



12 October 2020

The Manager
Market Conduct Division
Treasury
Langton Cres
Parkes ACT 2600

By email: MCDInsolvency@Treasury.gov.au

Dear Sir/Madam,

Insolvency reforms to support small business

Thank you for the opportunity to provide a response in relation to the Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (**Bill**) and associated Draft Explanatory Materials.

As a leading professional services firm, KPMG Australia (**KPMG**) supports the measures proposed to allow small business to restructure their debts and maximise their opportunity for survival. We are also supportive of the measures proposed to streamline the liquidation process for small business which cannot survive in the face of the current pandemic.

KPMG has one of the largest restructuring services practices in Australia and around the world. We provide restructuring, turnaround and insolvency services to a wide range of clients from small and medium businesses to large institutional and multi-national organisations.

We strive to contribute to the development of reliable and practical insolvency procedures to assist Australian businesses facing financial difficulty so that they may contribute to a strong and prosperous economy. We welcome the opportunity to contribute to the development and implementation of the reforms proposed for small business.

Our submission is structured as follows:

- In **Part 1** we set out our general observations and recommendations in respect of the draft legislation and explanatory materials.
- In **Part 2** we set out some detailed recommendations as to the drafting of the amendments introducing the small business restructuring process and the formulation of the supporting regulations.
- In **Part 3** we set out our observations and recommendations in respect of the proposed simplified liquidation process.

Part 1: Overview and recommendations

KPMG considers that the current Bill, as drafted, will do much to assist small businesses suffering financial hardship as a result of the current COVID-19 pandemic. The effectiveness of the reforms will, however, depend heavily on several key settings and items of detail that are yet to be finalised.

KPMG understands that key aspects of the reforms will be progressed later, through associated subordinate legislation (both regulations amending the *Corporations Regulations 2001* and rules made under the *Corporations Act 2001*) and will include details governing the operation of the new simplified insolvency processes. KPMG will participate in further consultation when these additional materials are released.

The proposed restructuring process needs to ensure that directors of small businesses are encouraged to utilise the new procedure at an early stage. Creditors and suppliers also need to have the confidence necessary to continue to trade with the business during the restructure period to support the plan and its implementation.

Small businesses owners also need to feel supported through the proposed restructuring process given the complex and intense demands that accompany a business entering into a restructuring process.

It will also be important to balance the need for independent oversight of the process to protect creditors' interests with the need to keep costs and complexity low.

The simplified liquidation procedure is well drafted and should serve as an effective method of dealing with small companies which have no prospect of survival.

KPMG Recommendations

A. Proposed Restructuring Process

1. That the **eligibility criteria for entering the process are clearly defined and readily calculable**. To the extent these criteria include a liabilities test, the regulations should specify which liabilities are to be included or excluded from the calculation.
2. That **some assurance or priority of payment is provided to those creditors and suppliers that continue to support the company during the restructure period** so that they are encouraged to trade on reasonable commercial terms. Creditors and suppliers will be reluctant to trade with the business (other than on Cash-On-Delivery terms) if they risk becoming merely another unsecured creditor should the restructuring plan be rejected by creditors or the restructuring period is terminated for other reasons. New debts incurred during the restructuring period should be **paid in full prior to payments being made to pre-restructure creditors under an approved restructure plan or as a priority over pre-restructure creditors in a subsequent liquidation**. Debts incurred during the implementation of an approved restructuring plan should be treated in the same manner as debts incurred while a company is subject to a Deed of Company Arrangement.
3. That **the powers and duties of the Small Business Restructuring Practitioner are clearly defined and his or her liabilities limited** to reflect:
 - a) the **limited control** the restructuring practitioner will have over the operations and assets of the business and the design of the proposed restructuring plan; and

- b) the need to **keep the costs of the process low**.
4. That the Small Business **Restructuring Practitioner should not be deemed to be an officer of the company** given that he or she does not control the company or direct its ordinary course of business operations. Being an officer would unreasonably burden the restructuring practitioner with directors' duties under ss.180-184 of the *Corporations Act 2001 (Cth)* (**Corporations Act**) and other liabilities such as WH&S, environmental and other regulatory liabilities.
 5. That in order to minimise complexity and reduce cost, consideration be given to specifying certain **standardised types of restructuring plans** which can be proposed to creditors with **pro-forma documentation** included within the regulations. Such options may include, for example:
 - a) a **"simple debt compromise"** - the creation of a fixed fund to *immediately* pay creditors an amount in full and final satisfaction of their claims; or
 - b) a more complex **"terms-based arrangement"** – being any other arrangement to satisfy creditors over time from the trading of the business, sale of assets or introduction of new funds or any other means.
 6. That **professional and independent oversight be maintained** over the process so that stakeholders have enough confidence in the process notwithstanding the continued involvement of directors and management in directing the company's affairs. In this sense, we believe **the qualifications and independence requirements of the Small Business Restructuring Practitioner should be commensurate with those applying to Voluntary Administration**. Care should be taken in any move to allow a lesser standard of practitioner in respect of small business restructuring procedures.

B. Simplified liquidation Process

1. That the **eligibility criteria for entering the process are clearly defined and readily calculable**. To the extent these criteria include a liabilities test, the regulations should specify which liabilities are to be included or excluded from the calculation. That the **qualifications and independence requirements of the liquidator should be commensurate with those applying to Creditors Voluntary Liquidations** and extreme care should be taken in any move to allow a lesser standard of practitioner in respect of the simplified liquidation process.

Part 2: Comments on the proposed restructuring process

The draft amendments are closely based on the existing Voluntary Administration regime (Part 5.3A of the Corporations Act) and incorporate some of the elements of the safe harbour regime introduced in 2018. We believe this is an appropriate foundation.

Based on our experience of other insolvency procedures including in particular Voluntary Administration, the effectiveness of the amendments in practice will depend heavily upon several matters of detail, which produce incentives or disincentives for stakeholders to participate in the process in good faith and for the right outcome. These stakeholders include directors and shareholders, management and employees, creditors and suppliers, government authorities and restructuring professionals.

Also, of concern is the need to keep the complexity and costs of the procedure sufficiently low to make entry into the process a commercially viable proposition.

With these imperatives in mind, we make the following comments on the proposed amendments.

Proposed section	Issue arising	Suggested action
452A	Objective does not specifically consider interests of creditors	Consider <u>modifying</u> 452A to read: "... to provide for a restructuring process for eligible companies that allows such companies: (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 <u>which provides a better return to creditors than an immediate liquidation of the company.</u> "
453A	It is not clear whether the restructuring period ends upon approval of the restructure plan (in which case a period of "plan administration" might follow) or whether it ends upon fulfillment of the plan requirements.	Clearly establish two periods: A "Restructuring Period" which runs from appointment of the restructuring practitioner to the approval or rejection of the restructuring plan and during which the moratorium applies (similar to the Voluntary Administration period under Part 5.3A) A "Plan Implementation" period which runs from approval of the restructuring plan until the fulfillment of its terms (similar to the Deed Administration period under Part 5.3A)

Proposed section	Issue arising	Suggested action
453A	<p>It is not clear what happens when the restructuring period ends without a restructuring plan being approved.</p> <p>Does the company remain with its directors and become again subject to the provisions of s.588G or, given the directors have resolved that it is (or is likely to become) insolvent or the company is deemed to be insolvent, does the company proceed automatically to the simplified liquidation process?</p> <p>If a restructuring plan is proposed, it is not clear whether creditors will be asked merely to vote on the plan or whether they will be asked to approve the plan, put the company into liquidation or return it to its directors (as is the case with Voluntary Administration).</p>	<p>In our view, given the company is deemed to be insolvent when proposing a restructuring plan, in circumstances where the restructure plan is rejected by creditors, the company should automatically transition into the simplified (or regular creditors voluntary) liquidation process unless creditors vote to release it from restructuring and continue under the control of its directors.</p> <p>Doing so would ensure that:</p> <ul style="list-style-type: none"> ▪ The directors propose the best possible restructure plan to creditors; and ▪ There is a definite outcome to the restructuring process.
453B	<p>As drafted, the directors do not need to actively declare or resolve that the eligibility criteria are met. Directors may not actively investigate the criteria, which may lead to companies incorrectly entering the process.</p>	<p>Include the requirement in s.453B(1) for a declaration by directors that the eligibility criteria are met or include such a statement in the resolution under s. 453B453B(1)(b)</p>
453C	<p>Measuring the liabilities of the company as a potential eligibility criterion may be complex and open to interpretation</p>	<p>Specify in the regulations what liabilities are to be included and excluded.</p> <p>Include easily identifiable and ascertainable claims such as trade creditors, secured claims, taxes due, related party claims, accrued employee entitlements (unpaid wages, annual leave, LSL, superannuation).</p> <p>Exclude contingent liabilities, uncalled guarantee exposures, lease tail liabilities, unquantified damages and contingent employee entitlements (e.g. redundancy and PILN)</p>

Proposed section	Issue arising	Suggested action
453E	<p>The Functions, duties and powers of the restructuring practitioner need to be carefully defined so as to strike the right balance between adequate oversight and limiting cost.</p> <p>There are some areas where it will be critical for the restructuring practitioner to have responsibility. These include notifying creditors, assuring compliance with the process and controlling the vote on the restructuring plan.</p>	<p>Consider carefully the extent of the restructuring practitioner’s functions duties and powers in the formulation of the relevant regulations.</p>
453E(1)(c)	<p>In order to provide reasonable levels of assurance to creditors, it is our view that the declaration to be made to creditors by the restructuring practitioner is that the restructuring plan is in the interests of creditors.</p> <p>This will mean that the restructuring practitioner will need to ascertain and advise creditors of the likely return under liquidation. We believe that this is information creditors would reasonably require in determining whether to support the restructuring plan.</p>	<p>Specify that the declaration to be made to creditors is whether it is in the interests of creditors to agree to the restructuring plan.</p> <p><u>Note:</u> see comments in respect of s.453A regarding what happens if the restructuring plan ends because the plan is rejected. If the conclusion is that the company enters into the simplified (or regular creditors voluntary) liquidation process, then the restructuring practitioner’s opinion should be similar to that under s.438A of part 5.3A.</p>
453I	Section omitted	Re-number or specify as omitted
453J	Current wording could be interpreted as meaning that the company must always continue to meet the eligibility criteria during the restructuring period.	If this is not intended amend s453J(1)(a)(i) to read “did not meet the eligibility criteria at the time of appointment of the restructuring practitioner”.
453LA	Reference in s.453LA(1)(a) to s. 453(1) should be “s. 453(1)”	Correct

Proposed section	Issue arising	Suggested action
453Q	<p>Omission of requirements to give notice to owners and lessors of property of the type found in s.443B of Part 5.3A. raises the question of whether a company in restructuring is liable to pay rents and other amounts payable while it continues to occupy premises or use property.</p> <p>Questions also arise as to the ranking of unpaid rents or other amounts payable as against pre-restructuring claims.</p>	<p>Clarify whether rents and other amounts for property used or occupied by the company during the restructuring period are payable by the company.</p> <p>Consider whether notice akin to s.443B(3) of Part 5.3A is required.</p> <p>Specify in the regulations how any amounts which are not paid are to rank against other liabilities of the company.</p>
453V	Relies upon definition of restructuring period (see comments in respect of s. 453A above)	See suggested action in respect of s. 453A above.
454H(2)(b)	<p>Refers to payment of surplus from sale of secured property to “the restructuring practitioner on behalf of the company”</p> <p>Given the restructuring practitioners limited role this may be better specified as simply paid to “the company”.</p>	Consider amending s. 454H(2)(b)
454J	Refers to the scope of sections 454K to 454N. Note there is no section 454N	Amend to read “Scope of Sections 454K to 454M”

Proposed section	Issue arising	Suggested action
455B	The proposal, variation, contents, and design of the restructuring plan to be specified in the regulations should be designed to minimise complexity and reduce cost of the Restructuring Process and restructuring plan	<p>Given the desire to reduce complexity and cost of the process, it may be desirable to specify the type of plan a company may propose to creditors and include pro-forma documentation within the regulations.</p> <p>For example, the regulations may specify the restructure plan to take the form of:</p> <ul style="list-style-type: none"> ▪ A “simple debt compromise” – the provision of a fixed fund to immediately pay creditors an amount in full and final satisfaction of their claims; or ▪ A “terms-based arrangement” – being any other arrangement to satisfy creditors over time from the trading of the business, sale of assets or introduction of new funds or any other means. <p>The intention of this would be to provide guidance to directors in formulating their restructure plan, ensuring minimum requirements are met and to streamline the process.</p>
455B(3)(c)	It will be important for a restructuring plan to treat like creditors equally and to have regard to the creditor payment priorities in s.556.	Specify in regulations that pari passu treatment of creditors and the priorities in s.556 must apply.

Proposed section	Issue arising	Suggested action
<p>Consequential amendment 8 - amending s.9 definition of "Officer"</p>	<p>Amendment makes restructuring practitioner an officer of the company.</p> <p>In our view, this is not appropriate given the restructuring practitioner does not control the company or direct its ordinary course of business operations.</p> <p>Being an officer exposes the restructuring practitioner to directors' duties under ss.180-184 and may extend to other liabilities such as WH&S, environmental and other regulatory liabilities.</p>	<p>Do not amend s.9 to specify the restructuring practitioner as an officer of the company</p>
<p>Consequential Amendments 47-54 amending s.553(1A), s.553(1B) and s.556</p>	<p>These amendments relate to the admission to proof of new debts incurred during the restructure period and priorities afforded in certain circumstances. The construction of these amendments and the referencing (especially in relation to s.556) need review.</p> <p>These provisions potentially impact on our recommendation that debts during the restructure period be given priority in a subsequent liquidation.</p>	<p>Review the construction and drafting of these amendments and correct as necessary.</p>

Part 3: Comments in relation to the proposed simplified liquidation process

KPMG Australia supports the proposed introduction of the simplified liquidation process as drafted.

In our view it is important that:

1. the eligibility criteria should be well defined and calculable; and
2. the qualifications and independence requirements of the liquidator should be commensurate with those applying to Creditors Voluntary Liquidations and care should be taken in any move to allow a lesser standard of practitioner in respect of the simplified liquidation process.

Conclusion

The measures outlined in this submission are intended to aid Treasury in designing and implementing a workable and beneficial process to allow small businesses to restructure their debts and maximise their opportunity for survival or, where the company cannot survive, to efficiently liquidate its business.

We would be pleased to discuss these measures with Treasury in further detail if required.

Thank you for providing KPMG with the opportunity to provide input on the proposed amendments and we look forward to working with you should we be able to provide further assistance.

Yours sincerely,

Peter Gothard
Partner
KPMG Australia

James Stewart
Partner
KPMG Australia