidence which we have cited to the contrary.

I guess the other thing that we would be interested in knowing is what sort of scheme – you now talk about a partial credit guarantee scheme. It would be helpful for us to know, for example, what sort of activities that would/wouldn't cover. Would it cover a person setting up a trading consultancy business? Would it cover someone taking out a Jim's Mowing – I mean, what would it cover? From that then what would the estimated cost of that scheme be to the Commonwealth?

The Commission looked long and hard at credit guarantee schemes for private infrastructure investment – and we found that there was no case. Even though the fact that these schemes are popular overseas is not – many countries don't have dividend imputation. In fact, very few did, yet we seem to think in Australia dividend imputations is a really good idea and because not many other people – we're not about to drop it. Indeed, the New Zealanders would love us to extend our schemes. So I think I mean, our view on this issue of credit guarantee is really that there is no compelling argument. The academic literature is, quite frankly, all over the place.

It may well be that what's going on in those jurisdictions where it appears to have been successful is actually interactions with other policies. Indeed, there may be no additionality and all it is is a reflection of other policies or generics and indigenous circumstances like scale, like – there are reasonable amount of high-tech start-ups in the mining sector and a lot of them are in Western Australia.

MS CILENTO: We have looked very close at it and we're obviously very aware of the rapid expansion of programs in most developed countries in particular seeking to encourage high-tech, innovative, entrepreneurial Fintech – various labels – but those types of businesses. The things that we've been keen to explore and, quite frankly, we are still looking at closely include where these schemes have been adopted overseas, what are the characteristics that make them effective or not? What's the rationale for it from a public sector – public good argument. What makes these businesses so special? Where is the evidence of that in terms of – you would know the usual economic arguments. But high growth multiplicative employment creation, investment creation, knowledge spill-overs, all of those sorts of things. So that there's sort of the rationale but also what's the experience been in terms of the specific characteristics of the program and the environment in which they operate that have made them successful or not?

Because, as Warren said, the research we've looked at it sort of depends a little bit on which one you pick. For us, even if there's an argument, we've got to come at it from the perspective what's actually able to be implemented? Even if you can mount a case that says there's tremendous public good there, how would we actually go about implementing it? Buried in the 400-odd pages when we looked at government assistance our sort of preliminary results were that if government is involved in providing any assistance for such a dynamic area, that match funding of some sort makes sense because you're asking the business itself to demonstrate a bit of skin in the game, for want of a better description.

In some ways it's not different – there's some parallels with that partial loan guarantee. But we are a little bit sceptical about how that plays out and what is the value – what's the opportunity for government to really add value? Where's the argument to expend taxpayer dollars on that if it's really just duplicating something else? Again, it's this – whatever information you can provide about where people are really struggling to access financing where it would appear that they have a viable business model, which is then subsequently funded by overseas VCs, that sort of information would be very helpful.

MS STYLIANOU: I've asked Deakin University and Brighton University in England that's providing a lot of the information and a lot of the research for us to have a look at this in greater detail. Most of what they've been looking at as well is especially the English model and how that works and the successes or otherwise that they've had there. We've in our small business white paper looked at different parameters in terms of sort of the lending, the interest rates, et cetera, and how that would work, which is being developed at the moment. It's basically going to be ready for release in August. So we've looked at sort of the details of how it actually might be rolled out in the Australian context, borrowing heavily from the UK context and also the US context. So, yes, we can provide that in our submission.

MS CILENTO: Just a couple of other observations which might be helpful. We are being very careful about the evidence we take out of the US, given the availability of funding around some of the universities. So the philanthropic funds aren't enormous and so we are trying to take those as a particular exception that we don't feel applies to Australia.

The other observation which has been recently sort of presented to us is that one of the very aggressive countries in adopting these various types of schemes and providing government support in a number of ways is Singapore.

MS STYLIANOU: Yes.

MS CILENTO: In fact, they're actually backing away from that now because they almost feel they've created an industry onto itself. This is not trying to be critical. We are really struggling with this and when we talk to people – we spent a bit of time talking to people in Australia about this and we do get the occasional entrepreneur who just looks at us and says, "I've never met an entrepreneur whose first point of call in developing their business model is to get government assistance." So that's what we're trying to grapple with is how you make it – if there's an argument, what's the practical - - -

MS STYLIANOU: Yes, and we are also mindful of the dangers, especially something like pump priming. You don't want to be in a situation where the government does take over from the private sector. That's why we're saying it needs to be very carefully designed so that it's seen as kick-starting almost – given also that we don't have a mature VC or BA markets here for finance, but almost to like kick-start, not pump prime, not be seen as the alternative to the private sector and then sort of start to pull away. That's why we're saying, especially in the current environment, something like a partial scheme, even a trial partial scheme, we think would be a very, very good exercise and good from a public policy point of view.

Even if it was only to happen in a couple of states. So we would be looking at how that

could be done in the Australian context. But we are mindful that you don't want to be seen as taking over from the private sector. So we wouldn't be suggesting that kind of a scheme.

DR MUNDY: I'm regrettably old enough and have written my PhD on these sorts of issues to remember the Victorian Economic Development Corporation and the Western Australian Development Corporation. The language that you used is pretty similar to the language that was used then. So I certainly am very – as a young treasury officer in Western Australia had to attend to the winding-up of the WA Development Corporation. So best intentions are in issue. We might just move on.

MS CILENTO: Can I just ask, one of the other things that we pointed to in the report was the potential growth of PTP, so peer to peer lending. How do you see that or how do the organisations and businesses that you've spoken to seeing that as a likely source of future funding? What are they anticipating in the growth there and whether there's any barriers for them accessing that type of funding?

MS STYLIANOU: I think everyone's just waiting for it to happen. Even today there was – what's it called – Direct Money was in the media about the IPO. There's a great big news article today about the problems with it. So I think that it's something that everybody is waiting for. We've spoken to treasury about – PTP as a subset of crowd funding and the different sort of models within that. But I think everyone's just sort of waiting for it to happen because I think a lot of people are seeing it not as a panacea but as a bit of a missing link.

There are various people out there already accessing different platforms. There's the New Zealand model and the UK, et cetera and the US. We sort of – in terms of the recommendation in the draft report or the draft recommendation, I mean, we agree that – and we have spent a lot of time thinking about what sort of measures and protections would you build into the system. Given that we've spent so much time from a policy perspective around consumer protection in the financial services industry, that we would probably not want to necessarily go down the path of New Zealand. We'd want to have a few more protections in there, especially for the so-called mum and dad investors.

MS CILENTO: What sort of protections? So we're now talking crowd-source equity funding.

MS STYLIANOU: Crowd-sourced equity funding, whether it's caps on how much they can invest, whether it's looking at the definition of what a sophisticated investor might be, whether it's in terms of the whole – one of the questions a lot of people ask is around the due diligence. Who's responsible for doing the due diligence on the business? How much is it a case of people have to do their own research?

MS CILENTO: Just to interrupt, I'm sorry, but do you think crowd-sourced equity funding, financing is an appropriate thing for mum and dad investors?

MS STYLIANOU: This is the big question, I think, and this is what a lot of people we've spoken to are grappling with. You get a lot of examples like out of – well, again, I refer to the UK where there's a lot of, some might say, crazy ideas out there that people try to get money for. Some people are quite happy to invest in them. I don't think we've had any big

sort of scandalous, fraudulent sort of disasters happen yet. And I know some people we speak to are sort of waiting for something to happen and then there might be sort of a regulatory reaction to that.

But I think that's sort of the big question is how do you encourage peer to peer lending without sort of putting – making sort of – without it being too restrictive but at the same time having enough around consumer protection. I mean, how far do you need to go with the consumer protection. So that's something that, again, we're sort of looking at in terms of like what sort of parameters do you put around it.

MS CILENTO: There is a definition of sophisticated investors which exists.

MS STYLIANOU: Yes, I know.

MS CILENTO: So if you had reasons to think that that was not appropriate, that would be useful.

MS STYLIANOU: And I think that's one of the things that we're looking at is, is it appropriate in this particular sort of scenario or not?

DR MUNDY: I guess we're minded to make recommendations to that effect and we've already made draft recommendations to that effect. So we won't be waiting for the world to catch up with their thinking. We'll be making recommendations. So if you're able to give us a definitive view on our draft recommendations, that would be most helpful. I think the other issue is – the thing that struck us is this debt gap, which we think PTP lending might fill some of but probably not all of, doesn't appear to exist in other jurisdictions. So any views that you have as to why that is the case. It may well be structural in the finance system – might have something to do with the absence of non-bank lenders or small regional banks in the US and the UK.

But any views that you might have in that regard would be quite helpful. I'd just like to move on perhaps to some issues around government policy. I note in the notes that you provided to us that you don't agree with draft recommendation 11.1, which is about governments demonstrating – really a suggestion that governments need to exhibit some proper prudence around grant programs and the like. Your response sort of indicates that you think – I think we're a little bit at cross-purposes where you're saying that human capital is an important issue here. We accept that, so I don't want to debate that point.

But I just want to clarify. Do you think that the proposition set out in recommendation 11.1 are in fact wrong or not desirable or are you just making the point that human capital issues are important?

MS STYLIANOU: I think it was generally that we're making the point that the human capital issues are, we think, absolutely critical. And I'll have to have another look in particular. But I think it was more sort of a general comment.

DR MUNDY: Just to assist you, recommendation 11.1 says all governments should give priority to – governments can walk and chew gum at the same time. So give priority in what matters. Providing information, assistance, reviewing assistance programs. So you think

they're okay, it's just that you think talent is a more important issue. You don't think we shouldn't recommend government should do these things.

MS STYLIANOU: Sorry, just say that again.

DR MUNDY: I'm just wanting to make sure that you – with respect to recommendation 11.1, all we're saying is that government should do a range of sensible prudent administrative things. I'm just wanting to make sure you're not saying that they shouldn't do.

MS STYLIANOU: No, we're saying they should.

MS CILENTO: Can I ask one specific question. The only thing that we talk about removing is assistance to attract new business to jurisdictions. Do you have a view on that?

MS STYLIANOU: We don't necessarily sort of oppose that they should go according to different jurisdictions or even certain sectors, because I think there's – from what my understanding from the draft report is that you're saying that there shouldn't be assistance connected to certain industries or certain geographical areas. We're saying that if there is a case for that, then we don't see any problem with that.

DR MUNDY: So it's all right to pick winners.

MS STYLIANOU: Yes, well, and I know the Productivity Commission is very much against picking winners.

DR MUNDY: It has been costly to the national economy.

MS STYLIANOU: Absolutely. We look at car manufacturing and different things like that. But we're saying also that – we're not looking at specific examples but, conceptually speaking, I think that even if you look at past examples where it's failed, but we don't think that necessarily means you shouldn't be looking at future cases, that it should be a principle that necessarily is going to apply to everything in the future. For example, tech start-ups, hubs, Fintech hubs in Sydney, you might say well, that's – bearing in mind what you said earlier to us, that yes, that might be picking a winner. But we think that might be worthy of looking at. So a Fintech hub in Sydney, which would be in competition with a Fintech hub in Singapore and Shanghai and New York and London, is something that is definitely worthy at least of consideration by the government if the government was going to support something like that.

DR MUNDY: How do you reconcile the competitive neutrality issues where we already have Fintech businesses, incubators and so on close in Sydney funded with private money? Is it your view that the government should set up in competition?

MS STYLIANOU: Well, I don't think it's necessarily in competition. I think that it depends on the design of the program as well. If you have a program that's designed so that other businesses or other hubs or accelerators or whatever they might be, incubators, can access the program or the funding, then I think that sort of goes some way to overcoming that argument.

DR MUNDY: But if the activity is already being encouraged in Sydney, it's occurring without government assistance, why would you provide – and assuming that the IPA – and I know it does accept that the Commonwealth has limited fiscal resources and has made public statements about the size of the deficit – why would you provide money to support an activity that appears not only to have emerged but be growing at a relatively rapid rate as opposed to spending money on other things? I mean, put aside pensions and schools but say improving educational outcomes and those sorts of things. I mean, how do we make the decisions about scarce resources? Do we favour those generic economy-wide things around training which you're quite keen on and skills development, which I don't think we probably have objections in principle to? How do we prioritise that sort of expenditure with respect to essentially providing funding for activities where there will ex-ante be no evidence of additionality benefits?

MS STYLIANOU: Well, we wouldn't necessarily be promoting that if there's no evidence. But what we're saying is that there is evidence, and that's what we're going by.

DR MUNDY: And you will be able to provide us evidence that supporting Fintech is a preferable policy option to more generic economy-wide assistance for improving say STEM skills and all those other policy options that are relevant here. Is that the evidence you're going to adduce?

MS STYLIANOU: We're talking about innovation. Innovation might be Fintech, it might not be. We also support the STEM research, STEM school, STEM in schools, whatever. So we're not – I mean, in our submission we weren't necessarily going to pick winners as such. I use Fintech more as an example because it's something I spent a lot of time working on – as an example, especially when you talk about examples of innovative start-ups needing finance. That's why I was picking Fintech as an example of that, not that we're necessarily saying the government should go out and spend money on Fintech.

DR MUNDY: So any suggestions as how we might prioritise government expenditure between these policy options would be very helpful, because we are keen, bearing in mind that governments have limited resources. The other thing we briefly touched on – I don't propose to explore it here – is what thinking, if any, you have around what level of government is appropriate to be involved in both the funding and the delivery of these schemes? Because I think it's fair to say that there's a body of evidence that suggests that sometimes the states are better at program delivery than the Commonwealth.

MS CILENTO: I mean, if you're looking to overseas examples it certainly seems to be how the delivery of this assistance is evolving away from federal/national funding to more localised and not even state government but actually at the local sort of council or city equivalent. So any views on that would be useful.

DR MUNDY: You mentioned that businesses in Australia experience greater barriers to innovation with no one dominating. Putting aside obviously the human resourcing issue and putting aside the access to capital issue, could you just give us a sense of what the other big ones might be?

MS STYLIANOU: Yes. I think what we looked at was a whole range of things, not

necessarily things that government can have some bearing on, but things like the general economy, the state of the economy. Labour was another one in terms of access to labour. We did a regional road show of small businesses around the country and we spoke to about 500 different small businesses. Two things that kept coming up absolutely without fail everywhere we went was the lack of appropriate skilled labour and education and training. So definitely sort of general economic conditions as well, greater competition in the economy, rising costs, those sorts of things is something that we've talked about in our submission. But that's fairly spread out.

DR MUNDY: But you're not suggesting that increased competition in the economy is a bad thing?

MS STYLIANOU: No, not at all. We're just saying that those were some of the range of factors that people pointed to.

DR MUNDY: I note that environmental barriers – environmental regulation was seen to be the most significant barrier. And you can take this on notice. But is that – should that be taken to include issues around planning development and land use rather than strict sort of pollution offences or land clearing or harm to – quite frankly, the vast bulk of businesses in Australia wouldn't go within cooee of a threatened species. So I just want to – the Commission has done a lot of work in this space. If that's planning and development and zoning and building approvals, we've done a lot of work on local government regulation as well. If that's the case, then I absolutely understand. If it's issues around the EPBC Act and the protection of whales – I just want to clarify that.

MS STYLIANOU: I think it's the former.

DR MUNDY: I suspect what's happened when the survey people have done it is they've just grouped the responses.

MS STYLIANOU: Yes.

DR MUNDY: But I just wanted to check that because that is – and I think in the past at IPA functions I've made a point about local government regulation is actually really important.

MS STYLIANOU: Yes, absolutely, and it has come up time and time again, also especially in the regional areas. But, yes, I think it's looking at it more broadly.

MS CILENTO: Just looking sort of still on the regulation theme, you express sort of tentative support for the approach that we've outlined for how you might regulate disruptive new businesses. I was just wondering if you had particular concerns there or things that you might like us to be particularly attuned to.

MS STYLIANOU: No, I just thought it was an interesting one around – I mean, I agree and I think the IPA would generally agree that we have to be flexible with the way we regulate as a country et cetera, especially given some of the disruptive technologies, et cetera that are coming. But it was more a case of – and this is something that I think we will certainly consider in greater detail to see if there is something that we can contribute to that

point. I think it's going to be one of those sort of big issues is how do you regulate around some of these disruptive technologies.

Even things like, for example, the cryptocurrencies – because I noticed in terms of whether you have GST on them or you don't – what does that mean certainly in terms of how and where people might access cryptocurrencies. So I think it's just a really, really interesting issue and I think we will certainly see if we can contribute to that.

MS CILENTO: The GST issue is quite a specific challenge for that business model. The broader approach, just for your information, I think we're taking is actually not inconsistent with the comments you make about regulatory arrangements more broadly where you refer to identifying the minimum requirements to meet regulatory objectives. So that's sort of where we're coming at it. But if there's anything specific that you think is particular to small business that might cause angst, that would be useful for us to know.

DR MUNDY: Because I guess the – if you make some notes – you make an observation about including the prevention of rent seeking. Well, it seems to us that most of the objections that are arising are actually precisely people protecting existing rents that are bundled up in regulatory systems. That's not to say that the regulatory systems weren't put in place at a time for a good reason or that people have acted in some sort of deliberate rent-seeking way. But it's really I think an – what we're trying to get at here is ideally there should be robust regulatory reviews all the time and these problems wouldn't emerge. But we're trying to deal with circumstances where a new technology emerges. Passenger transport and accommodation seem to be the two – because we are very mindful that a lot of this technology is not disruptive. In fact, the vast bulk of it isn't.

So we're just keen to sort of understand – and we've spent a fair amount of time trying to think through a structured process which would enable really consumers to gain access to the benefits of this technology quickly. Also, I guess what we have in the back of our mind – and we'd be interested in your views on this – is that there is a risk that if the consumer cannot get access to that technology quickly, the business might not proceed and that technology might be lost to the consumer. So there's a degree of irreversibility here which is I guess not that dissimilar analytically to the old problem of what happens when you flood a valley with a dam. The valley is gone.

MS STYLIANOU: Yes.

MS CILENTO: I think that was about it from me.

DR MUNDY: Thank you very much for coming along and we very much look forward to your submission in the fullness of time.

MS STYLIANOU: Thank you very much. Thank you for your time.

DR MUNDY: That exhausts our witness list for today. I understand there might be someone in the audience who wants to make a brief statement. So if you could please come to the front and grab a seat, any seat. Now, before I do this, I give this warning as a general proposition. Any comments you make to the Commission are not privileged in the sense that there is no protection from defamation in evidence given to the Commission. It is our

preference that you don't name individuals or firms. I've got every confidence in people but sometimes people get – so if you could state your name and the capacity in which you appear.

MS BROWNLEE: Sure. My name is Jo Brownlee. My business name is Future Perspective. I am pleased to be following on the previous lady in that I am one of the micro-businesses and do work with micro-businesses. So rather than being industry representation level, it's the real local experience. My submission, although I didn't read it word for word before I walked in the door – it had a couple of themes – there was an aspect around funding and one of the points I was making was about superannuation and opportunity to provide funds. That sat complementary to but not compete with government funding. I note the very strong statement that was made in the relevant chapter. So I understand that there's just not return on investment in there.

But, nonetheless, I do still very much wish to pursue the funding opportunities for business. My main focus is chapter 11. I also wish to make comment on the structure of the business versus – the size of a business versus its numbers of years in operation in that I work in an interesting space. I do work around tech and innovation as well as I do have experience coming out of – the bulk of my employment is actually out of the public sector. So I understand the policy side of it as well as working with the small businesses.

I very much turn from a personal perspective – I very much would encourage the disconnection between micro-businesses needing to put their personal assets on the line. So that's just very much from a personal perspective. I didn't actually intend to make any submission, otherwise I would have put my name on the list. But because of the nature of how you're conducting this, I actually feel confident enough to do so. So thank you for that.

My summary point is actually about the content of chapter 11 versus the tone of the recommendations in chapter 11. I don't feel that the entrepreneurial innovative assistive vibe that comes through the text is actually reflected into the recommendations. The recommendations, to me, read more formally and more fell into that normal government tone of absolutely yes, we need good governance around any funding because it is public money but it felt to me that the recommendations left off that support that was coming through, particularly from page 255 onwards in the chapter.

An example of that is box 11.9. That's titled "The Necessary Conditions for Government Assistance". If you were seeking an example, I believe the state government's technology development voucher is indeed one program that does strike the right balance from the people who use the program in terms of it's nimble but it does seem to support those businesses at that very early stage in their idea or more than an idea but in their business model, which is that step before you've got that nice strong business case. It is actually that dilemma, the Catch-22 of if you can write up a good strong business case, you probably don't need the government support and vice-versa.

MS CILENTO: Can I ask the businesses that are accessing that particular voucher or funding, how much is it and what are they – is it sort of seed funding? Is it pre-development funding? Have you got any sense of how successful those businesses are in terms of actually still being in business a year or two after?

MS BROWNLEE: I probably don't have enough clients to say that I'm representing a sample. But in terms of the clients that I do work with, the businesses aren't necessarily brand new businesses and they're not necessarily by 20-somethings or 30-somethings. They may be 40 and 50 year old somethings, so who are employees elsewhere and are running their own business after-hours.

MS CILENTO: And they're tech-related businesses?

MS BROWNLEE: Yes, absolutely, in that whatever – as we're all struggling with the language, whether it be stem or innovation, whichever we want to call them. Yes, it's – so in terms of the Victorian technology development voucher program that we're waiting to be re-released since the change of governments in Victoria, that's a \$50,000 program. However, there are related – it's a suite of programs that if you present to government the scale of your problem and your solution and you align with the various product offerings that they have for you and, of course, if you fit their base criteria, there is money available.

One of the challenges, as written in my submission, is that the round-based funding in terms of it would be much more useful to businesses if it was an open round with no particular close dates, if the program was always open rather than waiting for round 1 every quarter, et cetera. I'll just refer to my notes so I didn't make my points. In regard to the recommendations, you made reference to recommendation 11.1 before and I'd like to do the same. There's a reference that the government should provide priority attention only where there is a market failure. I would hope that that really strongly language is toned down a little in that that would be the usual case. However, there may be other cases.

MS CILENTO: What would the exceptions be that you think would justify the allocation of taxpayer money?

MS BROWNLEE: I think the perfect example is the stage of the business idea or the business model. So it might be at that formative stage where you really need to turn it from – to use language from this morning – about the viability. If there's a set of support resources for the very early stage in order for the idea to be viable and is at a point of viability, that then it can move off into maybe - - -

MS CILENTO: Are you saying that even at a point of viability that those businesses are not finding access to finance elsewhere?

MS BROWNLEE: Let me just reflect on that. Well, I think in terms of the risk appetite for the money when we are talking about small businesses and the houses on the line, some are close to looking at their superannuation payments and their risk appetite is quite different to younger members in the same teams, et cetera. So the various different appetites even within the business, let alone in between the different businesses, is putting tension as to whether the team goes forward because of one director may be older than the others and have different concerns. I'll just leave it at that for the moment.

MS CILENTO: Yes, sure, okay.

MS BROWNLEE: So that was that one point. There is an example in the state government system where there was – for a particular program the government basically

funded the entire market opportunity, which is an interesting case in reverse in that there's a legitimate business sector out there but the state government wished to promote this type of business, this particular program. That's obviously a challenge too in the reverse. So when should it be private sector? But then, equally, when should government and why would government want to cover the whole of the market and then basically bring zero value to the qualifications and accreditation of those people who could do the work had it not been for the government paying for all. As you say, it's a totally complex model of exactly when to offer what money to whom. So I absolutely – it's not a one-size-fits-all.

DR MUNDY: Jo, are you going to make a submission in writing to us?

MS BROWNLEE: I could summarise basically my notes of today, if that's useful.

DR MUNDY: Yes. Because that would be helpful because we have colleagues in Canberra who are working on this sort of material. So it'd be helpful for them to have it in written form.

MS BROWNLEE: Sure. I don't have too many more things to say. Based on your comment earlier about London or New York and why not let the businesses go, equally, why not let them stay? When we're talking about families, we're talking about individuals who live in Australia, why can't we have those – I don't particularly align with the finance sector, but your example was the finance sector. Why can't we allow our techs to stay here, whether they be finance techs or innovation techs, et cetera?

DR MUNDY: I'm not saying that they should go but I guess the point is what if I have an absolute passion for the mining industry and I happen to live in the home counties of England? They're not going to set up there.

MS BROWNLEE: No, they're not.

MS CILENTO: I mean, the other point that we've picked up on a little bit too is that there is a bit of funding coming the other way and one of the challenges that inhibits the VC market here in terms of the ability to diversify and whatever else has been met, to some extent, by people coming – US money, for example, coming into Australia. It often comes with a number of directors that have quite useful experience. So even if a business stays here, the money – yes, the returns may eventually flow to the US but there is, it would seem, an emerging source of additional capital.

MS BROWNLEE: My experience also has even with businesses in – very capable businesses but in the very early stage where you may not be able to clearly define a product or a service to receive full say normal Westpac banking finance type experience that people are looking to the international venture capital funding and very much in the tech innovation space, but that is my experience.

DR MUNDY: And for the market for the product is – the domestic market isn't big enough than expanding - - -

MS BROWNLEE: Yes, and it depends where your product is too. Like if the innovation is – the natural market is a worldwide market, therefore why not go, because then you're

needing to align with the international regulations. So there is no barrier because you're already having to comply with those international regulations.

DR MUNDY: LookSmart and (indistinct) are two examples of high-tech successes coming out of Melbourne and only existed (indistinct) not with us any more, existed for a long period of time with offices here and in San Francisco.

MS BROWNLEE: Yes. The only final point that I wanted to make at this stage was that the comment about Singapore and there's an argument that they're actually funding in industry. I actually don't see a problem with that in that if the core business that's being supported is that innovative business and they're receiving some money and they get to advance their work and so long as it does have that evaluation-based criteria and it is delivering the spill-over benefits, et cetera, that even if you do then have the grant writers that sit around them, well, you might have one grant writer to 40 businesses and that may be a very good division of labour or an efficient division of labour.

MS CILENTO: My observation was actually their observation, that they now have businesses that are actually existing solely for the sake of receiving grants and haven't formed on a commercial basis.

MS BROWNLEE: So as long as they deliver the value, I hope, at the end and then I wouldn't mind - - -

DR MUNDY: But we have seen examples in Australia, particularly with banks, setting up whole edifices simply to extract money from government schemes.

MS BROWNLEE: I understand the point you're making. I'm not experienced in that, but I understand it. But if the government criteria makes sure that government is deriving value, does it matter? So I just challenge that in terms of if the value add is there, is that necessarily a problem in and of itself? Because we do need jobs and if that is a legitimate job that legitimately exists in the marketplace, so long as it delivers the value intended, I personally don't mind that approach.

DR MUNDY: Thank you very much, Jo. That's been particularly helpful. Thank you.

MS BROWNLEE: No worries.

DR MUNDY: These hearings stand adjourned until 8.30 am in the Masonic Centre in Sydney on 30 June.

**ADJOURNED AT 1434 UNTIL
TUESDAY, 30 JUNE 2015 AT 0830**