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Dear Sir/Madam

Insolvency reforms to support small business

Thank you for the opportunity to consult on the reforms proposed by the Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (A Bill for an Act to amend the law in relation to insolvency, and for related purposes).

1 Introduction

This submission is made in my capacity as a Registered & Official Liquidator. I have been a Chartered Accountant and a Member of the Australian Restructuring Insolvency and Turnaround Association (ARITA) for almost 20 years and I continue to be a member in good standing of both organisations. I have worked exclusively for, or as, an Insolvency Practitioner since 1994 and was registered as a Liquidator in 2006.

Having worked with all Corporate Insolvency reform since the early 1990's, I believe I am qualified to comment on the Bill which is said to enact "the most significant changes to the Australian insolvency framework in almost 30 years."

2 Objectives of the reforms

The Government contends that:

"The insolvency system is facing a number of challenges:

- An increase in the number of businesses in financial distress because of COVID-19.
- A 'one-size-fits-all' system, which imposes the same duties and obligations, regardless of the size and complexity of the administration.
- Barriers of high cost and lengthy processes that can prevent distressed small businesses from engaging with the insolvency system early, reducing their opportunity to restructure and survive."[1]

The reforms are further said to compliment the measures of the Coronavirus Economic Response Package Omnibus Bill 2020 (and extended by the Corporations and Bankruptcy Legislation Amendment (Extending Temporary Relief for Financially Distressed Businesses and Individuals) Regulations 2020) which have reduced

[1] Australian Government fact sheet "Insolvency reforms to support small business" - September 2020.

the number of companies that have gone into external administration over the period from March to July 2020 when compared with the same period last year.

The temporary safe harbour relief against insolvent trading and the increase in the time and amount for which creditors can enforce a statutory demand has not avoided insolvencies, they have merely been delayed.

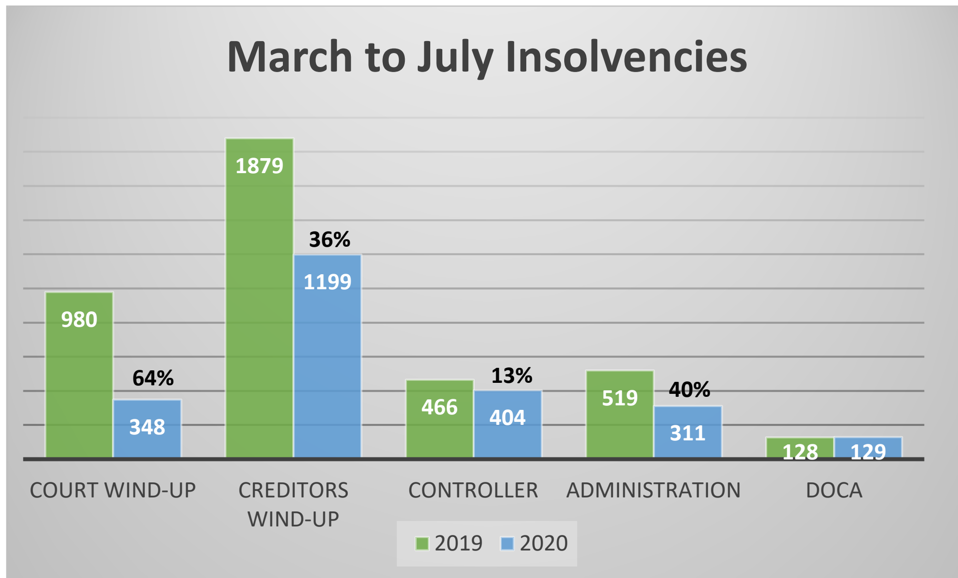

Figure 1 - ASIC Insolvency Statistics Series 2 – Types of insolvency appointments

For relief of the insolvent trading provisions under subsection 588G(2) to apply, Section 588GAAA requires in subsection (1)(c) that the debt has to be incurred "before any appointment during that period of an administrator, or liquidator, of the company." (One assumes that as part of these reforms this temporary measure may be expanded to include a Small Business Restructuring Practitioner.)

Approximately 50% of the reduction in the number of Liquidations were court initiated. The proposed Simplified Liquidation Process ("SLP") applies only to creditors' voluntary winding ups.

Submission 1

If the Government is serious about facilitating the ability of directors to proactively pursue workouts and reducing the stress on the system due to the inevitable catch up of insolvencies, consideration should be given to:

(a) A more permanent extension of the time for which, the increase in the monetary amount and time to enforce statutory demands (allows more time to pursue informal workouts); and

(b) Extending the period of and removing the requirement that relief from insolvent trading is only obtained once an insolvency practitioner is appointed (gives directors certainty to pursue a workout); and

(c) Extending any SLP to include court-initiated liquidations (reduce cost of assetless administrations).

3 Process of the reforms

It is virtually impossible to consider all the implications of the proposed reforms or for that matter the practicalities of how to implement them, without the majority of the legislation (which is to be released later in the form of regulation).

The Government contends that due to present circumstances there are compelling reasons why much of the legislation should be made through regulation for example:

"Issues may arise that were not contemplated at the time of drafting because the debt restructuring process is a new regime. Further, because this new regime has been developed in response to the significant and continuing economic consequences of the Coronavirus, there is greater than usual need for the Government to be empowered to deal with unintended or unforeseen consequences, particularly those that risk undesirable outcomes for companies and creditors."[2]

This approach, while expedient, has the potential to leave us with a system that never achieves its objectives, quickly becomes redundant and further complicates insolvency practice for many years.

Submission 2

Consideration should be given to enacting a sunset date in the legislation say, for its automatic repeal in two years' time (or at the very least a review mechanism) to allow for the possibility that the legislation will not achieve its objectives.

4 Debt Restructuring

The last comprehensive report on a review of Australia's insolvency laws was published in 1988 by the Australian Law Reform Commission (ALRC Report No. 45 commonly referred to as the Harmer report).

There were a number of principles outlined in the Harmer report which were considered necessary to guide the development of insolvency law. To cite just a few:

- *"The fundamental purpose of an insolvency law is to provide a fair and orderly process for dealing with the financial affairs of insolvent individuals and companies; and*
- *An insolvency administration should be impartial, efficient and expeditions; and*
- *The law should provide a convenient means of collecting or recovering property that should properly be applied toward payment of the debts and liabilities of the insolvent person; and*
- *The principle of equal sharing between creditors should be retained …"; and*
- *Insolvency law should, so far as it is convenient and practical, support the commercial and economic process of the community.*[3]

The haphazard manner in which law reform has developed since 1992 has seriously undermined the integrity of the system (as envisaged by Harmer) and confidence in the impartiality of Insolvency Practitioners. Now, more than ever, Insolvency Practitioners are heavily regulated, face increasing costs of doing business and are consistently pitted against debtors' and creditors' and members' competing interests.

The principles of equal sharing and efficiency have been steadily eroded via such measures as (to name just a few):

[2] Paragraph 1.135 Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 - Exposure Draft Explanatory Materials
[3] Page 15-16 ALRC Report No. 45, 1988

- The Introduction in 1993 of the Director Penalty Notice ("DPN") regime in the Taxation Administration Act 1953 for PAYG withholding; and
- Corporations Law Amendment (Employee Entitlements) Act 2000; and
- The General Employee Entitlement Redundancy Scheme ("GEERS") (circa. 2000) and the later the Fair Entitlement Guarantee ("FEG") Act 2012; and
- The Personal Property Securities Act 2009; and
- Corporations Amendment (Insolvency) Bill 2007 (mandating employee entitlement protection in DOCA's and streamlining Creditors' Voluntary Liquidations); and
- Tax Laws Amendment (2012 Measures no. 2) Act 2012 (extending the DPN regime to include the Superannuation Guarantee); and
- The Insolvency Law Reform Act 2016 (Introducing further reporting obligations and enhancing powers of creditors and members); and
- Treasury Laws Amendment (Combatting Illegal Phoenixing) Bill 2019 (extending the DPN regime to include Goods and Services Tax ("GST")).

Arguably the collective reforms have not had a major impact on the number of DOCA's that are accepted by stakeholders, but they have had a significant effect on the ability (or desire) of companies to avail themselves of the VA process and have limited the available options.

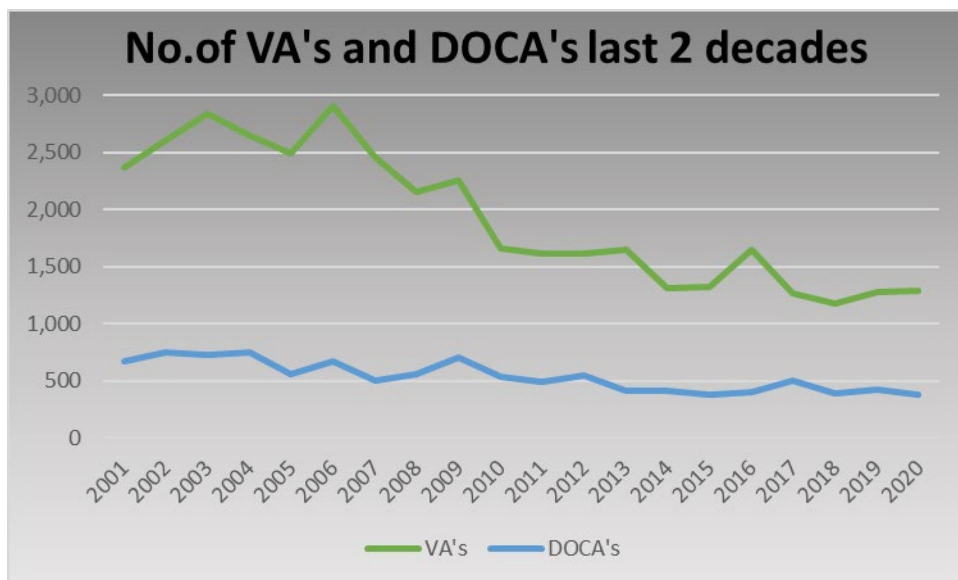

Figure 2 - ASIC Insolvency Statistics Series 2 - VA and DOCA appointments (FYE 30 June)

The Government proposes introducing a small business restructuring framework which it has largely modelled from the Voluntary Administration ("VA") process in Part 5.3A of the Corporations Act 2001 (*Cth.*) ("the Act").

The objective of Part 5.3A is to provide for the business, property and affairs of an insolvent company to be administered in a way that:

(a) Maximises the chances of the company, or as much as possible of its business, continuing in existence; or

(b) If it is not possible for the company or its busines to continue in existence – results in a better return for the company's creditors and members than would result from an immediate winding up of the company.[4]

The objectives of Part 5.3A is crucially important at a practical level to the VA process and any Deed of Company Arrangement ("DOCA") because it provides the "yard stick" by which the practitioner and/or a Court can test whether a proposal is equitable.

The Governments Fact Sheet on the Insolvency reforms to support small business sets out a succinct overview of the proposed process.

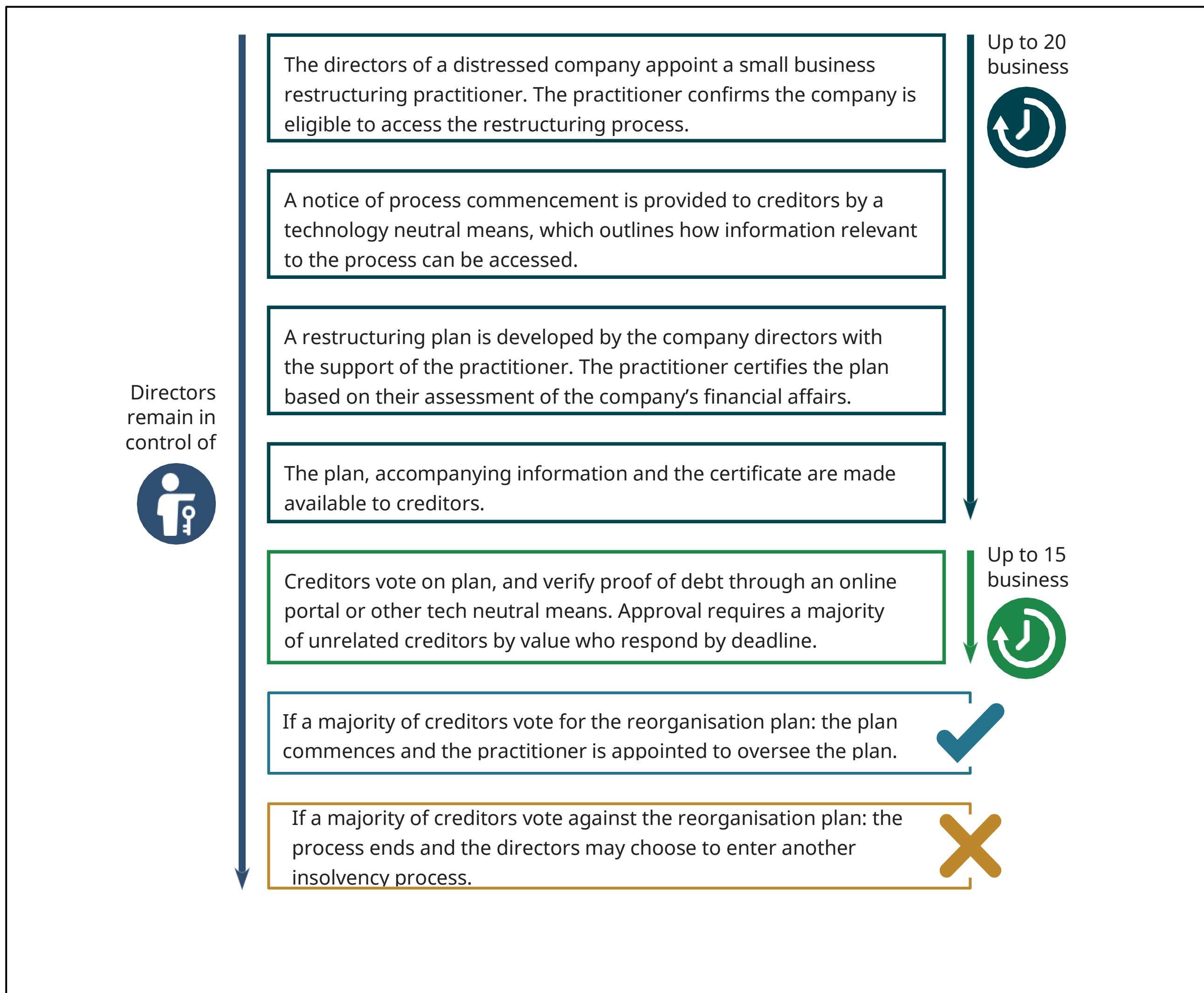

Figure 3 - Government Fact Sheet – Overview of the new restructuring process

The objective of the proposed Part 5.3B – Restructuring of a company, is defined by Section 452A and that is to provide for a restructuring process for eligible companies that allows the companies:

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[4] Section 435A Corporations Act 2001 (*Cth.*)

(a) To retain control of the business, property and affairs while developing a plan to restructure with the assistance of a small business restructuring practitioner; and

(b) To enter into a restructuring plan with creditors.

With respect, and noting the objectives of Part 5.3A, there is no legislative "yard stick" against which a practitioner or a Court can decide whether what is being proposed is equitable and/or on the whole in the best interests of all stakeholders (For example. Section 453P Winding up company and adjournment of hearing).

In essence, anything goes and should be recommended. The only deciding factor is whether creditors voting for a proposal, accept it.

This puts a practitioner in the unenviable position of having to guess what may or may not be acceptable to creditors and, more likely than not, creditors will complain that the proposal is not good enough and directors will blame the practitioner when it doesn't succeed. Particularly in the case where, unlike a Voluntary Administration, it does not appear that creditors have the opportunity to replace the SBRP (i.e. as under Section 436E of the Act).

Submission 3

Consideration should be given to amending subsection 452A(b) to provide that the objective of the part is to ensure that it "results in a better return for the company's creditors and members than would result from an immediate winding up of the company".

To be eligible to enter the process under the proposed section 453C no person who is a director of the company or has been within the preceding 12 months can have previously used the process or a SLP. The Explanatory Memorandum notes that is an important safeguard and an anti-phoenixing measure.

This measure seems inconsistent with the objectives of the process unless they have purely been designed as a once off anti-COVID measure. There are adequate safeguards in place to prevent abuse of the system because creditors have the ultimate say on whether or not to accept a proposal.

The above measure will also add administrative cost to the process, requiring a practitioner to verify eligibility by undertaking costly ASIC historical personal director extracts.

Submission 4.

Consideration should be given to allowing a director to avail themselves of the SBRP on more than one occasion.

While a company is under restructure the proposed section 457B requires that the company must set out in every public document etc. the expression ("Restructuring Practitioner Appointed"). This is inconsistent with the objectives of Part 5.3B and in my view places undue emphasis on the role of the SBRP and is likely to lead to the assumption that he/she has greater power than the supervisory role envisaged.

Other than the requirement in 457B it is also unclear as to what other public notifications may be required. I.e. Will advertisements of appointment, voting on a plan, execution of a plan have to appear on the Published Notices Website and will a plan be lodged with ASIC. All of these come at a cost.

Submission 5

Consideration should be given to amending section 457B to ("Under Part 5.3B Restructure") or "(Under Restructure") to emphasis that control of the company in the ordinary course of business does not rest with the SBRP.

Finally, I will note that actual or imminent insolvency is not conducive to undertaking a successful restructure which, generally requires a strong balance sheet or access to additional equity. Strategies that involved merely "parking debts" to be paid off out of future profits were a feature of many DOCA's in the early 1990's and proved largely unsuccessful.

Submission 6

Directors of an eligible small business are ill equipped to deal with the competing interests of stakeholders in an insolvency administration. As a consequence, there is likely to be significant reliance on the SBRP to deal with PPSA and other creditors. Moreover, given the terminal nature of an appointment (section 455A - a company is taken to be insolvent if it proposes a plan) there are considerable professional risks in accepting such a role.

Further, noting the modified definition of Section 553 – Debts or claims provable in winding up there is a real risk that prior to the restructuring plan being implemented creditors' positions can deteriorate with no recourse other than to prove against the company.

Accordingly, I do not see any significant cost or other benefits in adopting the SBR process that are not already offered under Part 5.3A of the Act. I do not accept the Governments assertion that exiting services are unavailable to small business due to cost.

5 Simplified Liquidation

The Government is proposing a simplified liquidation process for the purpose of winding up the affairs and distributing the property of a company in a creditors' voluntary winding up.

Its intention is *"to supplement the 'one–size-fits-all' liquidation regime with a regime that has appropriate pathways for less complex liquidations, in particular for incorporated small businesses. By reducing complexity, time and costs in the liquidation process, the simplified liquidation process is intended to ensure greater returns to creditors and employees."*[5]

The Government contends that the process as proposed will be cheaper and more efficient because of the following key modifications:

- *"Reduced circumstances in which a liquidator can recover an unfair preference payment from a creditor that is not related to the company; and*
- *Only requiring the liquidator to report to ASIC (under section 533) on potential misconduct where there are reasonable grounds to believe that misconduct has occurred; and*
- *Removing requirements to call creditor meetings and the ability to form committees of inspection; and*

[5] Paragraph 3.3 Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 - Exposure Draft Explanatory Materials

- *Simplifying the dividend process (where creditors receive a return proportionate to their debt) and the proof of debt process (where creditors provide information as to the debt they are owed, which is assessed and accepted or rejected by the liquidator); and*
- *Maximising technology neutrality in voting and other communications."*[6]

The above goals could reduce the cost of a liquidation, but the process proposed is overly complicated and does not apply to court liquidations which are arguably the largest drain on industry resources.

If a company is being wound up in insolvency the role of the directors and members are subordinate to the interests of the creditors yet bizarrely the Government is proposing that the process is initiated by directors, verified and adopted by the liquidator and then not rejected by the creditors:

1. Section 498 - Declaration (by directors) that company eligible for the simplified liquidation process; and
2. Section 500A – Liquidator may adopt the simplified liquidation process but not if at least 25% in value of the creditors request under section 500AB not to follow it; and
3. Section 500AC – Liquidator must cease to follow the simplified liquidation process if no longer eligible or in other circumstances prescribed by the regulations.

Submission 7

A simplified liquidation process would be of benefit in situations where there are limited assets and creditors are not desirous of, or concerned that, extensive investigations are carried out. However, it should be a positive onus on the creditors to request that a simplified process be followed. The liquidator can assess the company's eligibility and in his or her first communication to creditors set out the right to request the process be followed (given it is their rights which are affected). I.e. greater than 25% in value of unrelated creditors request the process be followed.

Of critical importance to the rights which creditors will forgo appears to be the right to remove the external administrator and appoint another. Section 90-35 of the Insolvency Practice Schedule (Corporations) requires the removal and replacement occur by resolution at a meeting. The proposed subsection 500AE(2) removes the ability to convene a meeting.

6 Refinements to the registration of liquidators.

I have no submissions to make in relation to the proposed refinements in relation to the registration of liquidators other than to note that it is unlikely to result in an influx of persons seeking registration to undertake SBRP roles. Anecdotally the biggest contributor to the decline in the number of registered liquidators in the country has been the introduction of the ASIC Industry Funding Model ("IFM") in conjunction with 3-year licencing fees.

[6] - Fact Sheet - Insolvency reforms to support small business

7 Virtual meetings and electronic communications

Submission 8

The ability to hold meetings virtually and communicate electronically is a welcome reform. However, it should be noted that putting a proposal to creditors is currently a metric under the IFM which carries a cost of upwards of $100 – this should be considered in any development of the SBR regulations with respect to notifications and advertisements.

8 Conclusion

Again, I thank you for the opportunity to make a submission in relation to the Corporations Amendment (Corporate Insolvency Reforms) Bill 2020; however, I am generally not supportive of the proposed reforms and consider that they have little chance in achieving the Government's policy objectives of supporting small businesses who have been effected by the economic shock caused by COVID-19.

While well intentioned, the proposed bill will only serve to further complicate the insolvency profession that is expecting an increase in volume of work but, is well placed with the existing laws to assist businesses who are experiencing financial difficulties provided that they seek qualified help early.

If you would like to discuss any aspect of this submission please, do not hesitate to contact me.

Yours faithfully

Andrew Needham
Principal & Registered Liquidator