Australian Institute of
CREDIT MANAGEMENT

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Helping companies restructure by improving schemes of arrangement

The Australian Institute of Credit Management (AICM) welcomes the opportunity to discuss potential reform of schemes of arrangement.

AICM represents over 2,600 credit professionals who contribute to a resilient economy and drive successful business outcomes through

- mitigating risk;
- maximising growth; and
- applying sound credit principles and practices.

Without our members, businesses are exposed to reputational damage, poor cash flow management and inefficient processes. Their employers are at risk of breaching regulatory requirements and not getting paid for hard won sales and services delivered.

Our members are the custodians of cash flow. They assess credit risk in all sectors and manage credit terms for the supply of goods, services and finance.

AICM members support reform of legislation that enables viable businesses to restructure, simplifies the insolvency regime and balances interests of all stakeholders.

A significant concern of AICM members with the proposed increased use of schemes of arrangements is the additional layer of complexity it will add to an already extremely cumbersome insolvency landscape.

The addition of the Small Business Restructuring Process (SBRP) to the Australian Insolvency regime has further increased complexity in the system impacting AICM members by:

- Making it harder to understand creditors rights during insolvency appointments.

- Adding to the cost of providing credit.

- Creating greater inefficiencies when managing customers at risk or in an insolvency process.

It is clear from consultation with AICM members, legal professionals, insolvency professionals and Australian Restructuring Insolvency and Turnaround Association (ARITA) that the limited benefits that could be achieved by reform of schemes of arrangement don't outweigh the impact on credit providers and all stakeholders by adding a further layer of complication to the insolvency landscape.

AICM members are of the clear view that a fully overhauled insolvency regime would provide benefits that greatly outweigh the inputs of government and all stakeholders to achieve.

Whilst AICM members don't support reform of schemes of arrangement in the short term, the below responses are provided with the intention that this discussion is considered in reform of the entire insolvency framework.

Question1: Should an automatic moratorium apply from the time that a Company proposes a scheme of arrangement? Should the automatic moratorium apply to debt incurred by the Company in the automatic moratorium period?

AICM members believe that directors should be sufficiently informed about the viability of the company to substantiate the ability to restructure without the need of a moratorium on enforcement of debts. The safe harbour mechanisms and the fact that most creditors will not initiate legal proceedings where a viable company is genuinely engaging with them further supports this view.

Therefore, AICM members do not support an automatic moratorium from the time a company proposes a scheme of arrangement without a court process or appropriately qualified insolvency professional (i.e. a registered liquidator) substantiating key eligibility factors such as:

- The likelihood of a scheme of arrangement will provide a better outcome to creditors than alternatives including other insolvency processes.

- The company is genuinely in distress.

- There are reasonable grounds to expect that a solvent entity will result from the restructuring.

The requirement to assess eligibility ensures the significant impacts of a moratorium on credit providers are justified and avoid abuse of the process.

AICM members believe there should be no moratorium for debts incurred during an automatic moratorium period.

Furthermore, it is the AICM's view that a sign that a business is viable is the ability to service debt incurred in the ordinary course of business. Therefore, a company unable to meet their obligations during a moratorium period is unlikely to result in a viable business emerging from a scheme of arrangement.

Providing certainty that payment will be made on debts incurred during a moratorium is important to ensure the business is viable and creditors have confidence to provide the support needed to continue operations and maintain value in the businesses.

Question 2: Would the moratorium applied during voluntary administration be a suitable model on which to base an automatic moratorium applied during a scheme of arrangement? Are any adjustments to this regime required to account for the scheme context? Should the Court be granted the power to modify or vary the automatic stay?

Basing the moratorium on voluntary administration is a suitable model to build on. As noted in response to Question 1, access to the moratorium should be subject to eligibility requirements. Additionally, aligning the process to voluntary administration will minimise the impacts of another insolvency process for credit professionals to interpret.

The liability of the administrator to debts incurred during a voluntary administration provides an effective method for ensuring the moratorium is not used to actively avoid creditors and assurance that the debt incurred during the period is paid.

AICM members support the ability of creditors to apply to the court to vary the stay but does not support the ability of the stay to be extended, as the costs of opposing a court action are prohibitive for many credit providers.

Question 3: When should the automatic moratorium commence and terminate? Are complementary measures (for example, further requirements to notify creditors) necessary to support its commencement?

The moratorium should not commence until verification has been conducted to ensure the company is eligible to access the moratorium.

AICM members recommend this verification is conducted under a court process or at a minimum by a registered liquidator.

Notification to creditors is essential to allow them to actively manage their exposures, the moratorium should not commence until it is reasonable to expect that all creditors have been notified.

Question 4: How long should the automatic moratorium last? Should its continued application be reviewed by the Court at each hearing?

A moratorium should last no longer than 30 days. Moratoriums significantly impact credit providers and therefore should be kept to the minimum viable period.

While AICM members generally oppose extensions, there are likely to be circumstances where an extension maybe in the creditor's best interests.

AICM members recommend that an extension should require approval by the majority of unrelated creditors (by dollar and number) before an application is made to the court. This process could be conducted efficiently using technology and provides efficiencies to the court reviewing the application and minimises costs for creditors wishing to object to the extension.

Question 5: Are additional protections against liability for insolvent trading required to support any automatic moratorium?

Insolvent trading is a significant cost to credit providers and occurs in most insolvencies. Therefore directors should only be provided protection from insolvent trading if they have acted in a timely manner and once creditors are on notice.

Question 6: What, if any, additional safeguards should be introduced to protect creditors who extend credit to the Company during the automatic moratorium period?

If a moratorium is provided without full disclosure, impacts on credit providers will include:

- Being unwittingly exposed to significant risks.
- Unable to make informed decisions.
- Inefficiencies such as undertaking recovery action when a moratorium is in place.

Creditors and other stakeholders should be informed of the moratorium by requiring disclosures as soon as it commences, in the same way as in Voluntary Administration and other processes.

ASIC company searches should reflect the moratorium in a similar way that Voluntary Administrations and other processes are reflected. This ensures creditors are able to search the register and the information flows through the relevant credit bureaus that provide alerts and monitoring services (used daily by credit professionals). This is the most efficient way to ensure credit providers are on notice and can make fully informed decisions.

Question 7: Should the insolvency practitioners assisting the Company with the scheme of arrangement be permitted to act as the Voluntary Administrators of the Company on scheme failure?

AICM members favour the administrator and/or liquidator being independent of the insolvency professional assisting a company with the scheme of arrangement to ensure there is review of the advice and conduct during this period.

This would provide greater creditor confidence that the schemes are only used by a genuinely distressed company and not used to defeat unrelated creditors.

Question 8: Is the current threshold for creditor approval of a scheme appropriate? If not, what would be an appropriate threshold?

AICM members support the threshold of 75% of creditors by number and value. Lower thresholds are likely to be detrimental to genuine creditors and enable manipulation by a minority.

AICM members don't support cross-class cram down generally but acknowledge it may be beneficial to creditors in select circumstances. If cross-class cram downs are to apply, it should only be possible with court approval and with adequate opportunity for creditors to oppose.

Question 9: Should rescue, or 'debtor-in-possession', finance be considered in the Australian creditors' scheme context?

AICM members do not support rescue financing without strong controls to minimise the impact on ordinary creditors returns in a subsequent liquidation.

Such controls could include rescue financiers only obtaining a return if it can be substantiated that the financing resulted in a better outcome for other creditors, or it would have if not for an unforeseeable factor.

Without controls on rescue financing, creditors could face further eroded returns from insolvency, further disincentivising support of businesses displaying signs of insolvency.

Question 10: What other issues should be considered to improve creditors' schemes?

Due to the very limited use of schemes of arrangements, AICM members do not have specific issues to be addressed.

Question 11: Are there any other potential impacts that should be considered, for example on particular parties or programs? If so, are additional safeguards required in response to those impacts?

Whilst ARITA represent insolvency professionals, the proposed structure included in their submission again shows their recommendations on insolvency reform balance and the interests of all stakeholders including credit providers.

The ARITIA proposal has received a limited review by AICM members and is broadly supported for further consideration. The key features of this proposal ensures a viable business to restructure effectively whilst balancing interests of creditors, other stakeholders (including government) and includes controls to prevent abuse.

AICM members feedback has shown that the following elements are key to enabling financially distressed business to restructure and a viable entity to emerge:

- **Risk of payments being deemed voidable preferential payments**

  Treatment of payments made to creditors immediately prior and/or during a scheme of arrangement is critical to ensure credit providers continue to support businesses displaying signs of insolvency.

  AICM members professional obligation to mitigate risk of preference payments is a key factor limiting their ability to provide continued credit and payment arrangements to businesses displaying signs of insolvency. By removing this risk more businesses will be provided the space to restructure without the need for a formal process.

  The current preference claim regime is a disincentive for creditors to support viable business displaying signs of insolvency. It imposes losses, costs and inefficiencies on creditors who provide support in addition to the loss exposure at the point an insolvency process commences.

  The evidence for the benefits of limiting the recovery of preference claims is seen through the implementation of limitations in the new simplified liquidations process. AICM members have reported these limitations are a significant step forward that should be built on to cover all insolvencies.

  In addition to calling for general reform of preference claims, AICM members recommend the reform of scheme of arrangements ensure payments received before and during a moratorium are protected from preference payment claims in a subsequent liquidation.

- **Clarity on fundamentals for creditors**

  Creditor support for restructuring and long-term prosperity of a company will be best achieved when there is clarity as to:

- When/if creditors get paid for pre-moratorium debt and moratorium debt?

- Who is liable for these debts?

- Priorities for payment.

- Security over assets such as supplies of stock secured by PPSR registration.

Uncertainty or eroding the creditors position on these elements will result in credit providers focusing on recovery of their debt and stock rather than supporting the restructure.

- **Role of the insolvency professional**

AICM members are generally sceptical of debtor-in-possession models due to the inherent risks of trading with insolvent entities and the absence of independent assessments and controls.

Creditor-in-possession models provide confidence to credit providers that their interests will be a priority and any misuse or debtor related causes of the solvency are identified and mitigated by an independent insolvency professional who is appropriately skilled and qualified.

The SBRP experience has shown that creditor confidence in the process is critical to success. Where the Restructuring Practitioner is anything less than an unrestricted registered liquidator, AICM members would immediately be hesitant to support a restructuring plan.

Balancing debtor-in-possession models with requirements that address creditors concerns will provide better outcomes for all stakeholders and maximise the value in the restructured entity.

We welcome the opportunity to further contribute to the discussion of reform of schemes of arrangement.

Yours sincerely

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