Australian Government

Australian Small Business and Family Enterprise Ombudsman

12 October 2020

Manager
Market Conduct Division
Treasury
Langton Cres
Parkes ACT 2600

via email: *MCDInsolvency@treasury.gov.au*

Dear Sir or Madam

Corporations Amendment (Corporate Insolvency Reforms) Bill 2020

The Australian Small Business and Family Enterprise Ombudsman welcomes the proposed reforms to Australia's insolvency laws that provide small business owners with the opportunity to obtain advice genuinely aimed at helping them turnaround their business, and where that is not possible, give them access to an orderly and dignified winding up.

We have consulted extensively with industry experts in preparing this submission, including with the Council of Small Business Australia (COSBOA), CPA Australia (CPA), Chartered Accountants Australia & New Zealand (CA ANZ), the Institute of Public Accountants (IPA), the Institute of Chartered Bookkeepers (ICB), the Association for Business Restructuring and Turnaround (ABRT), the Australian Turnaround Management Association (TMA), and the Australian Institute of Company Directors (AICD).

Based on our consultation, there is broad support for the reforms. However, there are three critical changes required to ensure that the reforms are effective:

1. Government should make available a small business viability review for businesses;
2. The category of *Small Business Restructuring Practitioners* should be expanded to include a range of trusted advisors with appropriate skills; and
3. Important detail that is currently proposed to be in regulations should be included in the legislation itself.

The following recommendations are also needed to help ensure that the system works as intended:

4. There should be an initial grace period introduced for restructurings under which only the advisory aspect and the development of a plan are mandatory;
5. Provisional Liquidation Applications should not be stayed;
6. The liability test in relation to restructuring should not be restrictive; and
7. There needs to be transparency around simplified liquidations with Government collecting data to allow creditors to hold directors to account where appropriate.

Further detail on these recommendations follows.

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Recommendations

As highlighted in our recent Insolvency Practices Inquiry (the Report), too often when small businesses face challenging trading conditions they find themselves pushed into costly winding up processes when they may have remained viable had appropriate turnaround advice been given.[1] The speed with which these changes are being implemented is therefore commendable and necessary given our current circumstances.

It is vital, however, that design and implementation are appropriate to ensure the best outcome for small businesses, their suppliers and employees, and the Australian economy. We are concerned that we are unable to view the regulations which will, we understand, provide much of the detail of these changes. This important detail proposed for the regulations should be included in the legislation itself. Further, no changes should be enacted until the material intended for the regulations is available and subject to appropriate consultation and scrutiny.

Establishment of a Small Business Viability Review

We have consistently advocated for the establishment of a Small Business Viability Review (the Review) since releasing the Report.[2] The Review is a critical precursor to a small business entering the restructuring or simplified winding up processes outlined in the Bill. For the new process to be successful, small businesses in financial difficulty will need a smooth path to a small business restructuring practitioner.

Access to professional, targeted advice goes to the heart of ensuring small businesses are able to manage through a crisis, adapt to a changing environment and, wherever possible, recover. Small businesses under financial strain do not have resources available to spend on professional advice. Their trusted advisers, usually accountants and bookkeepers, are best placed to assist the business owner take stock of their position and make a decision about whether they are able to restructure, or need to wind up. Ensuring that this advice is provided as early as possible in a difficult time is the key to ongoing business viability.

We expect that approximately 500,000 Australian small businesses would benefit from a Review, and at a maximum of $5,000 per Review, this would cost the government approximately $1.5 billion.

Eligibility for Small Business Restructuring Practitioner

The eligibility of professionals to register as Small Business Restructuring Practitioners (the Practitioners) is critical to the success of the reforms. A business' trusted adviser will most often be best placed to provide this advice. This third class of practitioners must therefore include local trusted accountants and advisers.

Small business owners avoid seeking advice from registered liquidators (RLs) until it is too late to restructure or rescue their business. There is significant stigma associated with seeing a RL, and the majority of small business owners hold concerns that seeking such advice would damage their chances of survival.

With just over 670 RLs in Australia there are insufficient practitioners to effectively manage the volume of restructures that will be required when the current moratorium on insolvent trading concludes. Further, throughout our Insolvency Practices Inquiry, we heard from many RLs who expressed reluctance to undertake work where there was little capital available to cover fees. Without opening eligibility to other appropriately skilled and knowledgeable advisors, many small businesses will be unable to source appropriate advice and restructure their business in a timely manner.

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[1] https://www.asbfeo.gov.au/sites/default/files/Insolvency%20Inquiry%20Final%20Report.pdf

[2] https://www.asbfeo.gov.au/news/news-articles/united-call-small-business-viability-review-program-budget

We propose that the third class of practitioner has the following attributes:

i. Be a member of an appropriate professional association (eg CPA, CA ANZ, IPA, ABRT, ICB, TMA) with a code of ethics;
ii. The association has identified members who are appropriately qualified for this task (for example Certificate of Public Practice (CPP) holders as members of CA ANZ);
iii. Be appropriately skilled and competent to perform the task, and appropriately insured; and
iv. Be a 'fit and proper person', i.e. never been convicted of a financial crime, not be an undischarged bankrupt, and never have been previously bankrupt.

The definition of this 'third class' should be included in Schedule 2 and the associated rules. The rules should specify this class and not make them subject to vetting by any other body, including ASIC. Any further vetting would delay their ability to provide much needed, immediate small business support.

Role of the Restructuring Practitioner

It is noted that the restructuring practitioner is required "to provide advice to the company on matters relating to restructuring", and make "a declaration to creditors in relation to the proposed plan". It is implicit that each of these aspects will be mandatory.

In order to maintain flexibility and utility, only the advisory aspect, and the development of the plan should be a 'mandatory function' during an initial grace period, allowing the public notification to be delayed. A restructuring plan may be met through issuing capital or external loan funds. Publication of a company being in financial distress can be a death knell, subverting the point of the legislation. This grace period should be restricted to a short window prior to publication of the capital/loan restructuring plan, and the benefits of 'safe harbour' under section 588GAAAB should be available.

Staying of Provisional Liquidation Applications

We oppose the staying of Provisional Liquidation Applications. The procedure for the appointment of a Provisional Liquidator is to protect the interests of those with a financial stake in the company, pending winding up. The application is granted because of urgency arising due to a threat to the company's assets, and usually comes with significant preparation and cost. Interrupting these applications may lead to directors 'gaming' the system without any corresponding advantage.

Liabilities Test

We note that the 'liabilities test' has not yet been published. Setting a restrictive liability test in relation to a restructuring will render these reforms ineffective. Large liabilities will flow from wages and premises, with much of that brought forward through lease breaches and staff redundancies. Any liability test will therefore favour companies whose debts are trading losses, and are the least able to be effectively restructured. The liability test will equally disadvantage any wages-heavy businesses. Adding the burden of contingent liability from redundancy or termination payments towards reaching a 'liability test' threshold would be counterproductive.

To minimise the flow on effect of insolvencies, the liabilities test should not exclude small businesses that do not have their employee payments up to date at the time of appointment. Instead, to support as many businesses as possible 'restructuring plans' should be required to address arrears in employee entitlements as a priority.

These comments do not apply in relation to Part B – Simplified Liquidation Process, as the company in that process is not to be saved in order to protect against job losses.

Further, on appointment of a restructuring practitioner, the insolvent company becomes liable for goods and services. In practical terms, this means that supply will likely only be 'cash on delivery', making it difficult to continue trading. To deal with this, consideration should be given to:

i. Enabling limited protection for directors during a permitted window between appointment to notification of appointment (allowing directors to decide to delay notification for a short period to implement a full recapitalisation); and
ii. The practical role that the ALLPAAP security holder will play, being a party entitled to step in and do so (in practical terms) in front of lesser security holders.

Data Collection and Reporting

The Simplified Liquidation process will likely lead to a two-tiered Insolvency Practitioner system. Transparency around the simplified liquidations is critical, and it is important that Government collects sufficient data to allow creditors to hold directors to account where appropriate. Sufficient data collection and monitoring will better allow Government to assess the efficacy of the reforms, and will guard against promotion of illegal phoenixing.

Thank you for the opportunity to comment. If you would like to discuss this matter further, please contact Miss Alexandra Hordern on 02 6121 5404 or at alexandra.hordern@asbfeo.gov.au.

Yours sincerely

Kate Carnell AO
Australian Small Business and Family Enterprise Ombudsman