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Dear Charmaine,

### **Insolvency Law Reform Bill 2013**

The Australian Institute of Company Directors welcomes the opportunity to comment on the exposure draft of the Insolvency Law Reform Bill 2013 (the Bill).

The Australian Institute of Company Directors is the second largest member-based director association worldwide, with individual members from a wide range of corporations; publicly-listed companies, private companies, not-for-profit organisations, charities and government and semi-government bodies. As the principal Australian professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

#### **1 Summary**

The Australian Institute of Company Directors limits its comments in this submission to the proposal in the Bill to insert a new provision, section 206BB, into the Corporations Act 2001 (Cth)(the Act). Section 206BB sets out a new procedure for the disqualification of directors.

The Australian Institute of Company Directors recognises that the requirements for directors to provide reports and to deliver books and records to administrators and liquidators are an important part of the regime which ensures the orderly and efficient administration and liquidation of companies in Australia. However, even when the subject matter sought to be regulated is important we are of the view that the legislation must observe natural justice and procedural fairness. This is particularly the case when the provisions contemplated pose a serious risk to the reputation and livelihood of the individual. On this basis, we have a number of concerns about the proposed disqualification provision.

In summary our comments are as follows:

- (a) The current law has been careful to limit the circumstances within which directors can be disqualified from managing corporations.

- (b) The current law allowing the disqualification of directors recognises the serious nature of disqualification as a penalty and incorporates procedural checks and balances to promote due process and fairness to the individual.
- (c) However the proposed provision, section 206BB:
  - i) does not impose a penalty that is proportionate to the misconduct;
  - ii) extends ASIC's power to disqualify directors without the need to seek a court order;
  - iii) is not supported by evidence which identifies a systemic failure in the current requirements to regulate the misconduct;
  - iv) does not sufficiently consider procedural fairness; and
  - v) does not appropriately balance the power of ASIC with the rights of the individual directors.
- (d) Further, section 206BB only allows directors to apply to a Court<sup>1</sup> for an order overturning the disqualification *before* the disqualification period commences. If directors first learn of their disqualification after it has occurred (for example, by not receiving the relevant notices) a director would not have a right to apply to a Court after the period of disqualification commences. This mechanism lacks procedural fairness.
- (e) By proposing section 206BB, policy-makers have failed to appreciate the significance of disqualifying directors, even if for a temporary period.
- (f) We therefore recommend that the disqualification provision be removed from the Bill.
- (g) If, however, the government continues with the proposal to insert section 206BB into the Act, we strongly recommend that:
  - (i) an earlier opportunity be provided, including at the warning notice stage and the compliance notice stage for a person to write to ASIC, setting out why they have a reasonable excuse. This mechanism should be expressly provided for in the legislation;
  - (ii) ASIC should be required to apply to Court for a disqualification order, rather than requiring individual directors to apply to Court for an order overturning the disqualification; and
  - (iii) a disqualification period should not be able to commence when an application has been made to a Court seeking that the disqualification be overturned.

## **2 Background to the Proposed Reforms**

The Bill sets out measures designed to further the frameworks governing registered liquidators and registered trustees, rules for handling personal bankruptcies and

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<sup>1</sup> As defined by section 58AA of the Corporations Act 2001 (Cth)

corporate external administrations and the power of the corporate regulator to regulate the corporate insolvency market.<sup>2</sup>

Specifically, proposed section 206BB of the Act sets out a procedure for automatically disqualifying directors who fail to:

- provide a report to administrators, liquidators or controllers; or
- deliver books to administrators or liquidators.<sup>3</sup>

If the person fails to comply with the specified reporting and notice requirements in the Act, a warning notice will be issued by ASIC.<sup>4</sup> If the warning notice is not complied with, after 10 business days, ASIC can issue a compliance notice.<sup>5</sup> If the person does not comply with the compliance notice, the period of disqualification begins 45 days after the end of the compliance notice period.<sup>6</sup>

A person who fails to comply with the compliance notice may apply to a Court for an order at any time before the period for which the person is disqualified starts.<sup>7</sup>

The disqualification period may be up to three years unless the disqualified person:

- complies with the reporting requirement or the notice requirement and lodges a declaration of compliance; or
- reaches the end of the external administration to which the reporting requirement or notice requirement relates,

whichever is earliest.<sup>8</sup>

However, if the person has already been disqualified under this section on two or more occasions, the disqualification period will be 5 years.<sup>9</sup>

### **3 Disqualification of Directors**

The Act currently provides that directors can be disqualified from managing a corporation in certain limited circumstances. The ways in which disqualification can occur may generally be grouped into three main categories. These categories are discussed in more detail below.

#### **3.1 Automatic Disqualification**

The circumstances within which a director can be automatically disqualified pursuant to the Act are limited. This approach recognises the severity of automatic disqualification and predominantly reserves the mechanism for circumstances where the director has already been convicted of a serious criminal offence as determined by a court.

A person will only be automatically disqualified from managing a corporation under the Act where the person:

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<sup>2</sup> Explanatory Material, Insolvency Law Reform Bill 2013 (Cth) 3.

<sup>3</sup> Insolvency Law Reform Bill 2013, Schedule 2 (Further amendments), Part 2.

<sup>4</sup> Ibid s 206BB(2).

<sup>5</sup> Ibid s 206BB(4).

<sup>6</sup> Ibid s 206BB(6).

<sup>7</sup> Ibid s 206BB(10).

<sup>8</sup> Ibid s 206BB(7).

<sup>9</sup> Ibid s 206BB(8).

- is convicted (under the law of Australia or a foreign country) on indictment of an offence that concerns making decisions that affect the whole or a substantial part of the business of the corporation;<sup>10</sup>
- is convicted of an offence (under the law of Australia or a foreign country) that is a contravention of the Corporations Act punishable by imprisonment for a period greater than 12 months;<sup>11</sup>
- is convicted of an offence (under the law of Australia or a foreign country) that involves dishonesty and is punishable by imprisonment for at least 3 months;<sup>12</sup>
- is convicted of an offence against the law of a foreign country that is punishable by imprisonment for a period greater than 12 months<sup>13</sup> or is disqualified from being a director of a foreign company or being concerned in the management of a foreign company under a court order from a foreign jurisdiction that is in force;<sup>14</sup>
- becomes (under the law of Australia, its external territories or another country) an undischarged bankrupt or has executed a personal insolvency agreement;<sup>15</sup> or
- is at the time disqualified from managing Aboriginal and Torres Strait Islander corporations under Part 6-5 of the *Corporations (Aboriginal and Torres Strait Islander) Act 2006*.<sup>16</sup>

It is notable that where a person is automatically disqualified as a result of these provisions, the person disqualified will already have been afforded due process by other legislative or judicial means.

### 3.2 Court's Power to Disqualify Directors

The majority of the powers to disqualify directors, however, are entrusted to Courts.<sup>17</sup> Courts for example, may disqualify directors on application by ASIC for:

- a contravention of a civil penalty provision;<sup>18</sup>
- corporate failures relating to insolvency and the non-payment of debts;<sup>19</sup>
- repeated contraventions of the Act;<sup>20</sup> or
- a disqualification under a foreign jurisdiction.<sup>21</sup>

For a director to be disqualified pursuant to these provisions, ASIC must apply to the Court for a disqualification order. The Court as an impartial arbiter will then determine whether contraventions have been committed and whether disqualification is warranted. It is notable that ASIC must apply to the Court for such an order.

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<sup>10</sup> *Corporations Act 2001* (Cth) s 206B(1)(a).

<sup>11</sup> *Ibid* s 206B(1)(b).

<sup>12</sup> *Ibid*.

<sup>13</sup> *Ibid* s 206B(1)(c).

<sup>14</sup> *Ibid* s 206B(6).

<sup>15</sup> *Ibid* s 206B(3).

<sup>16</sup> *Ibid* s 206B(5)

<sup>17</sup> As defined by s 58AA of the *Corporations Act 2001* (Cth).

<sup>18</sup> *Corporations Act 2001* (Cth) s 206C.

<sup>19</sup> *Ibid* s 206D.

<sup>20</sup> *Ibid* s 206E.

<sup>21</sup> *Ibid* s 206EAA.

### **3.3 ASIC's Limited Power to Disqualify Directors**

The serious nature of disqualification as a penalty is reflected in the limited power currently granted to ASIC to disqualify a director of its own accord, without seeking a Court order. At this stage, ASIC is limited to being able to disqualify directors under section 206F of the Act if within a 7 year period the person has been an officer of two or more corporations and while an officer (or 12 months after), the company was wound up.<sup>22</sup> This section is designed to tackle fraudulent phoenix activity.

Pursuant to ASIC's power under section 206F of the Act, ASIC must give the person a right to be heard and can only disqualify a director if they are of the view that the disqualification is justified. Further, the director may seek judicial review of ASIC's decision.

In summary, the current law relating to the disqualification of directors reflects the severity of disqualification as a penalty given that it is used to punish individuals for serious wrongdoing and to protect investors and the public from those that have committed serious criminal offences. Prior to disqualification occurring, a series of procedural checks and balances is incorporated into the legislative regime to promote due process and fairness to the individual. This is particularly evident in provisions which require a Court to first determine whether a serious breach of the Act has occurred and whether disqualification is an appropriate penalty.

## **4 Extension of ASIC Disqualification Powers Proposed by the Bill**

The Australian Institute of Company Directors is of the view that proposed section 206BB is anomalous to the limited powers of disqualification currently set out in the Act and represents an unwarranted extension of the regulator's powers without stringent court supervision. Our basis for this view is set out below.

### **4.1 Gravity of the penalty must be proportionate to the misconduct**

As director disqualification has predominantly been reserved for punishing serious misconduct, it is not clear that the failure to deliver up books or provide a report, while important, is of the same gravity as the other offences or circumstances attracting disqualification (such as being convicted on indictment of a serious criminal offence).

We are concerned that providing ASIC with the power to disqualify directors of its own accord, for the director's failure to deliver up books and records or to provide a report is disproportionate to the gravity of the breach to which the penalty applies. We note that the disqualification contemplated would prevent a director from managing *any* corporation, not just the corporation for which the notice to provide a report or to deliver books and records applies. Further, we are of the view that the misconduct falls well below the circumstances required to be established before directors will be disqualified pursuant to other provisions of the Act (as set out above) and is an undesirable and unjustifiable extension.

### **4.2 No evidence pointing to systemic failure in current regulation**

Moreover, it is not apparent from the explanatory material that there has been a systemic failure of the current requirements to effectively regulate the provision of

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<sup>22</sup> Ibid s 206F(1)(a).

reports or the delivery of books to liquidators and administrators.<sup>23</sup> The explanatory material instead refers to ASIC's successful prosecutions pursuant to the relevant provisions.<sup>24</sup>

We note that no economic analysis or empirical evidence is provided to support the need for extending ASIC's powers in this manner. Extending ASIC's limited disqualification powers, without the support of evidence which shows a systemic failure in the effectiveness of the current provisions is concerning, given the long-lasting negative impact disqualification can have on a director's livelihood and reputation both locally and internationally.

#### **4.3 Procedural fairness must be observed**

We are of the view that proposed section 206BB does not meet an appropriate, or even a minimum, standard of procedural fairness.

##### *4.3.1 The provision should allow a reasonable excuse to be raised earlier*

As drafted, automatic disqualification would be based on ASIC's view of non-compliance without an express built-in legislative mechanism to allow the director to raise a reasonable excuse prior to seeking a court order.<sup>25</sup> Section 206BB provides that an individual may raise a reasonable excuse after they have failed to comply with a compliance notice but before the period of disqualification begins.

We are of the view that the legislation should provide an opportunity for a director to write to ASIC, setting out why they have a reasonable excuse at a much earlier stage, including upon the receipt of a warning notice and a compliance notice. This may have the additional benefit of preventing an unnecessary escalation in the issue and may avoid wasting the regulator's limited resources.

It is important to note that once the liquidator or administrator has been appointed to the company, the directors will no longer be overseeing the affairs of the company and will not be in control of the books or records on the company's premises. At this stage, a director will not have the same ability to compel officers or employees to provide books or to retrieve documents, so that they can be provided to the liquidator or administrator. Further, the documents requested by the liquidator or administrator may not exist or may not be in the director's possession which would suggest a reasonable excuse for non-compliance.

To avoid the need to seek a court order, there should be an express mechanism within the legislation to allow directors to raise a reasonable excuse at an earlier stage. Only in circumstances where the compliance notice has not been complied with or ASIC is of the view that the excuse is not reasonable, should ASIC then be able to apply to a Court to seek a disqualification order.

##### *4.3.2 ASIC should be required to seek a disqualification order from a Court*

We are firmly of the view that ASIC should be required to make an application to a court seeking a disqualification order before a director can be disqualified. Contrary to this approach, the proposed section 206BB provides that ASIC, rather than a Court, will be able to disqualify directors and the individual must apply to a Court to have the disqualification overturned. We are of the view that placing such a burden on an individual is inappropriate, excessive and fails to appreciate that the costs of seeking a court order may be prohibitive for an individual.

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<sup>23</sup> Explanatory Material, Insolvency Law Reform Bill 2013 (Cth) 30-31.

<sup>24</sup> Explanatory Material, Insolvency Law Reform Bill 2013 (Cth) 31

<sup>25</sup> See Insolvency Law Reform Bill 2013 cl 21, s 206BB(9-10).

In the majority of circumstances ASIC will have greater access to resources and legal advice in making a court application, compared to that of an individual director (particularly a director of a small business). This imbalance raises concerns as to the fairness of subsection 206BB(9) which places the burden of making a court application on the individual director.

We re-iterate that if ASIC is of the view that a director has committed a serious breach of the Act, the legislation should require ASIC to apply to a Court to prove the breach and to show that a disqualification order is warranted. The proposed provision, section 206BB fails to do so.

As such, we are firmly of the view that ASIC's power to disqualify directors should not be extended. Disqualification is a serious penalty for misconduct and should remain as far as possible, an order that can only be made by a Court. This ensures that individuals have the opportunity to be heard and will not face serious penalties or the loss of their livelihood without due process being observed.

Further, we are of the view that a disqualification order should not be made until a Court (as an independent and impartial decision-maker) has considered all relevant evidence to support a finding that a serious breach has occurred and until a Court concludes that disqualification is the appropriate penalty having regard to the circumstances of the case. It does not sit well with the principles of natural justice for ASIC to be able to disqualify directors from managing corporations based solely on ASIC's view that there has been non-compliance with the relevant provisions of the Act.

#### *4.3.3 The disqualification period should not be able to commence when an application is before the Court*

We note that as drafted, the disqualification period commences (subject to a *court order* under subsection 206BB(10)) 45 business days after the end of the compliance notice period. It is conceivable that a person may seek a court order under subsection 206BB(9) and for the matter not to be heard and determined within the 45 day period. Under these circumstances, and because a court order has not yet been made, a person could be automatically disqualified even when the matter is before the Court. This mechanism lacks procedural fairness and natural justice given the severity of disqualification and its impact on the individual's livelihood. As set out above, a person would be disqualified from managing *any* corporation as soon as the disqualification commences. Although we are of the view that ASIC should be required to apply to a Court for a disqualification order, even if the proposed procedure is retained, no disqualification should be allowed to commence if an application has been lodged with a Court seeking to overturn the disqualification.

#### *4.3.4 The individual should have the right to apply to a Court at any stage*

As drafted, section 206BB provides a limited ability for a director to apply to a Court. This is because the director can only apply to a Court for an order *before* the period of disqualification begins.<sup>26</sup> If for some reason, the person is not aware of the disqualification (for example by not receiving the relevant notices) and the disqualification commences, the director would be prevented from applying to a Court to have the matter independently determined. Although we are of the view that ASIC should be required to apply to a Court for a disqualification order, if the

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<sup>26</sup> Insolvency Law Reform Bill 2013 cl 21, s 206BB(9).

proposed procedure is retained, an individual should have a right to apply to a Court to have the disqualification overturned at any stage.

We hope that these comments will be of assistance to you. If you would like to discuss any of our views, please contact me or Leah Watterson on (02) 8248 6600.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'John H C Colvin', followed by a horizontal line extending to the right.

John H C Colvin

Chief Executive Officer &  
Managing Director