ARITA
AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

5 May 2021

Manager
Market Conduct Division
Treasury
Langton Cres
PARKES ACT 2600

By email: MCDInsolvency@Treasury.gov.au

Dear Sir/Madam

Consequential amendments to small business insolvency reforms

Thank you for the opportunity to lodge a submission in the response to the exposure draft legislation and explanatory material for the consequential amendments to the small business insolvency reforms.

Comments on provided materials

ARITA has reviewed the provided materials and makes the following comments:

Exposure Draft Treasury Laws Amendment (Corporate Insolvency Reforms Consequentials) Bill 2021

- ***Item 15*** **–** we query whether the substitution table included in section 522-1 should include a reference to 'restructuring practitioner for the corporation' for *Corporations Act 2001* (Cth) (Act) references to 'restructuring practitioner for the company'.

- ***Item 26 and 27*** – We question whether this amendment will cover communications sent by an external administrator in respect of a company, as the external administrator does not ordinarily send the communication in their personal capacity, but rather as the external administrator of the company. In such instances it would appear that the deemed location would be the company's registered address, which has no relevance in an external administration.

  We suggest it would be clearer if there was a particular category for communications by external administrators that states that the communication comes from the principal place of business of the external administrator.

- ***Item 28*** **–** In our view the amendment relates to eligibility to appoint a small business restructuring practitioner (SBRP) and should be included in the eligibility criteria in s453C rather than 453B.

- ***Item 30 proposed s456LB(2)*** – The Explanatory Memorandum states that the addition of s456LB is consistent with the existing protections in relation to voluntary administrations. We note that voluntary administrations does include a similar provision (s 442F), but there is no similar provision for Deeds of Company Arrangement. However, proposed s456LB has two sub-sections – the first relates to the restructuring of the company and the second relates to the plan. If the intent is to mirror provisions in Part 5.3A, then proposed s456LB(2) should not be included and only s456LB(1) should apply. This is appropriate as in both a Deed and a Plan, it is the directors that are responsible for the ongoing operations of the company.

- ***Item 31*** - In our view the amendment relates to eligibility to use the simplified liquidation process and should be included in the eligibility criteria in s500AA rather than 500A.

- ***Item 32*** **–** The reason why proposals without meetings cannot currently be used to obtain creditors approval for matters under 477(2A) is due to the definition of "resolution" in s 9 of the Act. We do not think that the amendment at Item 32 adequately deals with this and we suggest including a specific definition of resolution which allows for a proposal without a meeting for the purposes of the proposed s506(1A). Further comments in relation to the use of proposals is included below.

Exposure Draft Treasury Laws Amendment (Corporate Insolvency Reforms Consequentials) Regulations 2021

- Regulation 5.3B.10 has been replaced by the proposed s456LA (at item 30 of the Exposure Draft Treasury Laws Amendment (Corporate Insolvency Reforms Consequentials) Bill 2021) but it is not listed as a regulation to be repealed. Regulation 5.3B.10 needs to be repealed.

Additional points which the changes fail to address

- **Tax lodgements and effect on simplified liquidation eligibility –** There is some doubt as to what the impact of outstanding part year returns that arise as a result of the appointment of a liquidator have on ongoing eligibility for the simplified liquidation process.

  Section 500AC requires that a liquidator <u>must</u> cease to follow the simplified liquidation process if the eligibility requirements are no longer met – there is no discretion. Section 500AA sets out the eligibility criteria, with (1)(g) requiring that the company has given returns, notices, statement, application or other documents as required by taxation laws (within the meaning of the *Income Tax Assessment Act* 1997) – there is no discretion. The eligibility criteria should be amended to only apply to lodgements due before the appointment of the liquidator or provide for substantial compliance.

ARITA

- **Proposals without meetings –** The proposed amendments at item 32 of the Exposure Draft Treasury Laws Amendment (Corporate Insolvency Reforms Consequentials) Bill 2021, only deals with the issue of compromising debts in simplified liquidations.

  We are firmly of the view that proposals without meetings should be able to be used to compromise debts and enter into agreements longer than three months for all liquidations. It is our understanding that the limitation on the use of proposals in these circumstances was due to a drafting oversight in the *Insolvency Law Reform Act 2016*.

  Requiring meetings to obtain creditor approval on these two matters results in significant increased costs for liquidations. Creditors have the opportunity to object to the matter being dealt with without a meeting, giving them protection in instances where they believe that a meeting is required. However, for the vast majority of liquidations, approval will be able to be obtain expeditiously and at lower cost via approval a proposal without a meeting.

  Specifically, we do not understand why the proposed amendments are limited to the compromise of debts. Liquidators in simplified liquidations will still not be able to enter into agreements longer than three months. Although we recognise that simplified liquidations are meant to be a simpler process, the liquidator is still able to take action to recover property for the benefit of creditors (eg. uncommercial transactions, creditors-defeating dispositions and limited preferences) and should not be constrained in their ability to recover such funds.

  For the liquidator to be able to take these recovery actions, they may need to seek funding. In most cases, funding agreements will be longer than three months, therefore a liquidator in a simplified liquidation will be unable to enter into funding arrangements to recover assets for the benefit of creditors. Failure to allow liquidators to be able to access funding in a simplified liquidation could mean that simplified liquidations are inappropriately used by directors and company advisers to keep assets from creditors, noting that the liquidator does not have unilateral power to terminate the simplified liquidation process once it is adopted. Adoption occurs at the very start of the liquidation process before the liquidator has an opportunity to investigate the company's affairs and the liquidator is reliant on the information provided by the directors.

- **Conditions on registration of restructuring practitioners**

  If a Committee decides that a person is to be registered on the basis that they may only act as an external administrator in the capacity of a restructuring practitioner of the company or a plan, the Committee must specifically impose a condition limiting their capacity under IPS 20-20(6). The imposition of this condition then triggers the statutory limitation under IPR 20-5(3) that the registered liquidator must not carry out work as an external administrator of a company otherwise than in the capacity of a restructuring practitioner for the company or for a restructuring plan made by the company.

  A further condition must also be separately imposed by the Committee to ensure that the registered liquidator seeking only to be registered as an SBRP must not act as a receiver or a receiver and manager of property of a corporation, a managing controller, or an administrator of a compromise or arrangement approved under Part 5.1 of the Act. This is because a receiver and receiver and manager are not external administrators and are not covered by the specific condition under IPR 20-5. If the Committee did not impose such a condition, the registrant would be registered to accept appointment as a receiver or receiver and manager.

We recommend that an automatic condition be imposed by the legislation limiting a Registered Liquidator's ability to practice where an application is approved by a Committee which sought registration to only practice in the capacity of a restructuring practitioner for the company or for a restructuring plan made by the company.

- **Winding up applications on foot at time of appointment of a restructuring practitioner –** In order to minimise costs of the restructuring process and give companies a chance to develop and put a plan to its creditors, all winding up applications should automatically be stayed. If the SBR is terminated before a plan is made or during a plan, the creditor should then be able to proceed with the winding up application. We question the large amount of potential court involvement and note that any involvement of the court is going to escalate costs significantly. The first two SBR appointments (of six appointments as at 5 May 2021) had outstanding winding up applications that had to be dealt with immediately following the appointment– significantly adding to the costs of these appointments. Both had the winding up applications adjourned and went on to have plans accepted.

- **Tensions in the role of a restructuring practitioner** - Tensions arise from the definition of an SBRP as both an agent of the company (s453H) and an officer of the company (s9) who also provides advice to directors (s453E) (under the debtor in possession model for the small business restructuring process) and is expected to complete investigations to make the required declaration to creditors in relation to a plan (reg 5.3B.18). Yet the regulations do not resolve this tension by providing a clear outline of a SBRP's duties (even though s453E(2) contemplates that the regulations 'may' do so).

  Recent cases (*Re DST Project Management and Construction Pty Ltd* [2021] VSC 108 and *Re Dessco Pty Ltd* [2021] VSC 94) highlight that there is a lack of certainty as to the exact nature of the investigatory duties owed by SBRPs and their independence requirements.

  The view that SBRPs are not required to conduct the same level of investigations as a voluntary administrator could be justified with reference to the legislative intention for the SBR process, expressed in the Explanatory Memorandum to the Corporations Amendment (Corporate Insolvency Reform) Bill 2020 but not in Part 5.3B of the Act itself, to provide a simpler, less expensive restructuring option for eligible small businesses than voluntary administration. Yet there are difficulties in reconciling the conduct of lesser investigations by a SBRP than a voluntary administrator with the duties a SBRP owes, as an officer of the company (included in the s 9 definition of that term), to act in the best interests of the company. The interests of 'the company' correspond with the interests of creditors when a company is operating in an 'insolvency context', as it would be when undergoing an SBR. The question is whether a SBRP could confidently say that a SBR is in the best interests of creditors if he or she has not completed detailed underlying investigations to inform that view.

Clarity on these issues is required to give SBRPs the level of certainty they need to be able to accept an appointment and exercise their powers in a manner that will not expose them to any breach of their duties, while allowing SBRs to be the lower cost process as originally envisaged.

- **S468 Void dispositions applying to transactions in the ordinary course of business during a restructuring in the event that the company is wound up by the court** – As s468(2) is currently drafted, only dispositions made or approved by the SBRP during the restructuring and by the company during a plan are exempt from being a void disposition in a subsequent court liquidation. This means that any ordinary course of business transactions undertaken by the company during the restructuring (which are allowed under the regime due to its debtor in possession model) will be void in any subsequent court liquidation, unless the court orders otherwise. This is not appropriate and will result in informed creditors withholding products or services during the restructuring due to fears of transactions subsequently being voided. If the law allows for these sorts of transactions to be properly undertaken in the restructuring, then they should be exempt from being void in any subsequent court liquidation. It appears that this drafting issue has arisen as the voluntary administration and deed provisions (in s468(2)(aa) and (ab)) have been copied for SBRs, however, this has not recognised the inherently different nature of the administration types.

- **Off-set of bank account funds** - The right of secured creditor banks to trigger off-set provisions against funds held in company bank accounts has been mirrored from the Part 5.3A provisions for SBRs. In a voluntary administration the personal liability and indemnity provisions provides comfort for a lender to extend credit to the Voluntary Administrator if there are insufficient cash assets to support ongoing trading (unless such liability is specifically waived by the Court). In the absence of such provisions, in an SBR the company directors are unlikely to be able to source such funding which is likely to undermine the ability to undertake the restructuring.

- **Provisions which conflict with control being retained by the directors** – there are numerous provisions that have been modelled off Part 5.3A which place requirements on the SBRP that in our view, due to this being a debtor in possession model, are not appropriate and the onus should be placed on the directors/company. This is particularly so since whether these occur on a restructuring appointment will be variable and as restructurings are fixed fee appointments that are intended to be low cost, it is not appropriate that the SBRP should have to either factor these potential responsibilities into the cost (thus increasing the cost of the administration) or bear the cost themselves in the event they are required. Examples of these provisions are ss 453R, 453S, 453T, 454F, 454M, 454H etc. We are happy to discuss this further with you if the Government wishes to take steps to ensure that the legislation appropriately allocates responsibility during the restructuring and plan periods.

- **Tax clearances in simplified liquidations** - As there is the requirement for the company's tax documentation to be up to date, there should be no obligation on the liquidator to obtain a tax clearance before making a distribution. Of course, if the ATO is a creditor they will receive the same notifications as other creditors about proofs of debt and dividends. However, we understand from practitioners that even when tax lodgements are up to date, obtaining a tax clearance from the ATO can be difficult and time consuming. As such, we suggest the obligation for the actual clearance be removed.

- **Consequences of incorrect eligibility declarations in simplified liquidations** – s498 does not include any consequences for an incorrect declaration. We note that in respect of a Declaration of Solvency for a members' voluntary liquidation, s 494 incorporates offence provisions into the section (s 494(4) and (5)). If a simplified process is adopted due to misleading information being provided by the directors, there should be a consequence. The adoption of simplified liquidation has consequences for creditor rights, for example not being able to take advantage of the lower percentage requirements to request a meeting of creditors at the commencement of a creditors' voluntary liquidation. As such, a liquidator should be able to have confidence in the information provided to them when considering whether to propose to creditors that the simplified liquidation process be adopted. Consequences for false declarations will encourage correct declarations to be made.

- **Simplifying remuneration** – An increase in the minimum statutory fee for streamlined liquidations to a commercial amount commensurate with undertaking the process may remove or limit the reporting and approval of remuneration from creditors. Fulfilling the reporting and approval process has a substantive cost and our view is that in many instances practitioners may choose to take a reasonable statutory fee (which does not require approval), rather than incurring the additional time and cost of reporting and seeking approval for a streamlined liquidation. The current statutory fee of $5,000 (indexed) would need to be increased to cover the reasonable cost, even with the streamlining incorporated into the simplified liquidation approach (particularly noting the retention of the three-month report and creditor requests for information).

- **Trusts** - We note the government's recent comments regarding an intention to consult on how trusts are treated under insolvency law. ARITA has being raising our concerns about trusts and insolvency for many years, including during the consultation on the small business insolvency reforms. We welcome the change to consult on this.

As always, we look forward to continuing to work closely with Treasury and the Government generally to ensure the efficiency and effectiveness of Australia's insolvency system. Should you wish to discuss any aspect of this submission, please contact Ms Kim Arnold, Policy & Education Director on 02 8004 4340.

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.