12 October 2020

Market Conduct Division
Treasury
Langton Crescent
PARKES ACT 2600

Via e-mail: MCDInsolvency@Treasury.gov.au

Dear Sir/Madam

Insolvency Reforms to Support Small Business
Feedback on exposure draft legislation and explanatory material

Worrells appreciates the opportunity to provide feedback on the Corporations Amendment (Corporate Insolvency Reforms) exposure draft ("ED") and accompanying explanatory materials ("EM") ("the reforms") released for public consultation on 7 October 2020.

About Worrells

Worrells is a national insolvency firm with 29 Registered Liquidators. By volume, Worrells oversees more external administrations than any other insolvency firm in Australia.[1] The majority of these external administrations are small business insolvencies, and consequently, Worrells is acutely aware of the challenges which exist within the existing insolvency framework for small businesses and Worrells is well placed to provide feedback on the reforms.

Further details about Worrells is provided in **Annexure A**.

Preliminary Comments

Subject to the points of feedback provided in this submission, Worrells welcomes and supports the reforms. The reforms will come as welcome relief for many small businesses in financial difficulty. In our view, many business owners that will have been forced into closure will now have the option of restructuring their affairs in a manner which balances the interest of all stakeholders.

We commend the efforts of Treasury in preparing such important and comprehensive reforms in such an expedient manner.

[1] Sivaa Consulting Pty Ltd: *Insolvency Ranking 2020 Financial Year* (https://www.sivaa.com.au/).

Liability limited by a scheme approved under Professional Standards Legislation.
Melbourne

These reforms are complex and the impacts will be far reaching.[2] There are many stakeholders in the insolvency framework; including the owners of small businesses, employees, trade creditors, financiers, statutory bodies, the general public as well as the insolvency profession. With an intended commencement date of 1 January 2021 and a significant body of subordinate legislation still to be developed–-we have concerns that the short timeline and the limited public and industry consultation may lead to unintended consequences. In this regard, we advocate for a comprehensive review of the legislation within 12 months of the commencement date (with appropriate consultation) to ensure these reforms are operating as they were intended.

The advent of the Coronavirus pandemic has undoubtedly meant that these reforms were required to be implemented quickly, and consequently the timeframe for public consultation has by necessity been shortened. This short timeframe has made it challenging for us to conduct a comprehensive review of the reforms. Nonetheless, in preparing this feedback, consultation has been sought from each of the Partners at Worrells across all states and regions. Given the importance of the reforms we have provided herein all relevant comments-–even where some of those comments are only preliminary positions or general observations.

Executive Summary

Our key points of feedback can be summarised as follows:

- The current eligibility criterion is likely to encompass complex businesses never intended to be dealt with under these reforms.
- To ensure the integrity of the insolvency framework a Small Business Restructuring Practitioner must have an equivalent level of education, training, professional qualifications and ethical standards as a Registered Liquidator.
- A significant shortcoming in the reform is the omission of an automatic transition into a Liquidation directly from a terminated or voted down restructuring plan.
- There is likely to be (at best) a modest reduction in the work required of a Liquidator in undertaking a simplified liquidation process, as compared with a standard liquidation.
- It is against the interest of all stakeholders in the insolvency framework to dilute the application of any provisions which are designed to ensure the fair distribution of assets in an insolvency administration. We urge that caution be applied in imposing any restrictions on the application of sections 588FA and 588FE of the *Corporations Act* 2001 (Cth) ("Corporations Act")[3].
- The reforms will create an inconsistency in the vesting provisions of the *Personal Property Securities Act* 2009 (Cth) ("PPSA") under Part 5.3A and Part 5.3B restructuring processes, which may lead to unintended outcomes and ultimately disadvantage creditors.

These points of feedback are elaborated below, along with other matters we consider warrant consideration by Treasury.

[2] Deloitte Access Economics Media Release 20 July 2020: "…*around 240,000 businesses in the hospitality, professional services, and transport industries, in particular, are at high risk of failure*…"
[3] Refer to section 500AE of the ED.

Particulars of Feedback

1. Eligibility Criteria

Primary test of 'simple' is a liabilities test

The reforms are aimed at achieving greater economic dynamism, and ultimately helping more "small" businesses to survive. To determine whether a company's operations are "small" enough to access these reforms requires only to pass a liabilities test.[4] We understand subordinate legislation will prescribe a cap on liabilities.

We have concerns that there may be highly complex businesses able to meet the eligibility criteria.

In our experience, the value of a company's liabilities (in isolation) is not determinative of the complexity nor the size of a business. For example, it is not at all uncommon to see external administrations of a company with liabilities below $1M (a potential threshold limit publicised[5]):

- Operating from multiple trading premises;
- Having yearly turnover in the many millions;
- Employing several staff (often under various awards, EBAs, contracts);
- Being party to complex contractual arrangements - potentially across several jurisdictions;
- Being party to complicated and protracted litigation;
- Being part of a broader and complex corporate structure;
- Acting as a corporate trustee of multiple trusts, or being the trustee of a trust whose terms give uncertainty about the powers afforded to a trustee on external administration; and/or
- Having complex and convoluted creditor claims.

We suggest a more specific set of eligibility criteria be considered to ensure these reforms are applied only to small businesses whose affairs are of modest complexity. We consider that at a minimum the eligibility criteria should also include a turnover cap. Public companies (both listed and unlisted) should be specifically excluded under these reforms.

In respect of the subordinate legislation, we encourage a prescriptive process to determine eligibility requirements to limit any ambiguity. For example, in respect of liabilities, whether this to include not yet crystalised employee claims, contingent debts (such as future lease liabilities) and/or unliquidated damages claims.

The need for appropriately maintained financial records

Frequently, a company's failure is linked to poor record keeping.[6]

---

[4] *Section 453C and 400AA of the ED.*
[5] *Josh Frydenberg, "Fighting chance for small business", 23 September 2020.*
[6] *ASIC report 19-363MR on Corporate Insolvencies (2019 FY) published 18 December 2019. In this report is was highlighted that 44% of all alleged misconduct reports by External Administrators included a suspected failure to maintain appropriate financial records.*

A fundamental tenant of the reforms is to streamline the process and have a 'lighter touch' by an insolvency practitioner. Achieving this will necessitate a greater reliance on the company's books and records--with a considerable amount of time presently expended in reconstructing financial accounts to determine assets, creditors and potential claims.

In order to maintain rigour in the system, only companies with appropriately maintained books and records should be eligible to be dealt with under a streamlined liquidation process or be eligible to enter into a restructuring process. We consider that the director's compliance with section 286 of the Corporations Act should be considered as an added eligibility criterion.

Past director ineligibility

We welcome the intention to deem ineligible directors who have previously proposed a restructuring plan and/or had a company administered through a simplified liquidation process.

We consider however a provision limiting the ability for the same <u>company</u> to propose a debt restructuring plan within a 12-month period (or some other timeframe prescribed by the legislation) is required. Currently the restriction is only imposed upon a director.[7] As presently drafted, section 453C of the ED could be interpreted as allowing the same company to propose multiple restructuring plans merely through a change in directorship (given the words "another company" in 453C(1)(b)). We understand this is not intended under the reforms.

Tax lodgements

We support eligibility criteria surrounding the requirement for a company's taxation lodgement obligations to have been met.[8] In our experience, many small business owners facing financial issues become delinquent in their taxation obligations.

We note this criterion is currently limited to simplified liquidations. We would support a similar provision in the eligibility criteria for the restructuring process. This appears to have been foreshadowed in paragraph 1.95 of the EM.

In our experience, it is not uncommon for directors to be unaware of their company's lodgment history and compliance. Prior to executing a declaration that the company meets the eligibility criteria for a simplified liquidation[9], it is recommended a director be required to obtain some form of compliance certificate from the Australian Taxation Office.

We also hold concerns that recalcitrant directors with a history of non-compliance in their taxation obligations may seek to bring a company's outstanding lodgements up to date simply to access the less rigorous rules under these reforms. It should be considered whether it is appropriate that this criterion be narrowed and only open to companies that have had a history of substantial compliance with their taxation obligations.

Further, section 500AA(f) of the ED states: *the company has* ***given*** *returns, notices, statements, applications or other documents as required by taxation laws* (emphasis added). We query as to whether the term "given" is intended to be interpreted as "lodged".

It is also recommended that the same/similar eligibility criteria apply in relation to other statutory obligations of a company (e.g. payroll tax and workcover).

Employee entitlements

---

[7] *Sections 453C(1)(b) and 500AA(1)(e) of the ED.*
[8] *Section 500AA(f) of the ED.*
[9] *Section 498 of the ED.*

We support the criteria that employee entitlements which are due and payable must be met before a restructuring plan can be proposed to creditors.[10] The protection of employees should be a paramount feature of our insolvency framework. We consider that employee entitlements in this context must include superannuation. In our experience many small business owners facing financial difficulty become delinquent in their superannuation obligations.

Companies acting as trustees

In our experience, conflicts between trust law and insolvency law often necessitate court authorisation to carry out the functions of a Liquidator in relation to the assets of a trust. This materially adds to the cost and complexity of a Liquidation. It is our view that the simplified liquidation process should be limited to companies that are operating in their own capacity, not in their capacity as trustees of a trust.

Single business across multiple entities

In our experience, it is not uncommon for small businesses to have their operations structured over two (or perhaps more) companies with the operations intrinsically intertwined. It is unclear whether the reforms intend to cater for small business who operate in such structures.

Mirrored eligibility criteria across restructuring and simplified liquidation

To the extent possible we support an alignment in the eligibility criteria for a restructuring process and a simplified liquidation.

2. Small Business Restructuring Practitioner ("SBRP")

We understand subordinate legislation intends to create a third class of registered liquidator that is able to act as an SBRP.

An SBRP will be required to consider whether a restructuring plan is in the best interest of creditors.[11] This would require that an SBRP be acutely aware of alternative insolvency options, their process and implications.

We consider an SBRP must have an equivalent level of education, training, professional qualifications and ethical standards as a Registered Liquidator. We hold grave concerns that a lowered standard for a SBRP risks undermining the insolvency framework and may expose already vulnerable small business owners to unscrupulous behaviour to the detriment of many stakeholders.

We hold further concerns that if the SBRP is to be a standalone registration which is limited to restructuring engagements only, it may lead to poorer outcomes and incomplete advice for vulnerable small business owners seeking guidance. We can foresee in such circumstances that by necessity a SBRP will limit their advice/recommendation on options to a debt restructuring process – whereas a voluntary administration or liquidation may in fact provide a better outcome for all stakeholders.

[10] Paragraph 1.95 of the EM.
[11] See e.g., section 453N(2) and 453J(1) of the ED.

We understand the Australian Securities and Investments Commission ("ASIC") will be responsible for registering, and monitoring, SBRPs. We would expect the same costs which are applied to current Registered Liquidators under the Industry Funding Mechanism (IFM) will be applied to anyone registered as an SBRP.

3. Effect of a debt restructuring process on the Company

Involvement of a SBRP

It should not be overlooked that once the creditors and suppliers have been made aware a company is subject to a debt restructuring process, its supplies and services will be restricted. Businesses may also experience employee departure through fear of non-payment and certain licences and registrations (e.g., building licences) may be cancelled or called into question. These are common problems faced in Voluntary Administrations.

Without adequate cash resources to pay for supplies on COD terms, there is a real risk that entering into a debt restructuring process will have the potential to force the business into closure - against the aims of the reforms.

We also anticipate the short timeframe under which the reforms are to be adopted may create confusion or uncertainty in the market about the rights or exposures of those continuing to supply to businesses undertaking a restructure. This lack of understanding may lead to suppliers pre-emptively ceasing supply or being unwilling to work with the process.

Despite the intention for "trading in the ordinary course" to remain with the directors, in our experience, directors will often lack the necessary skills to not only trade the business in a restricted state, but at the same time manage numerous creditor claims as well as dealing with the restructuring process. We anticipate that a SBRP will be heavily called upon in relation to the trading operations. This will not only add to the costs of the process, but further reinforces the need for the SBRP to be qualified to the same standard as a Registered Liquidator.

Safe harbour protection for debts incurred whilst undergoing a restructure

Current provisions propose to afford safe harbour protection from insolvent trading to directors trading-on a business under a restructuring process.[12] Conversely, under the voluntary administration regime, Voluntary Administrators who trade-on a business with a view to restructuring its operations are held personally liable for debts incurred during the process.[13] We fail to understand why there is a divergence in the exposure for trading liabilities under both regimes.

We consider the same imposition of liability should be placed on directors who will be managing the trading of the business through a restructure as is placed upon a Voluntary Administrator. This will not only encourage suppliers to work with the company during the relevant period but also ensure that only business directors committed to the restructure are entering the process.

---

[12] Section 588GAAB of the ED.
[13] Sections 443A and 443B of the Corporations Act.

4. Subsequent Ineligibility

In our experience, the quantum of creditors in an external administration frequently exceeds what is listed in a company's records or has been estimated by the business owners at the commencement of an insolvency process. Commonly the true liability position is not known until sometime into an external administration, once there has been communication with creditors.

There is inconsistency in the way in which subsequent ineligibility is treated between a restructuring process and a simplified liquidation[14] - with a SRBP having the discretion to continue the debt restructuring process irrespective if the company is later deemed as no longer meeting the eligibility criteria. We consider it would be appropriate for an SBRP to be mandated to terminate a restructuring process if a company is subsequently determined not to meet the eligibility criteria.

We have concerns that the debt restructuring process could be undermined if a stringent position on eligibility is not adopted.

5. Terminating or exiting a debt restructuring process

There is discretion on the SBRP as to whether or not to terminate a restructuring process when[15]:

- It would not be in creditors' interests to make a restructuring plan;
- It would be in the interests of creditors for the restructuring to end; or
- It would be in the interests of creditors for the company to be wound up.

We suggest it should be a positive duty on a SBRP to terminate the restructuring process in either of these circumstances. We fail to see the benefit for any stakeholder to continue with a restructure when either of the above criteria have been met.

6. Automatic transition from restructuring to liquidation

We strongly suggest amendments be made which would allow a process to have a company automatically placed into liquidation following a terminated, or voted down, restructuring plan. A direct transition to Liquidation is an option which is currently available in the Voluntary Administration regime.[16]

Given the intention to streamline the insolvency process and reduce cost, we consider it would not be in the interest of any stakeholder to allow a company that is, or is likely to become, insolvent[17] and has had a restructuring agreement either voted down or terminated to be handed back to the directors and to continue trading. In our view this would unduly prejudice both current and future creditors and many may be forced (at considerable cost) to pursue their own rights to have the company placed into liquidation.

---

[14] Sections 453J and 500AC(1)(a) of the ED.
[15] Section 453J of the ED.
[16] See e.g., section 493C(c) of the Corporations Act.
[17] With the director(s) having signed a declaration to this effect under section 453B of the ED.

A government factsheet on the reforms[18] suggest that once the debt restructuring process ends the directors may choose to go into voluntary administration or liquidation. In our view, a company that has failed in its restructuring plan is very unlikely to be subsequently successful in achieving a restructure through a voluntary administration. This is particularly true given the voting requirements in a voluntary administration are more onerous[19]. Moreover, we consider sufficient safeguards exist in the unlikely event restructuring through a voluntary administration was considered plausible after a failed restructuring plan given an appointed Liquidator is able to enliven the voluntary administration provisions.[20]

We are of a strong view that an insolvent (or likely to become insolvent) company that is unable to restructure should be formally wound up and not allowed to continue trading and incurring further debts to the detriment of creditors and in breach of directors' duties.[21]

7. Restructuring practitioner's right to inspect records

Rationally, a SBRP will have the right to inspect and copy company records.[22] It is unclear however how the SBRP is able to force compliance and/or what penalty may be applied to a person refusing to comply with this provision.

8. Same practitioner acting as SBRP and subsequently Liquidator

Clarity needs to be given as to whether an issue of independence would arise if a Registered Liquidator, who is also a SBRP, is able to take appointment as Liquidator to the same entity following a failed restructuring process. Given the cost savings that would be expected, and the intention for the process to be streamlined, we consider there may be merit in not restricting the same practitioner from dealing with both the proposed restructuring and (if it were to follow) the liquidation of a company.

9. Unregistered restructuring practitioner

We consider the proposed penalty to be imposed in circumstances where a person who is not a Registered Liquidator consents to act as a restructuring practitioner should be increased to protect the integrity of the insolvency framework.[23]

10. *Voting process - harmonisation achieved in the recent insolvency law reform*

The *Insolvency Law Reform Act* 2016 ("ILRA") harmonised several aspects of the personal and corporate insolvency processes, including the way voting is dealt with without a physical meeting[24]. To the extent possible we consider these reforms should not depart from the harmonisation achieved under the ILRA.

---

[18] Refer to: https://ministers.treasury.gov.au/sites/ministers.treasury.gov.au/files/2020-09/Insolvency-Reforms-fact-sheet.pdf
[19] IPR 75-115 of the *Insolvency Practice Rules (Corporations) 2016* (where a poll is demanded, which in our experience is typically how a vote on the company's future is determined).
[20] Section 436B of the Corporations Act.
[21] For example, duties owed under Sections 180 – 183 of the Corporations Act.
[22] Section 453G of the ED.
[23] Section 456B(3) and Schedule 3 of the ED (namely: 50,000 units).
[24] IPR 75-130 of the *Insolvency Practice Rules (Corporations) 2016*

11. Simplified liquidation - declaration of eligibility

Directors are afforded a period of 5 days to provide the Liquidator a declaration of eligibility for their company to be dealt with under the simplified liquidation process.[25] We suggest this declaration should be provided at the time of passing a resolution to appoint a Liquidator. We understand a key aim of the reforms is to expedite the liquidation process. We cannot see any reason to add delay to the process and in our experience financial information about a company's affairs is, and should be, provided at the time of the commencement of a voluntary liquidation.

12. Features of a simplified liquidation process

Certain suspended provisions rarely apply

The reforms seek to gain efficiencies in the liquidation process by, inter alia, suspending the operation of certain provisions of the Corporations Act which otherwise apply[26]. In the main, these provisions relate to: meetings, committees of inspection and reviewing liquidators. In our experience, only vary rarely are any of these provisions enlivened in small liquidations. We consider the costs savings from the suspension of these provisions to be minimal, if any.

Offence reporting

Similarly, whilst offence reporting to ASIC under section 533 of the Corporations Act will also be a suspended provision in a simplified liquidation, in our experience reporting under this provision does not materially add to the costs of a liquidation. We consider, on balance, the costs savings from the suspension of this provision will be minimal.

We otherwise strongly support a mechanism to identify and report offences or misconduct under a simplified liquidation. This appears to be foreshadowed in paragraph 3.64 of the EM.

We understand further clarity on the features of a simplified liquidation will be provided in the subordinate legislation.

Creditors rights to request a simplified liquidation process not be followed

We agree with the importance for creditors to have a voice as to whether they oppose a simplified liquidation process to be followed in relation to a particular debtor.[27] We suggest however that creditors ability to exercise that right be limited to a specified time period (e.g., within 20 business days' of receiving notice of a Liquidator's intention to adopt the simplified liquidation process). We have concerns that there may be reluctance for a Liquidator to adopt the simplified liquidation process and expediently distribute any assets by way of a distribution– where creditors may subsequently request that a standard Liquidation process be followed.

---

[25] Section 498 of the ED.
[26] Section 500AE (1) and (2) of the ED.
[27] Section 500AB of the ED.

13. The importance of unfair preference & voidable transaction provisions

We understand that subordinate legislation may provide circumstances under which the unfair preference and voidable transaction provisions will be limited in their application when a company is being dealt with as a simplified liquidation.[28] We urge proceeding with caution in any dilution of these provisions which are designed to ensure the fair distribution of assets in an insolvency administration. We consider it may add to distrust in the system and set up a future which may involve abuse by nefarious participants.

14. Implications of the reforms on the vesting provisions of the PPSA

Under section 267(2) of the PPSA a security interest granted by a company ("Grantor") in favour of another ("Secured Party"), may, if it is not previously perfected (i.e. the security interest is unperfected), vest with the Grantor and not the Secured Party if a voluntary administrator or liquidator is appointed.

Consequential amendments should be made to section 267 of the PPSA to include the event of a restructuring process under Part 5.3B of the Corporations Act (to mirror voluntary administration and liquidation). If consequential amendments are not made to the vesting provisions, it may lead to unfair and unintended outcomes given:

- The security interest would vest in the Grantor under section 267(2) of the PPSA if a voluntary administrator is appointed to the company under Part 5.3A of the Act; whereas
- The security interest would not vest in the grantor if a SBRP is appointed to the company under Part 5.3B of the Act.

We consider that in circumstances where there is a potential valuable asset subject to an unperfected security interest, there may create an inconsistency in terms of outcomes for creditors under different restructuring options (i.e., Part 5.3A as compared with Part 5.3B), and therefore may impact a recommendation to directors on the type of restructuring appointment that should be made. Circumstances should be avoided that would result in a recommendation being made on the basis of the vesting provisions of the PPSA, as this may not be in the interests of creditors.

Failure to make consequential amendments to the vesting provisions of the PPSA may also:

- Compromise the SBRPs recommendation to creditors under the restructuring proposal. For instance, the restructuring process and recommendation may be compromised if a better outcome for creditors will be achieved by the appointment of a liquidator, which would enliven the vesting provisions[29]; and
- Disadvantage creditors generally, as once a SBRP is appointed, a Secured Party with an unperfected security interests would be on "notice" of the company's insolvency and their unperfected security interest, potentially compromising the voidable transaction provisions.[30] This is particularly the case given Part 5.3B does not (at this time) provide for an automatic transition from the restructuring process to liquidation. In the event a restructuring proposal is not accepted by creditors, this may result in a Secured Party with an unperfected security interest not only registering their security interest, but allowing the Secured Party the opportunity to take possession of the collateral resulting in the Secured Party attaining a preference or priority over other creditors.

---

[28] Section 500AE(3)(a) of the ED.
[29] Section 267(2) of the PPSA.
[30] Section 588FL of the Corporations Act (Part 5.7B).

15. Consequential amendments required

In the time afforded to the public for consultation it has not been possible for us to comprehensively consider the consequential amendments which may be required to both the Corporations Act and other legislative instruments.

By way of general comment only we make the following comment:

- In circumstances where there may be a transition back from a simplified liquidation into a standard liquidation certain requirements imposed on the Liquidator may not be possible for the Liquidator to comply with (e.g., the timeframe under which a Liquidator is required to lodge a 533 report[31]).

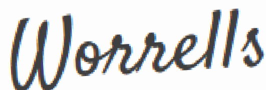
We remain open to giving this matter further consideration if further time is provided for consultation.

Contact Information

We again commend the efforts of Treasury in preparing these important reforms in a manner which balances the interests of all stakeholders.

We would welcome any opportunity to discuss any aspect of this submission. Contact to Worrells should be made through our communications manager in the first instance, Kate Lee: (07) 3225 4318 or kate.lee@worrells.net.au.

Dated: 12 October 2020



Worrells Board

[31] Section 533(1)(d) of the Corporations Act.

Annexure A - About Worrells

Worrells is a firm dedicated to solvency management, insolvency administration, and forensic investigation. Founded in 1973, today the firm has 26 partners in 32 offices across Qld, NSW, ACT, Vic, SA, and WA.

Worrells' specialises in all insolvency administrations—in personal and corporate matters as registered bankruptcy trustees and liquidators—and we are proud to have more registered bankruptcy trustees than any other private insolvency practice in Australia.

The firm has been built on the premise of innovation which pivots around our proprietary technology to deliver our insolvency, forensic and specialist solutions. The decision to invest significantly in our developing proprietary technology in-house was made 20 years ago, which shifted our operations to be paperless well in advance of many in the accounting industry. Today we have five fulltime in-house programmers on staff. This technology is a constituent of the unique Worrells offering, and a point of difference from our competitors.

Developed under the direction of accountants for accountants means that any file process that can be automated is automated. And follows the six-sigma process to minimise the number of steps required to its lowest possible point. The benefits are numerous and wide reaching. We can respond to regulatory changes as they happen, adapt our interfaces with external agencies to lodge statutory requirements e.g. with the ATO, ASIC etc., and our accountants' time can be used to add value to any process/file rather than repeating rudimentary low-value tasks. Critically, it means that fees generated from time-charging, which is based on one-minute increments, is minimised and reflective of designations (task and skill is aligned) within our team structures.

Our technology has delivered an online portal for creditors to see in real time (updated twice daily) all transactions, actions, and status on our files. This underpinned one of Worrells' core values of being transparent. And the firm has received accolades within the courts for the level of detail and communication we make available as standard.

Worrells' key tenet and value proposition is to deliver Plain Talk, Straight Answers, and Fast Results.