PROPERTY COUNCIL of Australia

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Manager
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By email: MCDInsolvency@treasury.gov.au

Dear Christine

Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020

The Property Council welcomes the opportunity to respond to the draft *Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020* (the draft regulations).

The Property Council supports the Government's proposed changes to corporate insolvency in Australia which are intended to reduce the complexity and costs in insolvency processes for small businesses.

However, we have two overarching concerns with the draft regulations:

- **Sanctity of the lease covenant is undermined** as there is no protection to ensure that landlords can enforce their rights under a lease where they have not voted in support of the restructure. Unlike other creditor classes, who may be under no obligation to continue to supply to the debtor company and may change their service terms during the restructuring process (for example to delivery on payment terms), a landlord is obligated to provide exclusive use of premises to the tenant throughout the lease term, and could therefore be forced to accept materially lower rent to their detriment.

- **Proposed scope of the regime could inadvertently apply to large businesses** as there is no 'small business' test and the calculation of the $1 million liabilities cap does not include future rent obligations that accrue after the restructuring date. This would not be in keeping with the policy intent which is to support small businesses.

Unless these issues are addressed, the proposed insolvency reforms could give rise to significant impacts for commercial property owners – many of whom are also small businesses – including for example, loss of cash flow, risks of breaches in debt covenants and in extreme situations, loan defaults and forced asset sales. Commercial property is a critical part of the Australian economy and financial system and the insolvency reforms should not inadvertently jeopardise the stability of our markets.

Our submission below provides further details and recommendations to address these critical issues. Additionally, we have included an issue log (attachment A) that outlines other areas of concern with the draft regulations.

1. Ensuring sanctity of lease contracts

A lease agreement gives rise to contractual rights and obligations for both landlords and tenants throughout the term of the lease, in particular, the exclusive use of premises is provided by the landlord in exchange for the tenant agreeing to pay rent and keep the premises in good order.

The relationship between property owners/landlords (creditors) and tenants (debtors) is unique insofar as the owner/landlord is providing an essential service for the business that is applying to restructure. Unlike suppliers of goods to a business who can change their service conditions dependent upon the current 'at time' situation of the business (moving to cash on delivery, withholding goods until invoices are paid), the situation for the landlord is very different in this situation.

Changes to future rent obligations should require landlord consent

The draft regulations do not contain any provisions to ensure that a tenant's future rent obligations under a lease cannot be altered without the consent of the landlord. This is because the definition of "*admissible debt or claim*" extends to future debt claims pursuant to section 553(1) of the Act. A claim to future rent under a lease is a known and certain claim and is not a contingent claim.

We advocate that the definition of "*admissible debts and claims"* is amended to exclude future rent and other future occupancy costs under a lease from the restructuring plan.

Without this clarity, lease conditions could be rewritten without consultation with the landlord and without the consent of the landlord. This fundamentally overrides the sanctity of lease contracts and could result in adverse financial consequences for landlords.

As the restructuring practitioner is removed from liability – unlike the current administration process where the administrator is liable for rent payments – the responsibility for rent payments must reside with the business seeking restructure.

The regulations should ensure that property leases are protected from alteration without the express consent of the owner/landlord and, additionally, that the regulations ensure that there are provisions for the ongoing payment of rent through the restructure. These are critical parts of the administration process for owners of properties that small businesses occupy.

Landlords should not be prohibited from enforcing rights under the lease

The current drafting of the regulations does not appear to provide landlords and owners with the same provisions currently expressed in the Corporations Act for the voluntary administration process. That is, a deed of company arrangement can only bind a dissenting landlord in respect of its personal claims against a company (i.e. claims for rent, including future rent) and not its proprietary rights (such as its rights to take possession of the leased property) (section 444D(3) of the Corporations Act) in circumstances where a landlord does not vote in favour of the Deed of Company Arrangement. Unlike the voluntary administration regime, the proposed regulations could be read and interpreted as enabling a restructuring plan to bind landlords in respect of all "claims" (for example, see the use of "claim" in regulation 5.3B.28).

The regulations should reflect, as the current Corporations Act does under section 444D(3), that the restructuring plan should not bind the owner/landlords' proprietary rights in circumstances where the owner/landlord does not vote in favour of the restructuring plan. The regulations should also make clear that a "claim" does not include proprietary or other rights which do not involve the payment of rent or other money.

Landlords should be entitled to rent owing during the restructuring phase

There is also opaqueness in the regulations on how the regime will deal with situations where rent is not paid by the debtor company during the restructuring phase where the debtor and the restructuring practitioner are finalising the restructuring plan.

The regulations are unclear on the landlord's rights to claim any unpaid rent during this period, how that debt is to be handled by the landlord for the twenty (20) day restructuring phase plus the fifteen (15) days for creditors to vote on the plan, and the ability of a landlord to enforce its rights under the lease in respect of such unpaid rental amounts incurred during the restructure period (noting our comments above on the issue of landlords exercising their rights under a lease).

Additionally, if the restructuring practitioner grants an extension to the debtor this period will extend by an extra ten (10) business days, potentially stretching the plan and acceptance period out to forty-five business days.

However, this situation could be amended by Treasury by providing clarity on how the debts are to be calculated and how any debt that may accrue after the commencement of the restructuring plan is to be mitigated.

2. Ensuring regime is limited to small businesses

In announcing the proposed changes to the insolvency regime, the Government was clear in expressing the intention was to limit these changes to small businesses, however the broad drafting of the liabilities definition and body corporate definition could extend the reach of the provisions to large businesses.

$1million liabilities cap should include future rent obligations

We continue to be particularly concerned that the $1 million loan liabilities cap will be applied at the date of the commencement of the restructuring period and will not include future rents or other debts that are included as liabilities to the landlord during the tenancy.

This is particularly disadvantageous to landlords who are likely to have significant current or future debt as at the date of the restructuring proposal unlike other creditor classes who may be under no obligation to continue to supply to the debtor company and may change their service terms during the restructuring process, for example to delivery on payment terms.

Rent typically accrues on a monthly basis, and therefore, the accrued liability at the time of a restructure will not accurately reflect the total rent payable across the lease term. Taken to the extreme, a tenant could have a monthly rent bill of $1m and therefore be under the threshold (assuming no other liabilities), but actually be committed to a lease worth many millions of dollars. Such a business would not typically be a "small business" that is the intended target of these measures.

This can be addressed by amending the $1 million dollar cap to include future debt and contingent claims for landlords and that further clarity on what comprises eligible "*liabilities*" is provided in the Regulations.

Ensuring large corporate groups are not inadvertently eligible for the regime

The regulations note that a 'body corporate' may seek exemption for a director from the seven-year prohibition under certain circumstances.

The current wording could lead to a situation where a group establishes separate companies who may separately apply for protection under the new provisions – where the companies may be spread across several tenancies with the one landlord this would mean that the property owner may be left with an accumulative debt above the $1million limit.

This anomaly could be addressed by defining within the regulations a specific definition of a small business under the eligibility criteria.

Conclusion
We recognise the challenge in constructing this new regime is ensuring that the debtor can continue to trade while restructuring their business in such a way so that any outstanding debts can be repaid in a timely and cost effective way for creditors. However, it is vitally important that in creating such a scheme that there is a recognition of, the vital service that the landlord plays in providing a property from which a business seeking to restructure is able to continue to trade.

It is critical that the draft regulations are amended to recognise the rights of owner/landlords in respect of their properties and the rights of owners/landlords to continue to receive rents from businesses that are in the situation of requiring restructure.

For this regime to function in the manner with which the government desires it must take these matters into account so that small businesses can continue to trade throughout this difficult economic time without also undermining lease contracts and the broader commercial property sector.

We are available to meet at your convenience to discuss these crucial issues prior to finalisation of the regulations. Please do not hesitate to contact me on 0400 356 140 or at bngo@propertycouncil.com.au or Collin Jennings on 0413 472 189 or at cjenning@propertycouncil.com.au.

Yours sincerely

Belinda Ngo
Executive Director – Capital Markets

Property Council submission
Attachment A – Issues log

Regulation	Issue	Impact	Solution
5.3B.03(1) - the test for eligibility is that the total liabilities of the company on the day the restructuring begins must not exceed $1 million.	The $1 million threshold is calculated at a moment in time.	There is no restriction on a company paying down a number of creditors in order to come under the $1 million threshold.	Consider whether the $1million dollar threshold should be assessed over, say two months.
	The test does not include contingent liabilities, which means it does not include future rent payable under a lease in existence at the day of restructuring.	This could capture businesses with leases that are well over $1 million in value and result in significant financial consequences for commercial landlords, many of whom have already provided significant ongoing rent relief to tenants under the Commercial Leasing Code.	Include contingent liabilities in the eligibility test in section 5.3B.03(1). Alternatively, include contingent liabilities for a period of time, for example, contingent liabilities incurred in the two-month period prior to the appointment of the restructuring practitioner.
	The $1 million threshold is currently contained in regulation, not legislation.	The $1 million threshold could be amended by parliament with very little consultation as it is contained within the regulations (rather than the Act). This could result in a greater number of companies falling within the threshold.	Consider including the definition within the Act.
5.3B.03(and 5.5.03). Unclear definition of "liability"	"Liabilities" is defined as any liability or obligation that is not contingent.	If debtors are unclear on how to quantify their liabilities (i.e. what is included), these new regimes may not be utilised by as many businesses as expected or may be utilised by companies that are not eligible.	Clarify how "liabilities" are calculated, whether it includes unliquidated damages, that the liability must be certain or readily quantifiable.
5.3B.03 – sets out prescribed circumstances for the	A prescribed circumstance is that: (a) the other company is a related body corporate of the company in	It is important that the regulations ensure that corporate groups are identified correctly so that companies	Remove the prescribed circumstance from 5.3B.03.

Regulation	Issue	Impact	Solution
purposes of paragraph 453C(2)(b) of the Act	relation to which the eligibility criteria are to be met; and (b) the other company is, or has been: (i) under restructuring; or (ii) the subject of a simplified liquidation process; and (c) if subparagraph (b)(i) applies—the restructuring practitioner for the other company was appointed no more than 20 business days before the day on which the restructuring of the company in relation to which the eligibility criteria are to be met began; and (d) if subparagraph (b)(ii) applies—the other company began to follow the simplified liquidation process no more than 20 business days before the day on which the restructuring of the company in relation to which the eligibility criteria are to be met began.	are not structured intentionally to fall within this regime (for example different tenant entities for each lease). Companies registered in Australia that are part of a large corporate groups (including international groups) should not be eligible.	
5.3B.04 -Small Business Restructuring Practitioner	It is unclear what Small Business Restructuring Practitioner (SBRP) needs to satisfy themselves before consenting to a transaction outside the "ordinary course of business"	The lack of clarity could give rise to potential abuse by the company and SBRP.	SBRP should only consent to transactions outside the "ordinary course of business" where it is in the best interests of creditors.
5.3B.19 – Restructuring plans **5.3B.26 - parties to a restructuring plan**	As soon as practicable after a company executes a restructuring plan, the restructuring practitioner for	The restructuring plan is binding on creditors whether or not they have provided a written statement in respect of the restructuring plan	Include a similar provision to section 444D(3) of the Corporations Act.

Regulation	Issue	Impact	Solution
5.3B.27(2)(a) - The plan is binding on a creditor	the company must do the following: … (b) ask each creditor to: (i) give a written statement setting out whether or not the restructuring plan should be accepted.	indicating whether or not the restructuring plan should be accepted, or where they have provided a written statement in respect of the restructuring plan indicating that they are against the restructuring plan. Unlike the voluntary administration regime, whereby a Deed of Company Arrangement can only bind a dissenting landlord in respect of its personal claims against a company (i.e. claims for rent, including future rent) and not its proprietary rights (such as its rights to take possession of the leased property) (section 444D(3) of the Corporations Act), a restructuring plan can bind landlords in respect of all claims.	
5.3B.22 – Clarity on 'substantial' compliance.	It is unclear what "substantial" compliance with paying employee entitlements and filing tax returns means.	It is unclear when a company will be eligible under the SME restructuring regime.	Delete reg 5.3B.22(b)
5.3B.230 – Restructuring approval plans	A majority in value of creditors can approve restructuring plan	This could result in unfavourable outcomes for creditors where a restructuring plan can be approved by one large creditor	This inequitable outcome can be addressed by requiring a majority in value and number of creditors to approve the restructuring plan. This is consistent with approving a Deed of

Regulation	Issue	Impact	Solution
			Company Arrangement under voluntary administration.
5.3B.28(3)(b) – Enforcement of property rights	A person bound by the plan cannot begin or proceed with an enforcement process in relation to a property of the company to recover an admissible debt or claim. Property of the company includes … any other property used or occupied by, or in the possession of, the company	As above.	As above.
5.3B.34(5) – Court making orders	The Court may only make an order under subregulation (4) on the application of …(b) the owner or lessor, as the case may be (for disposal of property that is used or occupied by, or is in the possession of, the company but which someone else is the owner or lessor).	The onus is on the owner/lessor to apply to Court not to dispose of property. This is unduly onerous on the owner/lessor of the property. There is no provision to require the restructuring practitioner or directors to disclaim the lease if they do not provide an assurance that rent will be paid during the restructuring phase. This is different from the provisions of s443B in the Corporations Act.	Onus to be placed on the restructuring practitioner to make the court application. Incorporate an equivalent of section 443B.

Additional issues

Issue	Impact	Solution
Unpaid debts incurred during the development of the restructuring plan before	Creditors will not know who is liable for debts owing to them during this period	Make clear that unpaid debts incurred during the development of the restructuring plan before voting are provable in any subsequent liquidation

Issue	Impact	Solution
voting are not currently provable in any subsequent liquidation		
Cost of the restructuring regime	The restructuring regime may be a high risk situation for the restructuring practitioner. Although control of the company is intended to remain with the directors, there are a wide variety of issues that the restructuring practitioner needs to deal with, give consent to and manage. There are significant penalty provisions for restructuring practitioners who fail to comply. This may ultimately end up being wider than currently known in light of the fact that indemnity and lien provisions mirroring that for voluntary administrations have now been included. The effect of this is that it may lead to greater involvement by the restructuring practitioner than anticipated, leading to greater costs incurred.	Provide that restructuring practitioners provide fixed cost estimates for each stage of the restructuring, and for oversight of the restructuring plan.
General lack of requirements to seek consultation from owners and lessors of property in circumstances where an owner or lessor's interests are adversely affected in a significant way	This may affect adversely affect the rights of owners and lessors, without their having any form of recourse, for example, if a restructuring plan reduces the amounts payable under a lease which would diminish the value of an owner or lessor's assets, the owner or lessor has no ability to challenge the restructuring plan if approved by a majority of creditors in value.	Provision needs to be given to owners or lessors of property to be able to apply to the court in circumstances where the owner or lessor's rights are affected in a significant way and to be able to recover property in that circumstance.
It is not clear what the implications are for director liability during the restructuring, or if the restructuring is unsuccessful	Can directors be liable for insolvent trading, for example, if the restructuring plan is unsuccessful?	Greater accountability for directors would assist to deter any wrongdoing, particularly given that the directors remain in control of the company during the restructuring process.

Issue	Impact	Solution
Court imposed extensions	There is no detail on the criteria that the court needs to take into account when deciding whether to extend the proposal period. There is also no limit on the period that the court can extend the restructuring period which would negate what is meant to be a 'quick' process. This could lead to the debtor accruing further debts during this process to the detriment of creditors.	There should be an obligation on the insolvency practitioner to justify/document the reasons for the extension. The regulations should apply a limit as a maximum for the court to apply. This should be no greater than an extension of another 20 business days.