Australian Banking Association

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Manager
Market Conduct Division
Treasury
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By email: MCDInsolvency@Treasury.gov.au

Dear Sir / Madam

Exposure draft: Corporations Amendment (Corporate Insolvency Reforms) Bill 2020

Thank you for providing the exposure draft of the Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (the Bill) for our feedback. We note that significant parts of the regime will be contained in the regulations, which we look forward to providing input on in due course.

Australian Banks committed to SME lending

Supporting small and medium enterprises (SMEs) has never been more important. Before the pandemic, SMEs contributed more than a quarter of Australia's GDP and employed almost half of the Australian workforce. If the economy is to recover rapidly from the effects of the COVID-19 pandemic it is ensuring the flow of credit and the right regulatory settings for SMEs, that is most critical.

The ABA and its member banks continue to provide support for the initiatives the Australian Government has announced to respond to the challenges of COVID-19. Australia's banks have played a key role throughout the crisis and stand ready to continue helping millions of SMEs as we move from emergency to economic recovery.

Since February 1, Australian banks have provided over $41b to SMEs and sole traders. They are lending roughly $1.5b a week to SMEs. Approval rates for loans have remained high throughout the crisis, with banks reporting they have approved around 70% of loan applications received. ABA members continue to provide new and tailored support measures to SMEs, be it removing merchant fees, providing new and flexible loan products or deferring business loan repayments to allow SMEs the time to get back on their feet.

Banks are also enhancing their resources for dealing with customer hardship as a result of the pandemic.

The ABA recognises that the reform measures set out in the Bill form part of the Government's efforts to get the settings for economic recovery right, and we support these efforts. Our comments set out below are intended to assist the Government in maximising the benefits of the reforms.

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Key points

- The Restructuring Practitioner should have the ability to reject a request for a company to access the Restructuring Process if there has been a change of director in the last 12 months.
- Creditor rights to exercise security interest – the regime should include something to mirror s440B of the *Corporations Act 2001* (the Act) – allowing the practitioner to consent to a secured party exercising its security interest at any time during the restructuring.
- Creditor rights of appeal / input – for creditors in the minority when voting, consideration should be given to how they can provide input into or appeal the plan, other than a court action, which is costly and time consuming.
- Timeframes – 20 business days is an appropriate time limit to develop the plan (as set out in the Treasury fact sheet); and there should also be a limit on the duration of implementing the plan e.g. 6 months.
- Anti-avoidance – there should be provisions to prevent owners from running down company assets or transferring them to another company, in order to qualify for the simplified restructuring regime.
- Binding the company – further clarity is needed on how the practitioner consents to asset sales, including any obligation to value assets similar to s420A of the Act.
- Engaging practitioners – the take-up of the scheme by high quality practitioners will require putting in place the necessary incentives. Without this, the regime risks not being as useful as it could otherwise be, as has been the case with the safe harbour regime.
- Specific provision should be made in the restructuring regime for contingent creditors to lodge a proof of debt, in the same way they can in the voluntary administration process.
- Plain English template documents should be mandated for use in communicating with creditors and other operational aspects of the regime

Debt restructuring

The ABA supports a simpler, expedited and lower cost process for restructuring and liquidation for small businesses with liabilities of less than $1m. Against that background, we generally support the Bill, but we have some comments and suggested improvements which we set out below.

One concern that we have is that, on the current drafting, it is possible that, in some respects, creditor rights could be adversely impacted or compromised. While secured creditors will have concerns in this regard, many creditors of small businesses are themselves small businesses. There would be a risk that if the new regime does not strike a balance between providing a simplified and quick restructuring process and appropriate protection of creditor rights it could inadvertently cause significant stress for creditors, in particular, small business creditors. This would be particularly relevant where, for example, the new regime is used to divert assets away from creditors, facilitates extended restructuring periods or compromises creditor claims without input or oversight from creditors.

As an overarching comment, the policy intention appears to be that while the restructuring plan is being developed the company should continue to be managed in the ordinary course and creditors' rights are stayed to give the company "breathing space". However, these outcomes could be undermined and creditors put at risk if the assets of the company can be dealt with.

Currently, the regime provides that the directors are not to transact in the company's property unless it is in the ordinary course of business, with the restructuring practitioner's (RP) consent or with the consent of the Court. There is a concern that allowing assets to be sold or transactions to be entered into even with the restructuring practitioner's consent could be open to abuse and allow for phoenix like behaviour. This concern underpins many of the comments raised below as it is necessary to provide creditors with further protections (such as on stay on rights, secured creditors being able to enforce at any time).

Another theme of our comments below goes to the practicalities of implementing the restructuring and restructuring plan. Clarity on the extent to which the moratorium, stay on rights, as well as the relevant time frames applicable to the restructuring period and the restructuring plan will be important in striking the balance between achieving the aims of the regime to support small business and protecting creditors, particularly, small business creditors.

We also have concerns regarding the ability of creditors to participate in the restructuring process, including voting, as well as the avenues for creditors to challenge or raise concerns with the restructuring process undertaken or the restructuring plan.

Since the new regime does not contemplate an investigation of the financial position of the company or the conduct of directors, it will be important for creditors to be take steps to protect their rights. Such protections would also be supported by anti-avoidance provisions which we have also commented on below.

Suggested improvements to the Bill

Stay on rights

Section 454P(1) of the Bill provides that a right arising by reason of the company restructuring cannot be enforced until the restructuring has ended. The issue arises whether a lender may exercise a right to a draw stop on further advances. Section 454P(8) of the Bill is intended to provide some comfort to lenders as the company cannot enforce its right to new advances of money or credit where the lender cannot enforce its rights against the company. This means neither the lender nor the company can enforce their rights with respect to further drawings but leaves the lender in a position where it cannot say it is relying on its draw stop right. The ABA suggests the approach could perhaps be refined and simplified by providing an exception to s. 454(1) of the Bill to allow the lender to exercise a right to stop further advances of money or credit during the period for the restructure or the restructure plan.

Improving company management

Notwithstanding the current economic climate, the regime does not fully take into account that many insolvencies arise from poor management and/or poor financial capability of management. A requirement that a company report back to creditors or have the RP sign off on financial statements prepared by management for a period of time after the restructuring has ended would add rigour to the company's financial management.

Electronic voting

Requiring voting and meetings to be undertaken electronically without adapting related process can have the unintended consequence of disenfranchising some creditors in particular unsecured creditors who are less familiar with insolvency / restructuring processes and who may not have easy access to electronic voting platforms. We suggest the bill be amended to ensure all relevant creditors can reasonably be made aware of the voting process and requirements. This might include providing creditors with written instructions for how to vote, translations where relevant and a requirement to provide and count a written ballot paper if requested.

Creditor rights

Section 440B of the Act allows an administrator to consent to a secured party enforcing its security interest outside the decision period. A similar mechanism should be incorporated into the new regime to allow the RP to consent to the secured party to exercise its security interest at any time during the restructuring. Otherwise if a secured lender does not exercise its security during the decision period, it will be locked into the restructuring even where it forms the view that the restructuring process is contrary to its interests. Without this right, there is less incentive for companies to pursue an expedited restructure.

Interest of the creditors: as a whole?

Some provisions refer to the 'interests of the creditors' (e.g. ss. 453J and 453L of the Bill) and other provisions to the 'interests of the creditors as a whole' (e.g. s. 453N(2)). Clarity on this point will assist the RP in its decision making. Where the RP is considering the interests of the creditors, it should always be 'creditors as a whole'.

Control of the company

Section 453K provides that while the company is under restructuring the "company" has control of the company's business, property and affairs. In the ABA's view, this should be changed to "directors" to clarify that the directors retain their powers.

Debtor in possession (DIP) financing

The Bill does not cover whether or how DIP financing will be facilitated. If the restructuring period is to facilitate the development of a restructuring plan and that period is for a limited time, then DIP financing should not be necessary during the restructuring period. It may only be required during the implementation of the restructuring plan. Allowing DIP financing provides an avenue for the restructure period to be used to for reasons other than restructuring of the company or, assuming debts incurred during the restructuring period would have a priority similar to in voluntary administration and liquidation, to change the debt structure of the company.

Creditors not contacted

The regime should outline the rights of creditors who are not contacted, as they were not identified in the process. This is one way the regime could be misused, by not disclosing some of the company's creditors. In voluntary administration, administrators advertise in relevant newspapers. Whilst we don't propose this moving forward, consideration should be given to other notifications methods including requiring notification to be made on the company's website.

Potential unintended consequences & other observations

Trade Credit & Unsecured Lending

We wonder whether the Government has considered the potential impact on trade credit / lending to SME businesses given the ease of removing claims. Given the potential impact on creditor claims, costs of capital could increase or credit terms could become more restrictive including, potentially, requirements for "all asset" security which could complicate credit applications and the costs of putting credit in place (see also our comments on the impact on small business creditors).

Enforcement on all property

The Bill contemplates a carve out to permit secured creditors to exercise their rights following the appointment of the RP if they have security over the whole or substantially the whole of the property of the company and that they enforce their security interest in relation to all of the property. There is a risk that this will force secured creditors to make a binary decision to enforce or permit the restructuring to proceed, limiting the available enforcement options. It means that it takes optionality away from secured creditors i.e. they either appoint a receiver to realise all the assets or they don't appoint and allow the restructuring to run its course.

Binding the company

Section 453L of the Bill provides that a transaction will be voidable during a restructuring unless it has been entered into in the ordinary course of the company's business, the RP has consented or an order of the Court has been obtained. This puts the onus on the counterparty to be satisfied that one of those limbs will be met. This does not give the contract counterparty sufficient certainty as they need to form a view on what is in the ordinary course of business for the company or seek approval from the RP or

Court and may have value or pricing implications. In most circumstances the contract counterparty will seek RP consent but that will require the RP to have sufficient information and form a view. This may slow the restructuring down while the RP forms its view. It is also not clear how they should form a view, for example, should consideration be given to whether values of the asset being sole are consistent with the requirements in s. 420A of the Act, or whether the transaction is in the best interest of the creditors as a whole, or will return a better outcome than if the asset is not sold. See also our general comment above regarding the purpose of the restructuring period.

Practitioner engagement

In our view, the economic incentive for practitioners to engage with the new restructuring scheme vis-a-vis other insolvency matters could also be considered further. One of the key reasons we observe driving the IP community not to take-up the Safe Harbour legislation is this balance between competing workflows and respective economics. Consultation on qualifications of RPs as well as the practicalities of managing the restructuring period and subsequent restructuring plan will be crucial in ensuring the intended outcomes of an expedited and lower cost restructuring option are achieved. It will also be important in promoting take up and accessibility of the new regime to small businesses.

Points requiring further clarification, in the Bill or Regulations

Creditor rights of appeal / challenging restructuring plan

Clarity is required about the basis upon which a restructuring plan could be challenged and who would have standing to challenge. This may include a challenge on the basis of the level or nature of information disclosed or where a creditor has been unfairly prejudiced. We understand from discussions with Treasury that this could be challenged in court – in which case the considerations for the court should be similar to those for challenging a deed of company arrangement (DOCA) in s. 445D of the Act, as a starting point. Court is a costly option for minority creditors who are themselves small businesses, so the regime could also consider how else they might challenge or have input into the restructuring plan.

Asset sales – how will the restructuring practitioner practically sell assets or consent to the sale of assets?

It appears that the RP can sell as agent of company, but it is unclear how they would do that in a short period of time – or is it intended that they have time to sell assets after the plan is in place? Again, we suggest the regulations clarify whether the RP will have any obligations as to asset value, for example, similar to s. 420A of the Act if they are selling assets as agent or consenting to the sale of assets.

Eligibility criteria (thresholds)

We understand that the reforms are intended to provide an alternative path to restructuring for small business and accordingly the eligibility criteria will include thresholds on the amount and type of debt to bring the business into the new regime. We note the Treasury fact sheet says that businesses with less than $1m in liabilities will be eligible. How this is calculated will be important to clarify including whether liabilities will be calculated on a consolidated basis for a group of companies, where a tax consolidated group or cross guarantees is in place or whether there is a holding company (see further comments on anti-avoidance below).

Time frames (restructuring)

The concept of a period of “restructuring” is fundamental to the new provisions ie the period which the RP is appointed, the power of the RP to bind the company, the moratorium on winding up and exercising third party rights and the stay on rights/ipso facto provisions all apply during the “restructuring” of the company. The EM at 1.4 notes the restructuring period ends when plan is ‘in place’, but we suggest the provisions clarify what this means. It is unclear how the plan will be “put in

place" whether it is a deed the company and the RP signs or just a deed poll by the company and how binding the plan will be. The timing between the creditor vote approving the plan and it being put in place will be relevant as well. We suggest that clarity be provided about whether it be similar to a DOCA, which must be executed within 15 business days of creditor approval.

Time frames (administrative process)

We suggest further clarity be provided on the time frames for providing information or a restructure plan to the RP and creditor voting be provided. The Treasury fact sheet indicated that a plan should be developed within 20 business days. We consider that 20 business days is an appropriate period to develop a plan (faster than the approximately 5 - 6 week voluntary administration (VA) process, consistent with the policy intention that this be more streamlined).

Time frames (limitation on extension)

Given the implication of the time frames, further clarity should also be given to whether time frames can be extended by the directors or with RP consent or creditor consent. We consider there should be some restriction on the aggregate time period to which the restructuring may be extended. We note that the initial period in recent reforms in the UK is 20 + 20 business days (to develop the restructuring plan). A limitation on aggregate time allowed would align with the intention to provide an alternative restructuring option and keep costs down by having an expedited process.

Indemnification of the practitioner

The draft legislation states that the RP will be an agent of the company. Clarity is needed about whether the RP will effectively be indemnified out of the assets of the company. Even for e.g. consenting to asset sales – we suggest they be indemnified, as long as their decision to consent to a sale was based on good faith and on information available at the time. Clarity on whether the RP would require any funding for expenses or be able to bind the company to finance arrangements during the restructure period should also be considered.

RP declaration

The RP will be required to provide a declaration to the creditors. It is not clear whether this will form part of a report prepared by the directors or will be a separate declaration made by the RP i.e. independent of the directors.

Electronic voting

Further clarity around how and when the electronic voting will be determined and the outcome made known to the directors would be useful. There is a risk that if directors are aware the creditors have voted against the restructure plan that they could seek an extension of time or adjourn a meeting and effect the restructuring plan during the adjournment. Please see our comments on Time Frames.

Information

The rights of creditors to request information from the company and the RP during the restructuring period should be clarified. Presumably these rights will be limited to facilitate an expedited process to allow directors and the RP to focus on the development of a restructuring plan but should not limit contractual rights to information so creditors can develop an informed view of the company and any proposed restructuring plan.

What is the timeframe allowed for implementation of the plan?

A limitation on the time for a restructuring plan to be implemented should also be considered. We would suggest 6 months to allow for a reasonable time for a sale process to be run for assets or re-negotiation of contractual terms. However, if the restructuring plan has not been implemented within that time it should automatically terminate and creditors may exercise their rights.

Renegotiation of onerous contracts

The new regime should provide a mechanism for assisting companies to renegotiate onerous contracts. We understand this is not the current intention, but the impact of onerous contract terms can be a significant barrier for the company recovering and restructuring. Such contracts can even be the reason for the slide into insolvency – in which case not providing a mechanism to address this issue in the new regime may mean the intended outcomes will not be achieved. Enabling the renegotiation of onerous contracts as part of the restructure or the restructure plan will be fundamental to small businesses restructuring.

Regulations

We recommend clarity and confirmation be provided about the matters identified below:

- Director personal liability will be as per voluntary administration i.e. not liable for e.g. ATO, superannuation debts; but does remain personally liable for debts incurred under a separate standalone personal guarantee where goods/services have been used for business purposes
- Valuation of assets will be as per Bankruptcy Act i.e. secured creditors value the relevant assets, not the insolvency practitioner. If the RP disagrees then they can ask for additional information to support that valuation.
- Definition of 'creditor' (e.g. contingent liabilities, how does rent owing under remaining term of a lease factor in): debt must be 'incurred'.
- To whom the RP owes a duty of care: this is not set out in the draft Bill but we understand the intention that the duty of care is to both creditors and debtors. The RPs will require clarity on this in order to be able to be involved in the process and make a declaration in respect of the restructuring plan.
- Whether priority provisions which exist under law remain unchanged.

Suggestions for additions to the regulations

In our view the regime could benefit by ensuring that the Regulations address the additional matters outlined below.

- Eligibility criteria (misuse / anti avoidance) – there should be some anti-avoidance restrictions to prevent a company transferring assets or running assets down to fall within the eligibility criteria.
- Eligibility criteria (corporate structure) - in addition to dollar thresholds, eligibility should consider the nature of the corporate structure and take into account whether a company is part of a group i.e. a tax consolidated group, there is an ultimate holding company etc. Consideration should also be given to the implications of whether the company has given a cross guarantee or is a guarantor to other obligations and whether the consolidated debt position should be applied for any dollar thresholds. Limiting the availability of the debt restructuring process to companies within a group would be in line with the intention to provide small businesses with an alternative route to restructuring rather than allowing companies such as holding companies to use the new regime.
- There should be provision for where a company is in a delayed repayment plan and fails to make the payments on time, allowing for renegotiating the offer if all creditors agree.

Please let me know if you would like to discuss any of the above.

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Yours faithfully

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