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Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 – Draft Regulations

The Australian Institute of Credit Management (AICM) supports the intended outcomes of the Insolvency Reforms to Support Small Business however, based on the current drafting of the bill and regulations we believe these will not be achieved.

Key themes of review include:

- Operation of the Restructuring is inefficient.
- Risks to creditors will increase.
- Drafting of the Bill, Regulations and Explanatory Memoranda lack clarity.
- Lack of clarity, certainty and confidence for creditors in the process.
- Opportunity for manipulation to defeat creditors and facilitate illegal phoenix activity.

Due to these concerns it is our member's position that it is likely the reforms will result in creditors mitigating risk by reducing credit terms offered when businesses are displaying signs of insolvency and being unwilling to support restructuring proposals. These concerns would result in more businesses entering creditor in possession insolvency processes and reduce the availability of credit to support viable businesses that could otherwise restructure.

Additionally, the absence of a requirement for creditors to vote on a next step when a plan or proposal fails is likely to result in zombie companies and/or greater preference for creditors to obtain and pursue personal guarantees in order to mitigate risks when extending trade credit.

In addition to our recommendations (and those of ARITA and AFIA) we recommend that the Restructuring and Simplified Liquidation process have a sunset clause of 2 years unless a full review is conducted and recommendations implemented.

A thorough and immediate review of the whole insolvency regime is fundamental to ensuring best outcomes. Industry generally agrees that the current regimes need thorough review and improvement, should these reforms be implemented with flaws already evident the trust and integrity of Australia's business environment will be significantly eroded.



We detail our concerns and expand further in **Attachment A** along with our submission on the exposure draft bill.

We welcome the opportunity to discuss our submission further.

Yours Sincerely

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Attachment A

1 - New Debt Restructuring process

Eligibility for the debt restructuring process

AICM members are not confident the eligibility criteria are appropriately set to ensure the intended companies will be able to access the process and concerned they do not support efficient operation of the process.

\$1 million liability threshold

As stated in our prior submission the \$1 million liability threshold is too high and other measures would be better suited. It is AICM's view that several small businesses may be ineligible due to the high credit requirements and cost of inputs while larger businesses with low credit requirements may gain access.

Books and records

AICM recommends inclusion of a requirement to have good books and records as a criteria for eligibility.

As the records of the company will determine the efficiency of the company to prepare a plan and the SBRP to assist and certify the plan good books and records are essential to the success of this process. We also note that the requirement should be balanced such that businesses that have made a reasonable attempt to maintain good books and records would be eligible.

The requirement to have reliable and accurate books and records will:

- Ensure the efficiency of the process.
- Allow the SBRP accurately assess the viability of the business whilst minimising costs.
- Aid the SBRP ability to certify that the company is able to meet its obligations under the plan will be costly if records aren't available.
- Ensure businesses accessing the process have the fundamentals in place to assist their long term viability and ability to honour a successful proposal.
- Give creditors greater confidence in the plan and prospects of meeting the plan.

Contingent liabilities

AICM recommends – detailed clarification of the term 'contingent liabilities' is required to provide clarity between the accounting and legal concepts.

Further, it is unclear who will be responsible for calculating contingent liabilities, the creditor, company or SBRP.

The exclusion of contingent liabilities further jeopardises the likelihood the plan will be accepted or be capable of completion. To expand:

- The restructuring process and/or plan will be derailed if contingent liabilities become due.
- Without clarity of these potential liabilities creditors aren't able to have certainty or confidence the process will be beneficial or assess the risks associated with the plan.
- By including information of contingent liabilities creditors can be fully informed when the process commences and/or when assessing a proposal.



Debt restructuring period

No Disclosure the value of creditors debt values or claims

As an accurate value of debts is not established until the plan has been formulated and presented to creditors, AICM member experience with companies entering insolvency processes indicate the majority of proposals will be based on debt values that are significantly understated.

AICM strongly recommends - the process is revised to ensure debt values are verified as early as possible by:

- Providing a schedule of debts with the directors' declaration and this included with the SBRP's notice to ASIC and Creditors; and/or
- Requesting creditors submit a proof of debt in the notice to creditors.

This recommendation will:

- improve the quality of the proposed plan,
- make the process much more efficient, and
- give creditors more confidence in the process.

Declaration of employee entitlements and tax lodgements

It is important for details of these liabilities and obligations to be established before preparation of a plan and to assess the likelihood of a successful plan being established.

The absence of a requirement to declare employee entitlements and tax lodgements are up to date (or can be brought up to date) before a plan is entered leaves opportunity for manipulation including obtaining a statutory protection to conduct transactions that defeat creditors.

AICM recommends - a requirement to declare employee entitlements and status of tax lodgements is made at the commencement of a restructuring plan.

Directors declaration

Currently the declaration specifically permits the directors to omit preference payments to related parties from this declaration. This is a significant omission which will be manipulated.

AICM Recommends – the declaration also consider related party preference payments.

Additionally, Creditors will not have confidence that the declaration is accurate and reliable if the SBRP is not experienced with insolvency and the operation of legislation related to voidable transactions. Further, a lack of experience with insolvency will increase the time and cost of the SBRP assisting with this declaration.

Ordinary course of business

While the ability of businesses to continue to trade is supported AICM members are concerned the subjective nature of this term may be manipulated by those seeking to defeat creditors. Further, the subjective nature of this test, low value of transactions and cost of enforcement it is unlikely manipulation can be successfully deterred or prosecuted.

This is a significant concern that could erode creditor confidence in this process and reduce willingness to support proposals.

This concern supports the need for the SBRP to be at same standing as liquidators to ensure they are able to efficiently identify transaction not in creditors interest and detect attempts to defeat creditors.

It was also noted that there is no restriction to transactions not in ordinary course of business once a plan is made. This may allow the company to enter transactions related to assets not bound by the plan but critical to the business jeopardising the plan.

The AICM Recommends – standard terms include restrictions to transactions that are reasonably likely to affect the performance of obligations under the plan.

PPSA Securities

While the ability of businesses to continue to trade is supported, operation of the regulations will erode creditors rights which could lead to credit being withdrawn from companies displaying signs of insolvency due to:

- Un-perfected Security interests vesting in the company.

While the vesting aligns with other insolvency processes, it would be unjust for the company to benefit from these assets where restructuring ends, the plan is rejected, or the plan fails.

- Unclear if creditor rights to proceeds of goods sold during ordinary course of business and subject to PPSA registrations.

AICM recommends – redrafting of these sections to allow creditors to maintain their security interests

Liability for trade during restructuring period

Greater clarity as to who bears the liability to debts incurred during the restructuring period is sought by AICM members.

While it is understood the company will be liable, clearer detail in the explanatory memorandum is sought on whether or not these amounts will be captured by the plan.

Timing of notice being provided to creditors

The Restructuring Processes commences when directors appoint an SBRP but creditors may not be notified until 5 days later. This creates a 5 day period where creditors rights are affected but they are not informed.

As debts during a restructuring period are at extreme risk of not being paid in full (plus there is uncertainty if these debts are payable by the company or captured by the plan) it is unreasonable to blindly expose creditors to this risk.

AICM recommends - commencing the process once the notice is published with ASIC and provided to creditors.

The consequence of not addressing this may be to increase creditors hesitation to extend credit to companies displaying signs of insolvency in order to mitigate risk.

Remove the term “arrangements”

The use of “arrangements” when describing transactions prior to restructuring maybe too broad as it captures:

- Credit agreements for supply on order, further limiting creditors ability/willingness to supply on credit terms during the restructuring.
- Pricing agreements for supply on order, resulting in suppliers to revert to full retail pricing during restructuring.
 - o If creditors lose rights to proceeds of goods subject to PPSR registration this significantly increases their risk and mitigation is to reduce sale of goods on credit to businesses displaying signs of insolvency.

AICM recommends removal of the term arrangements.

The Small Business Restructuring Professional

As noted throughout our submission the creditors willingness to engage in the restructuring process and support proposals will hinge on their ability to be confident their interests are protected and being overseen by the SBRP.

While we support the intent to minimise the cost of the process, we recommend that this is best achieved by ensuring the SBRP is appropriately qualified, educated and experienced to conduct insolvency appointments.

To achieve the best outcomes for all stakeholders the SBRP needs to assist the directors with minimal disruption to the operation of the business, assess their plans, consider a diverse range of creditors, navigate complex legislative requirements and have a working knowledge of other insolvency processes. Further, the nature of this legislation indicates much of the operation of the process and decisions will only be clear after repeated use and/or establishment of case law.

Therefore, **AICM recommends** that SBRP’s are only fully registered liquidators for a minimum of 12 months when registration requirements could be reviewed.

Alternatively, if the SBRP is capable of holding a restricted registration the **AICM recommends** this is disclosed on all communications and they are not entitled to hold themselves out as a ‘liquidator’. This will ensure creditors are able to fully understand the capacity in which they act.

Fixed price remuneration

AICM members are concerned that due to the uncertainty of the work that will be required by an SBRP fixed price remuneration may lead to:

- Over quoting of the fee to cater for uncertainty.
- Short cutting work creditors would rely on to be confident their interests are protected.

Debt restructuring plan

Minimum detail provided with plan

Creditors ability to approve the plan will require them to be provided with sufficient information to assess the business case for incurring a bad debt. As structured the proposal is not required to contain information that will enable creditors to efficiently assess the proposal.



Without inclusion of a minimum level of information:

- Creditors may not engage with the process
- Creditors are likely to seek details from the SBRP which will increase costs and impact the efficiency of the process.
- Companies seeking to defeat creditors may manipulate this to obtain further time.

AICM recommends – Proposals include at a minimum:

- The reason restructuring is needed,
- Details of the company's assets,
- How restructuring will enable the business to continue trading, and
- What factors will support the company meeting obligations under the plan.

5 year period

Business conditions are likely to be tough for many years to come and the business environment is increasingly volatile and dynamic, therefore the longer the term of a plan the greater risk of failure making the potential returns to creditors less certain.

It can also be assumed that a standard maximum term of 5 years is likely to result in most plans being made for this term.

AICM recommends – 2 year standard maximum term, with the ability of the SBRP to approve up to 3 years where it can be shown this is in creditor's interest.

Value of secured debts

The value of secured debts is likely to be contentious as while the regulations state secured debts are valued to the extent the debt exceeds the security there is uncertainty as to:

- Who values security? Debtor, creditor or company
- What valuation method is used? Forced sale, Market value, retail value or wholesale value.
- The dispute resolution process on the value of security

Treatment of payments made under a plan that terminates

The regulations do not state if payments received under a plan would be voidable as an unfair preference payment if the company subsequently enters a liquidation process.

Should these payments be subject to preference claims creditors willingness to support restructuring would be further eroded.

AICM recommends the regulations specifically exempt payments made to unrelated creditors from voidable preference claims.

SBRP certification of the plan

To emphasise our earlier recommendation, we note the certification of the plan will only provide confidence to creditors if they are able to rely on the SBRP's knowledge, qualifications and experience.

Disclosure of debts

Currently a disclosure of debts included in the formulation of the plan is only made when the plan is provided to creditors.

As noted earlier, the ability for plans to be formulated and accepted efficiently requires the value of debts being verified as early as possible.

The regulations permit an SBRP to cancel a company's proposal to make a restructuring plan if one or more affected creditors were not disclosed in the proposed restructuring plan. It is highly likely this will happen in the majority of plans hence our earlier strong recommendation that the process is amended to efficiently establish the value of debts long before a proposal is put to creditors.

Accepting a proposal for a restructuring plan

Disclosure of proposed plan

Ensuring creditors receive the plan as quickly as possible to ensure efficient operation of the process. AICM members are concerned that the plan will be sent using records of the small business that may be incorrect. This is a significant issue for businesses (including SME creditors) that don't monitor ASIC notices and where the company's primary contact point is a generic address such as remittances@creditor.com as these addresses are often monitored by technology unable to identify urgent items such as these plans.

AICM recommends the SBRP is required to:

- Make reasonable efforts to validate contact details for creditors. Such as comparing company records to PPSR records, ASIC records and invoices received by the company.
- Lodge the plan with ASIC, this will ensure that any creditors omitted from the plan and not notified by the SBRP will be able to access details of the plan and SBRP efficiently and provide details of the debt most efficiently.

Period to respond

Under the proposed structure creditors expect the voting on proposals to be highly ineffective and prone to failure considering:

- The first plan is highly likely to change when accurate debt values are agreed, and omitted creditors included.
- The process to assess the value of debts and amend the proposal could be repeated numerous times.
- Changed proposals could be misinterpreted from a duplication of a prior proposal.
- Failure to amend a vote following a change could result in an unsatisfactory proposal being accepted or vice versa.
- Costs to the SBRP will increase due to the repeated assessments and changes to the plan.

AICM Member experience strongly indicates the above will be highly likely in the majority of restructuring processes and is a key factor that will erode the ability of the debt restructuring processes success.

Acceptance by the majority in value

The acceptance by majority in value will create an imbalance of power toward creditors with large debt values.

AICM recommends – Voting aligned with the current voluntary administration process which will ensure lessor valued creditors do not lose power and maximise uniformity between processes.

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Purchased debts valued at amount paid

The AICM supports this measure to ensure related parties and others with vested interests are unable to manipulate the process.

Termination of the Process

As detailed in our prior submission AICM strongly recommend that a creditor vote is taken to decide the next step when a proposal is not accepted or the process otherwise cancelled.

This is especially relevant where a proposal has been made and the business deemed insolvent.

To further support the recommendation AICM members have noted that likely reactions to a terminated plan would be:

- To deem the company insolvent and not trade with the entity.
- As no plan could be formulated wind-up proceedings are unlikely to provide a commercial return so unlikely to be initiated, potentially resulting in zombie companies.

An orderly decision on the next step should include options to return to directors, liquidation or voluntary administration. This would ensure that all viable options to maximise outcomes for all stakeholders are available and explored.

The effect of making a restructuring plan

Creditors debts not included in the plan can be admitted by SBRP after plan made

While initially supportive of this inclusion members noted that their concern that they are not afforded an opportunity to accept or reject the revised/reduced return that would result.

This is a significant concern as it undermines the certainty of the initial plan and the clarity of the process.

AICM recommends – creditors are afforded another 5 day period to accept or reject the revised plan



Terminating a plan

AICM members support the termination of a plan if the company/directors provided misleading information, however it is unclear if the creditors debts remain compromised.

AICM recommends – that when a plan is terminated, especially due to misleading information, the full value of the debt admitted, less any payments, is due and payable on the day the plan is terminated.

General Comments

Exemptions and disputes to be dealt with by application to courts

Due to time and cost, the use of courts to deal with disputes does not provide creditors confidence in the process and further the supports the need for the SRBP to be a full liquidator.

SBRP to declare referral fees paid

AICM members strongly object to the inclusion of this regulation which legitimises the use of referral arrangements and erodes the independence of the SBRP and confidence in the process.

Meetings of creditors

AICM recommends - meetings of creditors are able to be held if the practitioner deems it would provide efficiencies, the circumstances warrant their use or the meeting would benefit creditors.



2 – Simplified Liquidation

Voidable transactions

AICM members welcome the amendments to circumstances that preference claims can be pursued however repeat our previous recommendation that preference claims to un-related creditors in the ordinary course of business are exempt to minimise the ripple effects of insolvencies.

Further the reduced circumstance don't reduce the time frame required for a claim to be brought by the liquidator, currently 3 years.

AICM strongly recommends – the time frame for a preference claim to an unrelated creditor be reduced from 3 years to 12 months

To support this recommendation we note that the AICM has been discussing this criteria with insolvency practitioners, legal professionals and other industry and business groups for several years (including in a panel discussion during the ARITA online conference this month with 300+ insolvency professionals attending). Despite this extensive consultation the AICM is yet to receive an objection to the 3 years being reduced to 12 months.

Meetings of creditors

As previously stated, meetings of creditors can provide efficiencies to all stakeholders and should not be prohibited from taking place. The AICM also notes comments of ARITA that the restriction of meetings may diminish the liquidators ability to achieve outcomes beneficial to creditors such as to collect payment of an outstanding claim of the insolvent entity by reaching a reduced settlement rather than no payment or incurring legal fees.

AICM recommends - meetings of creditors are able to be held if the practitioner deems it would provide efficiencies, the circumstances warrant their use or the meeting would benefit creditors.