Episode 27: Summary

HEARSAY The legal podcast

Episode name: At the Edge of the Insolvency Cliff: The new small business restructuring process
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What area(s) of law does this episode consider?

In this episode we discuss the Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (Cth) and specifically, the new small business restructuring process which it will introduce.

Why is this topic relevant?

The small business restructuring process is Australia's first debtor-in-possession regime, and one of the Commonwealth government's policy responses to the economic effects of the COVID-19 pandemic. If the number of distressed businesses requiring turnaround and rescue next year is anything like media predictions, it's important for commercial lawyers to understand all of the tools that are available.

What are the main points?

- A board of directors who reasonably believe that their company is insolvent or will become insolvent in the future can appoint a restructuring practitioner for the company: s 453B.
- There are other eligibility criteria before the board can appoint a restructuring practitioner, including that:
    - the company has no more than $1 million in liabilities (not including contingent liabilities, which are excluded from the restructuring process, as discussed below);
    - the company must not already be under restructuring, administration, deed administration, or liquidation; and
    - the company, nor any of its related entities, have not been subject to a restructuring within the last 7 years.
- Unlike every other formal insolvency process currently available in Australia, after the restructuring practitioner is appointed, the company's directors will remain in charge of the company on a day-to-day basis – this is what is meant by a 'debtor-in-possession' model.
- However, the restructuring practitioner must:
    - Investigate the company's affairs for the purpose of certifying that the company is eligible for restructuring (r 5.3B.16(2)(a)(i)) and is likely to be able to discharge the obligations in the plan (r 5.3B.16(2)(a)(ii)); and
    - Give their consent to any transaction affecting the company's property that is not in the ordinary course of business (s 453L(2)(b)).

  So in practice, the restructuring practitioner will give a lot of guidance on the company's turnaround and have a fairly active role in monitoring and approving steps the company makes to effect its turnaround.

- The purpose of the restructuring process is to allow the company to formulate and implement a *restructuring plan*.

- A restructuring plan has few restrictions, other than that it must not involve the transfer of the company's property to another entity and must not involve a payment plan longer than 5 years (r 5.3B.13(4)).

- All admissible debts and claims rank equally in a restructuring plan, and if creditors are not being paid in full, then all creditors receive a proportionate amount (r 5.3B.25).

- Secured creditors can only participate in the plan to the extent their debt exceeds the value of their security.

- Before the plan becomes effective, a majority in value (not value *and* number, just value) of the company's creditors must approve the plan by replying to the proposal stating that it should be accepted – there are no creditors meetings required under restructuring (r 5.3B.23).

- The claims of contingent creditors are not admissible in the restructuring (r 5.3B.01, definition of "admissible debt or claim"), and those claims aren't released at the end of the restructuring plan (r 5.3B.30(2)). This is very different to the current state of affairs (for example, s 553 of the *Corporations Act*, which says that debts and claims "*present or future, certain or contingent, ascertained or sounding only in damages*" are admissible to proof in a winding up. This exclusion could cause some practical difficulties for companies in restructuring: creditors might dispute that they are contingent creditors, or companies might be unable to properly restructure their affairs because compromising contingent debts might be critical to doing so.

What are the practical takeaways?

- At the time of writing, the regulations are still in exposure draft form, so they may be subject to change; but in their current form, there are a lot of features of the process that make its effectiveness questionable.

- With secured creditors only participating in a restructuring process to the extent their debt exceeds the value of their security, with contingent creditors excluded from the process, and related party creditors excluded from voting, the largest creditor in most small business restructurings will be the ATO – which means it will be the ATO that will be deciding whether most small business restructuring plans are approved or not.

- Restructuring practitioners must agree a fixed fee with the company before their appointment, which is a big change to the current system where most insolvency appointments are time-charged. We're big fans of fixed fees here at Hearsay, and they work great for everyone when the work involved can be predicted. But with so much uncertainty about the extent of the restructuring practitioner's role and involvement at the outset of the engagement, some insolvency practitioners might be less than enthusiastic about taking on restructuring appointments.

Show notes

Corporations Amendment (Corporate Insolvency Reforms) Bill 2020:

- First reading

- Explanatory memorandum

- Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020 – Exposure draft

- ARITA’s submission on the exposure draft regulations

- Saving Entrepreneurs, Saving Enterprises: Proposals on the Treatment of MSME Insolvency