ARITA
AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

26 February 2021

Manager
Market Conduct Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: MCDInsolvency@Treasury.gov.au

Dear Sir/Madam

Increasing the statutory demand threshold

Thank you for the opportunity to lodge a submission in the response to the Treasury's discussion paper dated 15 February 2021 in relation to a potential increase in the statutory demand threshold beyond the current $2,000 debt value.

Background

The current statutory demand threshold was temporarily increased to $20,000 as part of the Government's package of legislative reforms passed on 25 March 2020. Originally due to expire on 25 September 2020, the temporary increase was later extended until 31 December 2020.

It is important to recall the truly extraordinary environment Australia was facing at the time of the temporary increase. With the global spread of COVID-19 having only just begun, little was known about the health, economic and social impacts the nation would encounter in the short and medium term and, necessarily, the fiscal support and legislative measures introduced by the Government were *reactive* to those unknown, unprecedented and potentially devastating risks.

Yet, 12 months on, Australia is now operating in what the Prime Minister has noted (in his press conferences on 4 and 5 February 2021) is a very different risk environment. With few cases of community transmission, the rollout of vaccines and a cautious economic recovery underway, the risk settings that may have justified the immediate COVID-19 fiscal and regulatory measures no longer exist to the same degree. The Prime Minister, Treasurer and Governor of the Reserve Bank have now all indicated that the believe the risk of a protracted

downturn (and therefore the risk of insolvency) have been avoided and that the economic recovery is stronger than expected. Indeed, the latter is a recurrent message in all of their public statements.

Additionally, following the passage of the *Corporations Amendment (Corporate Insolvency Reforms) Act 2020* (Cth) on 10 December 2020, there is now in place a dedicated small business restructuring process (along with a simplified liquidation process) to support distressed businesses that continue to be impacted by the pandemic-related economic downturn.

Summary of ARITA's position and questions for consideration

In light of that changed risk setting, and because of the adverse consequences for vulnerable stakeholders and the efficient use of capital identified below, we do not believe the Government should increase the existing $2,000 statutory demand threshold.

As always, our position reflects the views of our members. In a survey conducted in August 2020 prior to the Government's further extension of the temporary increase in the threshold to $20,000 from 25 September 2020 to 31 December 2020, 57% of our members who responded opposed any increase in the threshold at all, while only 16.7% supported a permanent extension of the threshold (whether to $20,000 or a lesser level).

We note the four questions identified in the Treasury's discussion paper: should the statutory demand threshold be increased, if the threshold is increased then to what amount, if the threshold is increased then when should it come into effect, and what would be the impacts of increasing the threshold.

In this submission, we deal with the first and fourth questions together. Due to ARITA's position that there should not be an increase in the current statutory demand threshold, it is not necessary for us to address the second and third questions.

Key points

It must be pointed out that any solvent company should be able to pay a statutory demand if it is issued or else the company naturally fails the legal test of solvency of being able to pay all debts as and when they fall due.

Fundamentally, there is a risk that, unlike the new small business restructuring laws that are intended to incentivise the rehabilitation of *viable* companies in financial distress, an increase in the statutory demand threshold may perpetuate the continued operation of *unviable* companies in a manner that would not only cause serious harm for vulnerable stakeholders, but also impede the efficient use of capital in the economy more broadly.

In that regard, it is necessary to take a step back to reflect on the underlying purpose of a statutory demand as an evidentiary tool to assist in proving that a company is insolvent. In practice, non-compliance with a statutory demand is the primary basis upon which a creditor commences proceedings to have a company wound up in insolvency.

As Farid Assaf SC notes in the leading Australian text on statutory demands, the evidentiary underpinning of the statutory demand process is critical to achieving one of the overriding purposes of Part 5.4 of the *Corporations Act 2001* (Cth) (***Act***), in which the statutory demand process is contained, of the speedy resolution of winding up applications – specifically, facilitating 'what is otherwise quite a difficult matter to prove by providing a "convenient and simple" method of establishing a company's insolvency' (Farid Assaf, *Statutory Demands and Winding Up in Insolvency*, LexisNexis, 2nd ed, 2012 at [1.1], referring to *Clarke & Walker Pty Ltd v Thew* (1967) 116 CLR 465 at 467 and *Re Willes Trading Pty Ltd and the Companies Act* [1978] 1 NSWLR 463 at 464).

The existing minimum debt threshold of $2,000, viewed in the context of a legislative scheme in the *Act* that enables a statutory demand to be set aside on the basis of a genuine dispute (among other grounds), sets a fair quantum for the presumption to arise. Indeed, as Kirby P noted in *FAI Insurances Ltd v Goldleaf Interior Decorators Pty Ltd* (1988) 14 NSWLR 643 at 649, 'a company's failure to pay a *small* debt may often be the best possible evidence of the company's insolvency' (original emphasis).

The operation of the statutory demand process, *including* with reference to a low minimum debt threshold, may indeed be seen as one of the foundational features of modern corporate insolvency law (as Mr Assaf points out at [1.20] of his text), having existed in the common law world since the enactment of the *Joint Stock Companies Act 1856* (UK), which at the time nominated £50 as the minimum threshold.

For comparative purposes, it is worth noting that the existing minimum debt threshold in Australia of $2,000 is of a similar quantum to that which applies in the United Kingdom (£750) and New Zealand (NZD $1,000).

An increase in the existing threshold would significantly limit the ability of creditors to initiate winding up proceedings. While they would retain the ability to do so irrespective of the value of the debt they were owed upon proof of the debtor company's insolvency, the cost and expense of doing so (typically in the context of incomplete information) would act as a substantial deterrent to the commencement of proceedings.

With this lesser risk of being wound up, companies facing endemic liquidity issues would have an incentive to continue to trade, accumulating debts across a number of suppliers and customers simultaneously as well as employees' wages, superannuation and other entitlements. It cannot be assumed that the insolvent trading regime, along with the broader general law and statutory duties owed by directors to a company, would alone serve as an adequate counter to that incentive.

Yet those stakeholders are the most vulnerable in the event of insolvency, and smaller suppliers and employees especially continue to face significant challenges in the current economic conditions as supply and demand shocks caused by the pandemic continue to impact multiple sectors in the economy.

By increasing the statutory demand threshold, assistance to a trading company therefore comes at the expense of multiple other stakeholders, and may cause a consequential widespread 'ripple effect' of financial hardship and, possibly, collapse.

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We note the Treasury's comments in the discussion paper that a statutory demand 'may also unnecessarily push a company into liquidation, where that company has long term viability and has a chance at a successful restructure'. However, in our view, while an increase in the statutory demand threshold would also benefit *viable* entities likely to return to profitable trade notwithstanding interim financial distress, the new small business restructuring laws, along with the insolvent trading safe harbour in section 588GA of the *Act* and the restrictions on the enforcement of *ipso facto* contractual clauses, already provide measures to give those entities 'breathing room' and an opportunity to explore a formal restructure.

As a consequence, in practice the primary beneficiaries of an increase in the statutory demand threshold would be *unviable* companies, giving rise to the moral hazard and potentially irreparable harm to vulnerable stakeholders identified above. In addition, as alluded to above, on a macroeconomic level, allowing unviable entities to continue to trade would simply delay the inevitable, tying up scarce capital (all the more limited in the current economic climate) and preventing a quick, cheap and efficient liquidation which would see that capital recycled and reinvested in more innovative and profitable ventures.

We therefore believe that increasing the statutory demand threshold would be a purely *reactive* regulatory measure lacking any coherent economic or social justification.

A further adverse consequence of an increase in the statutory demand threshold – which may impact *all* companies – would be that financiers and suppliers, facing an increased risk of insolvency loss due to a lesser ability to issue a statutory demand in the event of default as a precursor to a winding up application, may alter their terms of trade. In particular, there is a risk that financiers and suppliers may increase the cost of providing finance, equipment or other products and services, or may seek more extensive security from trading companies. For smaller companies operating in industries considered to be particularly 'at risk' (for example, in the hospitality, retail and tourism sector at present), there is a prospect that financiers and suppliers may simply refuse to conduct business with those companies altogether.

This would leave many companies without the necessary stock and working capital – the lifeblood of any business – to trade. At a time when the Government's policy priority is economic recovery, supported by enhanced business activity, innovation and jobs growth, that outcome would be highly detrimental to Australia's economy, as well as individual livelihoods.

We look forward to continuing to work closely with the Treasury in relation to any modification of the current statutory demand threshold. Should you wish to discuss any aspect of our submission, please contact Dr Kai Luck, Legal Counsel, at kluck@arita.com.au.

Yours sincerely

John Winter
Chief Executive Officer

About ARITA

The Australian Restructuring Insolvency and Turnaround Association (ARITA) represents professionals who specialise in the fields of restructuring, insolvency and turnaround.

We have more than 2,200 members and subscribers including accountants, lawyers and other professionals with an interest in insolvency and restructuring.

Around 80% of Registered Liquidators and Registered Trustees choose to be ARITA members.

ARITA's ambition is to lead and support appropriate and efficient means to expertly manage financial recovery.

We achieve this by providing innovative training and education, upholding world class ethical and professional standards, partnering with government and promoting the ideals of the profession to the public at large. In 2019, ARITA delivered 118 professional development sessions to over 5,300 attendees.

ARITA promotes best practice and provides a forum for debate on key issues facing the profession.

We also engage in thought leadership and public policy advocacy underpinned by our members' knowledge and experience. We represented the profession at 15 inquiries, hearings and public policy consultations during 2019.