

Insolvency reforms to support small business

Submission to the Treasury
October, 12, 2020

Introduction

ACCI welcomes the opportunity to comment on the proposed insolvency reforms to support small business. ACCI supports the central intent of the reforms and the proposed new laws aimed to make it easier for small businesses to approach insolvency and turnaround practitioners. Developing a streamlined insolvency framework is required to better meet the needs of small businesses that are facing complex operational and financial challenges. As COVID-19 has created conditions that limit a small business from operating, some pre-existing cash flow issues have been exacerbated. We anticipate a sizeable proportion of small businesses requiring services to restructure, pivot or shut down their operations while needing to minimise impacts to employees, customers and creditors.

The intention to create an opportunity for firms to restructure at a low cost while maintaining maximum flexibility and minimising business disruption is a welcome opportunity to better meet the needs of Australian small businesses, their creditors and employees. However, there are some pertinent issues that may arise in the process that detract from the policy outcomes intended. This includes:

- due to the speed and nature of proposed legislative amendments, there is potential obfuscation of the roles and responsibilities between new and existing restructuring practitioners, creditors and company directors leading to sub-optimal outcomes;
- eligibility criteria may create a disincentive for firms that are most in trouble from seeking the assistance they require;
- concerns with the potential disruption in the decision-making processes, that could lead to unintended consequences that affect the rights of creditors and small business owners;
- the lack of detail regarding processes to be taken by businesses that operate as trading trusts;
- the lack of detail regarding the skills and experience required of newly registered liquidators to prevent illegal phoenixing and rent seeking behaviour;
- the time period allocated between the implementation of new Corporations Regulations and Insolvency Practice Rules, the interaction of these new rules with the *Corporations Act* and the training required by new and incumbent practitioners to provide accurate advice;
- the broader financial literacy issues of small business operators that have not been adequately addressed alongside the proposed reforms.

The new debt restructuring process

ACCI endorses new laws that allow the company, by resolution of its directors, the ability to enter the debt restructuring process when it meets the proposed eligibility criteria. However, concerns have been raised in relation to the need to have kept tax lodgements up to date to become eligible. This may create a significant barrier for businesses requiring the services of an insolvency practitioner due to potentially unmet super guarantee payments made with the extension of JobKeeper to insolvent firms.

There are also concerns over whether the financial constraints placed on firms may have resulted in temporary cash flow issues leading to unmet or foregone tax obligations. These are not typically the fault of the business owner. For example, the Victorian Chamber of Commerce found that some business that followed improper advice on the cash flow boost had continued to operate on the basis of expected cash flow boost only to be told later by the ATO that they are ineligible for cash flow boost payments and have outstanding obligations. In this instance, eligibility criteria should require a business 'to have made appropriate actions to engage with the ATO' rather than to have 'met all outstanding payments'. This requirement would encourage those that have acted in good faith to participate in a debt restructuring process and those that may be most in trouble to seek the services of appropriate qualified practitioners.

Questions have also arisen in relation to the revised timeframe involved in the new debt restructuring process. The newly proposed timeframe is longer than the current voluntary administration (VA) process, with the restructuring plan potentially taking 35 business days, up from 15-25 business days under the current VA process. The timeframe should be revised down and/or creditors should be engaged earlier in the process to avoid delays.

In relation to unsecured debts, there are further questions raised over eligibility, including how the \$1 million cap on debts would be determined. A cap with a hard figure is problematic in circumstances when it is found during the process of restructuring, that the debt exceeds \$1 million and the practitioner may be expected to terminate the process. While caps are useful in terms of being indicative, they create barriers to those on the edges of the threshold. Identifying and resolving business liabilities of close to \$1 million may require practitioners more than 20 days to resolve. In this case, an extension should be granted to allow practitioners more time to identify and resolve these issues.

It is also unclear at this stage, who will bear the burden of financial responsibility for meeting debts incurred during the debt restructuring process as in the traditional sense the burden falls on a practitioner post appointment. This requires clarification.

ACCI is supportive of safeguards that will prevent the process from being used to facilitate corporate misconduct such as illegal phoenix activity and we require greater clarity on what they will entail. Currently this is limited to a prohibition on related creditors voting on a restructuring plan, a bar on the same company or directors using the process more than once within a prescribed period (proposed at 7 years), and the provision of a power for the practitioner to stop the process where misconduct is identified. The bar placed on directors using the process more than once over a 7 year period may be too long, and we expect this to be revised down to factor in a more dynamic and uncertain economic environment that business owners are currently operating in.

The streamlined insolvency process

We understand that there will be subordinate legislation governing the operation of the new simplified insolvency processes and we look forward to actively engaging in that process. At this stage, we are supportive of a streamlined insolvency process, in order to provide a simpler, cheaper and faster means of accessing an insolvency process for small business. However, there are some uncertainties. The first relates to who is expected to fund insolvency practitioners to liquidate small businesses. The other relates to concerns expressed by practitioners and creditors that the threshold may be too high and may be capturing more complex liabilities.

Where the threshold is perceived to be too high, as it aims to capture almost 80% of all insolvencies, appropriate measures should be taken into consideration to reduce the burden of investigations and reporting obligations to allow for this percentage of insolvencies to be maintained. If 20 days is not available due to the complex nature of liabilities, then extensions where appropriate should be granted. There are further concerns, regarding the number of companies with little or no assets and the reduced circumstances in which a liquidator can seek to clawback an unfair preference.

Proposed recommendations that Government set up a fund to cover the costs of practitioners to liquidate small business who meet the definitional requirements but whose realisable net assets are insufficient to meet the practitioners' reasonable costs should be explored. This may incentivise full participation particularly in assisting asset-poor insolvent businesses.

Complementary measures to support insolvency system

Small business owners often lack the financial literacy required to make decisions on the viability of their business. In our Pre-budget submission, published in December 2019, we proposed to government that the Department of Industry, Science, Energy and Resources be tasked to work with ACCI to explore the development of a pilot program to increase awareness of services available to small business owners in order to improve their financial literacy. This program could involve the production of fact sheets and delivery of seminars for small business owners on vocational educational and training opportunities, and other services they can access to improve their financial literacy, as well as the range of financial products available to support their business growth. We raise this here, because it is necessary to address some of the underlying causes that have led to insolvent firms.

We also support changes to encourage practitioners to enter or return to the profession, as long as the standards of the profession are maintained.

ACCI understands the time constraints placed on government to amend current legislation, however we are concerned that the lack of detail of the proposed Corporations Regulations and Insolvency Practice Rules, may create uncertainties for business owners and practitioners. A determination needs to be made on whether the proposed reforms will be made permanent or temporary and whether this may act to improve or destabilise creditors confidence in small business financing. It should also be determined with greater levels of certainty on the commencement date.

Conclusion

ACCI supports the central intent of the proposed amendments. We encourage Government to provide further clarity where necessary, particularly in relation to who bears the financial responsibility during the debt restructuring and insolvency process, refining eligibility criteria to capture financially distressed small businesses who have acted in good faith, providing further confidence on the required skills, experience and qualifications necessary for small business restructuring practitioners, and determining whether complementary measures, such as financial literacy fact sheets can act to reduce the incidence of cash flow constraints and further issues in the future.

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