MinterEllison

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Dear Sir/Madam

Further submission in relation to insolvency reforms to support small business

1. Introduction

1.1 We refer to the exposure draft of the Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020 (Cth) (**Regulations**) and its explanatory memorandum. We also refer to MinterEllison's earlier submission dated 12 October 2020 (**Bill Submission**) regarding the Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (Cth) (**Bill**).

1.2 Please note that the views expressed in these submissions do not represent the views of MinterEllison's clients.

1.3 As with MinterEllison's Bill Submission, given the short time that has been available since the release of the Regulations, we make the following submissions on limited aspects of the Regulations, and some further submissions in respect of the Bill, as set out below.

2. Use of the term 'liabilities'

2.1 The use of the expression 'liabilities' in r 5.3B.03(1) is inconsistent with the definition of 'admissible claims' under r 5.3B.01 and the understood concept of 'debt' under s 553(1) of the *Corporations Act 2001* (Cth) (**Act**). This inconsistency may be productive of ambiguity in assessing the eligibility of a company to implement a restructuring plan.

2.2 Further, the definition of 'admissible claims' presents a possibility for disputes as to which claims by creditors are compromised by a restructuring plan based on the taxonomy of those claims as 'contingent' or not.

2.3 From a policy perspective, these reforms would have an increased impact (and potentially uptake) if (as with deeds of company arrangement under Part 5.3A of the Act (**DOCAs**)) a broader class of creditor claims are compromised by a restructuring plan. This could be achieved through removing the limitation in paragraph (c) of the definition of 'admissible claims' in the r 5.3B.01, or alternatively increasing the debt threshold of $1 million as stipulated in r 5.3B.03, or both.

2.4 For an example of how a DOCA can affect a contingent claim, see *Australian Gypsum Industries Pty Ltd v Dalesun Holdings Pty* Ltd [2015] WASCA 95.

3. Application of statutory immunity to omissions by restructuring practitioner

3.1 The proposed statutory immunity from liability for restructuring practitioners provided for in r 5.3B.10 may be of limited utility to restructuring practitioners because it leaves open a potential for disputes about whether a particular act by a restructuring practitioner falls within the scope of r 5.3B.10.

3.2 Further, r 5.3B.10 does not specify whether an 'omission' (as opposed to a 'thing done') by a restructuring practitioner will fall within the scope of the immunity.

4. Certification of restructuring plan and related issues

4.1 A restructuring practitioner is required to, by s 453D of the Bill, as soon as practicable after being appointed, make a declaration of relevant relationships. This declaration must then be given to as many of the company's creditors as reasonably practicable.

4.2 In light of the requirement to make and give a declaration on the company's creditors, the requirement in r 5.3B.16(2)(d) and (e) to provide certain information about the relationship between the restructuring practitioner and either a broker or an affected creditor, appears to be duplicative.

4.3 The inquiry and verification requirements in r 5.3B.16(4) will already require costs to be incurred to determine whether a restructuring practitioner can certify the restructuring plan. This is an effective and important check to ensure the quality of the restructuring plan certification. However, the requirement in r 5.3B.16(2)(c) for the restructuring practitioner to set out reasons why he or she 'does not believe on reasonable grounds a matter mentioned in paragraph (a) or (b)' reverses the onus on a restructuring practitioner to set out reasons for a belief which they do not hold which will increase costs for a restructuring plan that ultimately the restructuring practitioner will not certify.

5. Consistent use of the term 'affected creditor'

5.1 Various requirements are imposed on restructuring practitioners by r 5.3B.19(1) in relation to proposing a restructuring plan. This provision uses the defined term 'affected creditors' in paragraph (a) and then subsequently the undefined term 'creditors' in paragraphs (b) and (c). First, it appears unclear why and undesirable that details of the plan should only be made available to 'affected creditors', if it is intended that details should only be given to creditors who are thought to be 'affected' by the plan, even though all unsecured creditors are ultimately bound by it and are affected to that extent. In our view this choice should be left to judgment or chance. Secondly, in accordance with the general principles of statutory interpretation (and the potential for disputes about the status of creditors depending on the classification of their claims), it is desirable that the requirements in r 5.3B.19 are further clarified by using the defined term 'creditors' universally in this provision.

6. The use of 'vouchers' in disputes regarding creditors' claims

6.1 The use of the term 'vouchers' in r 5.3B.20(3)(iii) appears to be unduly restrictive or technical and should be replaced with a more general requirement to provide 'relevant documentation'.

7. Ambiguity regarding timing of 'reply' for the purpose of 'acceptance'

7.1 It is unclear when a 'reply' stating a plan should be accepted is effective to precipitate a plan being *accepted* in accordance with r 5.3B.23(1). The ambiguity can be resolved by deleting the words 'who reply' after the words 'affected creditors' and replacing them with the words 'whose replies are received by the restructuring practitioner'.

8. Impact of restructuring plan on subsequent secured creditors

8.1 Under r 5.3B.27(3), secured creditors are bound by the restructuring plan to the extent that the value of their security is less than the amount of their claim. In relation to senior secured creditors, this provision is satisfactory and does not create ambiguity.

8.2 However, in the case of subsequent secured creditors, practical difficulties arise with ascertaining the extent to which they are bound by the restructuring plan e.g., is a subsequent secured creditor able to avail itself of the full value of the property over which it has a subsequent security interest or is the extent determined net of any prior ranking security interests?

8.3 Similar issues arise in relation to the timing of the valuation of the security e.g., at the commencement of a restructuring plan, the security is valued at less than the secured creditor's claim and the secured creditor is then bound to that extent and its claim is compromised. If, subsequent to the restructuring plan being completed, the value of the security increases, is that same secured creditor's claim still limited to the net amount that was not compromised or will they be entitled to the full amount of their original claim?

9. Court termination of a restructuring plan

9.1 A Court is empowered by r 5.3B.54(1)(e) to terminate a restructuring plan if it 'would be contrary to the interests of the creditors of the company as a whole'.

9.2 Sub-paragraph (e) adopts different language from in the comparative s 445D(1)(f) of the Act which allows for a Court to terminate a DOCA on the basis of unfair prejudice to one or more creditors or the creditors of the company as a whole. Sub-paragraph (e) does not empower a Court to terminate a restructuring plan on the basis of prejudice to 'one or more such creditors' leaving open the possibility that discrimination against certain creditors (which does not similarly impact the creditors of the company as a whole) may be countenanced. We nevertheless expect this issue is being considered in light of the requirement that all admissible claims must rank equally and be paid proportionally (but see on that point the comments made in paragraph 11 below).

10. Status of certain voidable transactions

10.1 Section 500AE of the Bill and r 5.5.04 of the Regulations limit the scope for a liquidator under a simplified liquidation to pursue unfair preferences (under s 588FA of the Act). If a company continues to be in a simplified liquidation, unfair preferences in favour of non-related parties that occur in the 3 month (not 6 month) period before the relation back day and which do not exceed $30,000 in value are not voidable as such.

10.2 But nothing is changed concerning other voidable transactions, so for example, a $25,000 payment to a creditor which no reasonable person in the company's circumstances would have made could still be challenged as an uncommercial transaction (under s 588FB of the Act).

10.3 Liquidators have hitherto often pursued the same transaction as both a preferences and an uncommercial transaction. For a case where the court accepted that a transaction could be categorised as both an unfair preference and an uncommercial transaction see *Re Ashington Bayswater Pty Ltd (In Liq)* [2013] NSWSC 1008. If liquidators in simplified liquidations are not to be distracted by 'low value' voidable transaction liquidations, then the position with uncommercial transactions should also be clarified.

11. Equal ranking of all debts and claims

11.1 Regulation 5.3B.25(1) provides:

> (1) A restructuring plan made by a company is taken to include all of the following terms:
>
> (a) all admissible debts and claims rank equally;
>
> (b) if the total amount paid by the company under the plan in respect of those debts or claims is insufficient to meet those debts or claims in full, those debts or claims will be paid proportionately; …

11.2 We question whether this *pari passu* approach as between related and non-related creditors is appropriately adapted to achieve equitable outcome for creditors having regard to their differing interests and relationships with the company that is under restructuring. While we accept that the debts and claims of related creditors should be considered and accounted for by the restructuring practitioner in some way, a strong justification can be advanced in favour of giving non-related creditors a superior return.

11.3 We can envisage a scenario where the debts and claims of unrelated creditors (e.g., trade creditors) will be unfairly attenuated by the value of debts and claims of related creditors, particularly where the related creditor is a director or a related body corporate of the company under restructuring. It is arguable that non-related creditors will feel a heavier burden in circumstances where the total amount paid by the company under the restructuring plan is insufficient to meet the debts or claims

in full. Non-related creditors will have contracted with companies on arms-length terms in good faith not having the insight that related creditors have with respect to the company. For this reason, non-related creditors take on greater risk when contracting with companies, and therefore should be entitled to greater participation in the funds distributed as part of a restructuring plan in acknowledgement of this risk. Simply put, is it fair that a financially non-distressed holding company should get the same cents on the dollar distribution as a non-related trade creditor who may, as a result of the insufficient distribution made to it, itself become insolvent? Or should the solvency of the company be addressed by an improved cents in the dollar distribution to non-related trade creditors, with the claims of related parties being forgiven without any payment being made to them, or deferred for payment at some future time, when the company's prospects have improved?

12. Omission of related creditors from schedule of debts

12.1 Under r 5.3B.29, rights are conferred upon creditors who have not been included in the schedule of debts and claims with respect to a company such that they may notify the restructuring practitioner of the omission with the view to having their debt or claim admitted.

12.2 However, r 5.3B.29(6) provides that, in such circumstances, the 'restructuring practitioner must reject the debt or claim if the restructuring practitioner is satisfied that the person is a related creditor of the company'. We query whether this requirement is fair as it deprives the restructuring practitioner of the discretion that is afforded to them under r 5.3B.29 in relation to non-related creditors. On one hand we accept that by virtue to being a related creditor, such creditors would more often than not be alive to the fact that the company to which they are related is under restructuring, though on the other hand, this is not guaranteed in all circumstances and may result in legitimate debts and claims of related creditors being compulsorily excluded through no fault of their own.

12.3 Further consideration should be given to whether the restructuring practitioner should have the discretion to admit related creditors in these circumstances, whether consistent with the treatment of non-related creditors or otherwise, and should no change be made to the draft Regulations, the explanatory memorandum would be improved by outlining the policy rationale behind r 5.3B.29(6).

13. Issues with the time for adoption of simplified liquidation process

13.1 Under s 500AB of the Bill, creditors are afforded 20 business days to direct a liquidator not to follow the simplified liquidation process. However, under s 500A(2)(a) of the Bill, a liquidator must not adopt the simplified liquidation process if more than 20 business days have passed since the 'triggering event' under s 489F has occurred.

13.2 The congruence of these two 20 business day periods creates either:

(a) a conceptual impossibility in that a liquidator could never adopt the simplified liquidation process until the time for doing so had expired, in order that the creditors have the benefit of the period they are entitled to lodge a notice under s 500AB; or

(b) a situation where the liquidator would effectively deny the creditors the benefit of the 20 business day period by adopting the simplified liquidation process before that time period has expired.

13.3 This tension could be resolved by shortening the time for the creditors to notify the liquidator or extending the time in which the liquidator may follow the simplified liquidation process.

14. Meetings in the simplified liquidation process

14.1 As outlined in our Bill Submission, we suggest there should be some capacity for a meeting of creditors to be called during the simplified liquidation process, rather than such meetings only being possible under the existing liquidation framework.

14.2 The capacity to call one meeting of creditors on short notice would be an appropriate middle-ground measure that would achieve balance between the interests of streamlining the liquidation process for small businesses and enabling creditors to express their, and hear each other's, views.

14.3 In the alternative, it would be appropriate to provide an electronic list of all creditors and their contact details to enable discussion between creditors throughout the simplified liquidation process, and

particularly in instances where there is a proposal by at least 25% of creditors by value to reject the simplified liquidation process.

We would be pleased to discuss any of the above matters and provide further input if requested.

Yours faithfully
MinterEllison

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