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Dear Sir/Madam

Submission to Treasury – Insolvency reforms to support small business - subordinate legislation

Introduction

The Australian Credit Forum (**ACF**) welcomes the opportunity to make a submission to Treasury in respect of the Exposure Draft Regulations and Rules released on 17 November 2020, proposed to support the reforms to the *Corporations Act 2001* (Cth) (the **Act**).

The ACF was established in the early 1970's by a group of senior credit professionals. The group recognised the need to develop an association where members could meet on a regular basis to exchange thoughts and ideas to strengthen their own knowledge but also the standards of the industry.

The association meets on a regular basis to discuss and review existing and proposed changes to the Federal and State Governments legislation that might have an impact on their company's credit policies and practices in their day-to-day role as credit professionals.

The members of ACF are drawn from all areas of the credit profession across a range industry groups including by not limited to senior credit managers, members of the legal profession, insolvency practitioners, credit insurance underwriters and brokers, mercantile agents and credit reporting agencies. The depth and diversity in experience of the members ensures that a broad cross section of the credit industry considers the impact of all relevant legislation.

Overview

The ACF welcomes the proposed amendments to the subordinate legislation which supports the *Corporations Amendment (Corporate Insolvency Reforms) Bill 2020* (the **Draft Bill**) in providing an avenue for small businesses to effectively navigate financial distress without the formality of administration or liquidation.

This submission addresses some of the key issues arising from our review of the exposure drafts of the *Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020* (the **Draft Regulations**) and the *Insolvency Practice Rules (Corporations) Amendment (Corporate Insolvency Reforms) Rules 2020* (the **Draft Rules**).

The ACF endorses the submission of the Australian Institute of Credit Management (**AICM**). The ACF shares AICMs support of the measures created by the draft subordinate legislation and agrees with the concerns raised by AICM's members. The ACF is supportive of the implementation of the recommendations made by AICM in their submission.

Key issues on the draft subordinate legislation

1. Liabilities test for eligibility pursuant to regulation 5.3B.03

Section 453C of the Draft Bill authorises the Corporations Regulations to prescribe a test for eligibility for debt restructuring based on the liabilities of the company. The Draft Regulations prescribe that, the total liabilities

of the company must not exceed $1 million on the day the restructuring process begins, with the exclusion of any liability or obligation which is contingent.

The ACF supports the simplified liabilities test and welcomes a test which concerns only the current financial position of the company. However, the ACF considers some practical concerns arise which should be addressed in the implementation:

Ambiguity arises around the process should a non-contingent debt become contingent during the restructuring process. The ACF notes contingent liabilities are likely to be a present reality in the financial position of a company entering into the restructuring process and the exclusion of these liabilities allow for companies that ought to be ineligible to undergo the restructuring process. The ACF recommends further sub provisions be inserted within regulation 5.3B.03 to address the process should a non-contingent debt become contingent.

The wide scope of the definition of liability provided at regulation 5.3B.03(5) incidentally includes liabilities from related party creditors in the calculation of the $1 million liability criteria. The ACF notes the inclusion of related party liabilities will likely exclude companies with significant related party liabilities from accessing the restructuring process. The ACF recommends clear drafting of the definition of 'liability' to confirm whether related party liabilities are to be included in the liability test.

2. Restructuring Plan

Section 455A of the Draft Bill requires that a company propose a restructuring plan (**Restructuring** P**lan**) to its creditors, who would be party to the Restructuring Plan should it be made. In addition to the prescribed contents of the Restructuring Plan provided for in the Draft Regulations, the Restructuring Plan will also include a set of standard terms which deal with the ranking, payment and determination of the value of admissible debts and claims.

The ACF notes the Draft Regulations do not require the Restructuring Plan to include details of the company's assets, the reason why restructuring is required or why the company will be a going concern should the Restructuring Plan not be accepted.

The ACF considers the Draft Regulations appear to allow a Restructuring Plan to simply state the total amount of the company's debt and a proposal for the company to pay an amount to satisfy that debt. As discussed in the immediately preceding paragraph, the company is not required to disclose details of assets or why restructuring is required in the Restructuring Plan. This may contribute to creditors being unlikely to accept the Restructuring Plan. Further, the ACF considers companies may utilise creditors reluctance to accept Restructuring Plans with limited information as a tactic to buy themselves further time to defeat creditors. The ACF recommends further sub provisions be inserted within regulation 5.3B.13 to remove any ambiguity and limit the scope of the requirements of the Restructuring Plan.

(a) Acceptance of Restructuring Plans in line with majority value of a company's affected creditors pursuant to regulation 5.3B.23

The Draft Regulations and explanatory materials provide a proposed Restructuring Plan is accepted if a majority of creditors, determined by their value in respect of the relevant liabilities, vote in favour of the proposed Restructuring Plan. The ACF understands this to mean that where a creditor holds a majority of the company's liabilities, they may solely dictate whether a Restructuring Plan is accepted, allowing majority value creditors to ensure the restructuring process predominately addresses their interests. The ACF understands the acceptance of a proposed Restructuring Plan based on the majority of creditors by value assists to streamline the restructuring process. However, the ACF is concerned majority value creditors will skew the balance of voting power away from lessor value creditors. The ACF recommends the voting process be amended to reflect traditional voting processes presently used in standard external administrations which will assist to ensure lessor value creditors do not lose power in the restructuring process.

(b) Definition of 'excluded creditor' pursuant to regulation 5.3B.23(c)

The ACF supports the exclusion of specific creditors from voting on a proposed Restructuring Plan.

It is ACF's view that the definition of *excluded creditor* be extended beyond a Small Business Restructuring Practitioner (**Restructuring Practitioner**), a related creditor of the company or a related entity of the Restructuring Practitioner. The ACF recommends the definition of excluded creditor be extended to include the company's directors and members, and professionals the company has dealt with within a 12-month period prior to commencing the restructuring process. The ACF considers broadening the definition of excluded creditors would assist in mitigating related creditors and professionals with a vested interest from issuing dishonest fees to the company in an effort to become a majority value creditor and control the voting of the Restructuring Plan.

(c) Exclusion of creditors meetings

The subordinate legislation does not provide for any requirement for the Restructuring Practitioner to call a meeting of creditors. Although the Restructuring Practitioner is required at different stages of the process to notify as many creditors as reasonably practicable of the progress of the restructuring, creditors are mostly kept out of the process, leading to confusion and inefficiencies for both creditors and Restructuring Practitioners. The ACF considers having no requirement for Restructuring Practitioners to call meetings of creditors may impact the confidence creditors have in the appointed Restructuring Practitioner's scrutiny. As such, the ACF recommends the insertion of provisions to the Regulations which require Restructuring Practitioner's to hold at least one creditor meeting prior to the Restructuring Plan being open for voting.

(d) 5-year maximum period for the Restructuring Plan

Regulation 5.3B.13 provides a Restructuring Plan must not exceed a period of 5 years from the day the Restructuring Plan was made. The ACF considers a period of 5 years to be excessive and recommends the period be reduced to a statutory maximum of 3 years with a provision allowing the Restructuring Practitioner to period of up to 5 years upon application by the company with consultation with creditors.

(e) Effect of Restructuring Plan on secured creditors

The ACF supports the limitation of secured creditors to be bound to a Restructuring Plan, as outlined in regulation 5.3B.27 where a Restructuring Plan is binding on secured creditors only to the extent of the difference between the values of the security interest and admissible debts or claims, if the value of the security interest is less than the value of the creditor's admissible debts or claims; or that the creditor consents to be bound, if the value of the security interest is equal to or greater than the value of the creditor's admissible debts or claims.

Further, the ACF supports the allowance for secured creditors to maintain their rights to realise or deal with their security interest, provided the secured creditor has not accepted a Restructuring Plan, or an order had been made excluding those rights.

The draft subordinate legislation does not indicate whether Restructuring Practitioners are obliged to inform secured creditors that they may realise and deal with their security assets despite the presence of a Restructuring Plan. The ACF recommends that the initial proposal of the Restructuring Plan to creditors includes information regarding the rights of secured parties under the *Corporations Regulation 2001* (Cth).

However, regulation 5.3B.34 permits a Restructuring Practitioner to dispose of encumbered property within the ordinary course of the company's business. The ACF understands, regulation 5.3B.34 explicitly permits Restructuring Practitioners to dispose of property subject to PPSR registrations within the ordinary course of the company's business, and the draft subordinate legislation does not comment on whether an affected creditor would have any right to the proceeds of the sale of such goods. The ACF understands, a creditor whose goods were disposed of in the ordinary course of the company's business would not have a right to the proceeds of sale, and subsequently would lose their security interest. The ACF considers, the creditor should have a right to the proceeds of sale of any goods subject to a PPSR registration which is disposed of by the Restructuring Practitioner, and as such, a provision should be inserted after regulation 5.3B.34 which provides for the proceeds to be paid to the creditor who held the registration, to assist in discharging the debt.

3. Company continues as normal if proposed Restructuring Plan fails

The draft subordinate legislation provides a company is to continue as normal should a proposed Restructuring Plan fail to be approved. The ACF considers the ability for a company in financial distress to continue as normal raises some practical concerns which should be addressed in the implementation:

(a) Pursuant to section 455A of the Draft Bill, a company is taken to be insolvent upon proposing a restructuring plan. It is unclear, should a proposed Restructuring Plan fail, whether a company will continue to be taken to be insolvent. The presumption of insolvency where a Restructuring Plan is yet to be accepted, creates a substantial preference claim risk. The ACF recommends further provisions be inserted to the draft Regulations which clarify whether an indemnity will be provided to any payments made during the restructuring process, to ensure the company continues to meet its debts during the proposal period.

(b) The ACF considers there is a significant risk the company will become a 'Zombie company' in circumstances where directors fail to place the company into liquidation and creditors do not see value in pursuing wind-up action. The ACF recommends where a proposed Restructuring Plan fails the company should immediately commence simplified liquidation if applicable.

(c) The ACF is concerned this may lead to an increase of small business owners facing personal liability, as creditors may pursue guarantors directly rather than the company where there is a risk enforcement actions against companies would be futile.

4. Small Business Restructuring Practitioner

The ACF supports the proposed qualification requirements of Restructuring Practitioners provided in rule 20-2 of the Draft Rules. The ACF considers although the Draft Rules require Restructuring Practitioners to be members of recognised accounting organisations, there is still scope for the process to be abused by inexperienced pre-insolvency or debt advisors. The ACF echoes its recommendations made in its submission on the draft Legislation dated 12 October 2020, that Restructuring Practitioners should be required to satisfy further qualification requirements, including:

(a) be a full member of the Australian Restructuring Insolvency & Turnaround Association (**ARITA**);

(b) have completed the ARITA advanced insolvency program;

(c) have at least 5 years of demonstrated restructuring experience; and

(d) be subject to the same oversight from ASIC as a registered liquidator.

The ACF considers the requirement for Restructuring Practitioners to meet the above qualifications will reduce the likelihood of inexperienced Restructuring Practitioners abusing the restructuring process and provide businesses with the best chance of success.

Further, the ACF notes the subordinate legislation only requires a Restructuring Practitioner to certify a Restructuring Plan contains all required information and are not required to form an opinion on the Restructuring Plan. The ACF recommends a provision should be inserted into the Draft Regulations to require Restructuring Practitioners to provide an opinion as to whether, the simplified liquidation process is in the best interests of creditors and presents a better outcome than a standard liquidation.

5. Remuneration of Restructuring Practitioner

(a) may accept referrals from brokers pursuant to regulation 5.3B.16(d)

The Draft Regulations account for situations where Restructuring Practitioners may be referred to a company via a broker. Regulation 5.3B.16(d) requires that the Restructuring Plan clearly states the relationship between the Restructuring Practitioner and the referring broker. The ACF understands regulation 5.3B.16(d) may have been constructed to ensure creditor confidence, however, considers the regulation contravenes the fundamental principle that third parties managing companies should be independent. The Draft Rules permit Restructuring Practitioners to engage in a liquidator role, where businesses undergo the new simplified

liquidation process. Where Restructuring Practitioners are effectively acting as external administrators, the ACF considers they should be held to the same standards of best practice as a registered liquidator. The ACF recommends, in the interests of increasing creditor confidence, referrals to Restructuring Practitioners should be explicitly forbidden.

(b) Remuneration of Restructuring Practitioners pursuant to rules 60-1A–60-1D

The Draft Rules specify that a Restructuring Practitioner is entitled to receive remuneration for necessary work performed during the establishment and continuation of the Restructuring Plan. The quantification of the remuneration will be determined by resolution of a company's board. The ACF is concerned allowing the determination of a Restructuring Practitioner's remuneration to be made by a company's board which may result in the passing of a resolution approving excessive fees, reducing the assets available to creditors. Further, creditors may lose confidence in the restructuring process in circumstances where they are not involved in the determination of a Restructuring Practitioner's remuneration.

The ACF considers a Restructuring Practitioners remuneration should be determined by affected creditors at the time the proposed Restructuring Plan is voted on. Upon proposing the Restructuring Plan, details of the company's available assets and the Restructuring Practitioners fees and costs should be included as part of the Restructuring Plan. The ACF considers that the determination of remuneration should be analogous to the criteria currently imposed for external administrators. As such, the ACF recommends appropriate provisions addressing this requirement should be inserted at regulation 5.3B.13. Further, the ACF submits a provision similar to provision 60-10 of the *Insolvency Practice Schedule (Corporations)* which provides a determination specifying remuneration of an administrator is to be made by either the company's members or creditors, should be inserted into the Draft Rules at rule 60-1C.

6. Report to creditors regarding dividends in external administrations pursuant to rule 70-40(2)

Rule 70-40(2) will require a liquidator to provide creditors in a simplified liquidation process a report detailing the circumstances relating to the winding up of the company, the date the company will likely be wound up and the likelihood of creditors receiving a dividend. While the ACF acknowledges the report is intended to be simplified in line with the process, the ACF is concerned that the report will not provide a comprehensive insight into the details of the dividends which may result in creditors having decreased confidence in the simplified liquidation process.

The ACF recommends that rule 70-40(2)(a) be amended to include similar elements to those featured in rule 70-40(3) including the estimated amount of assets and liabilities of the company and details of what happened to the business of the company.

7. Value of creditor claims based on company records

The draft subordinate legislation provides the value of a creditors claim will be based on companies' records at the time the proposed Restructuring Plan is created and noted in the proposal statement provided to creditors. A creditor is not made aware of the value of their claim until the Restructuring Plan is proposed, being up to 20 business days from the day the restructuring began, pursuant to regulation 5.3B.15(1). The impact of these provisions is that the company determines which creditors are affected creditors and the value of their claims. Although this is able to be disputed by a creditor, provided the proposed Restructuring Plan has not been accepted, a dispute must be raised within 5 business days of receipt of the proposed Restructuring Plan.

The ACF notes, upon a dispute being raised, a Restructuring Practitioner is afforded the ability to review and recommend changes to the proposal, provided the total debt increase is significant. However, the draft subordinate legislation does not provide guidance as to what is considered significant for the purposes of the provision. Further, the ACF considers the review by the Restructuring Practitioner could delay the restructuring process and the review period of 5 business days could limit the time the Restructuring Practitioner has to review the disputes in the event multiple creditors lodge a dispute. The ACF recommends the value of creditors' claims should not be based on company records, and instead creditors should be notified at the beginning of the restructuring process and required to provide details of their debt or claim which is then verified against the companies records. This will allow for any disputes to be resolved within the proposal period, being 20 business days, before the Restructuring Plan is proposed.

8. Un-perfected PPSR registrations vest in the company

In line with the current voluntary administration process, any un-perfected PPSR security interest vests in the company. The ACF understands un-perfected PPSR security interests vest in the company, pursuant to sections 267 or 267A of the *Personal Property Securities Act 2009* (Cth), even where the proposed Restructuring Plan fails to be implemented and the business continues. The ACF considers permitting un-perfected security interests to vest in the company, whether the Restructuring Plan is adopted or not, will affect creditors ability to recover debt in the event the Restructuring Plan fails, and the creditor has lost its rights to assets. Further, it is the ACF's view, this would likely jeopardise support offered by creditors to businesses who are displaying signs of insolvency. The ACF recommends the inclusion of a provision, with clear drafting, within the Draft Regulations which will exclude the vesting of un-perfected PPSR security interests where a proposed Restructuring Plan has failed to be implemented.

9. Purchase Money Security Interest

The ACF considers the draft subordinate legislation does not effectively afford creditors the ability to verify the status of their security interests upon the appointment of a Restructuring Practitioner. The draft subordinate legislation appears to require creditors to rely upon the company and Restructuring Practitioner to ensure property with a security interest is not dealt with outside the permitted dealings in the draft Regulations. The ACF echoes its recommendation made in its submission on the draft Legislation to insert a provision to the Draft Regulations which provides a process to secured parties with a Purchase Money Security Interest registration to attend the business' premises, conduct a stocktake and verify items subject to their security upon appointment of a Restructuring Practitioner.

Further, the draft Regulations have not provided recourse to suppliers for payments of goods or services supplied throughout the restructuring period, whilst the company continues to trade. The ACF recommends provisions should be inserted into either the draft Bill or draft Regulations similar to those in section 443A of the Act, which provide an administrator is liable for any orders or services incurred, allowing for the same liability to be imposed on the Restructuring Practitioner.

Observations

The ACF makes the following general observations on the proposed amendments.

1. The ACF supports the prevention of related creditors from voting for the Restructuring Plan.

2. The ACF notes the draft subordinate legislation does not provide for a breach of an accepted Restructuring Plan to trigger an insolvency event. The ACF recommends the definition of triggering event referred to at regulation 10.43.01(2) of the Draft Regulations be amended to include a breach of an accepted Restructuring Plan as a triggering event.

3. The ACF supports the amendments to circumstances in which preference claims can be pursued in a simplied liquidation pursuant to section 588FE of the Act and accepts the amendments to regulation 5.5.04. However, the ACF reccoments that:

    (a) payments to unrelated creditors made in the ordinary course of the company's business, regardless of the $30,000 limit, should be exempt from preference claims to assist in minimising the effects of insolvencies on creditors; and

    (b) a provision should be inserted into the Draft Regulations which limits the time frame for a liquidator to bring a preference claim against an unrelated creditor from 3 years to a period of 12 months.

4. The ACF recommends the insertion of a provision to the Draft Regulations addressing what is to occur upon the termination of a Restructuring Plan by either the Restructuring Practitioner or the Court, including but not limited to, whether debts remain compromised, and whether payments made during the restructuring process would be at risk of a preference claim.

5. The ACF recommends the insertion of a provision to the Draft Regulations addressing the ambiguity of what occurs during the 5-business day period between when the restructuring period ends and when the Restructuring Practitioner must communicate the acceptance or rejection of the plan.

6. The ACF recommends a definition be provided to “substantially complying” in regulation 5.3B.22(b).

7. The ACF welcomes the introduction of virtual meetings for creditors as described in rule 50-6 and accepts the requirements of those meetings. However, the ACF recommends that:

   (a) there should be clarification on what a suitable poll would be for the purpose of counting votes in virtual meetings; and

   (b) more information should be noted regarding what systems would ensure the security and integrity of documents. The ACF understands that this definition may be difficult as the evolution of technology often outpaces legislature.

8. The ACF supports the requirement for a liquidator to publish a new report within 1 month, where a company has ceased to follow a simplified liquidation process, pursuant to rule 70-40(3)(b)(ii).

It is imperative there is transparency in the small business insolvency process, and that both secured and unsecured creditors are afforded opportunities to ensure their interests are protected.

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Anna Taylor
Chairman – Legislation Sub-Committee
Australian Credit Forum