Association of Independent Insolvency Practitioners
By the practitioner, For the practitioner

12 October 2020

Manager
Market Conduct Division
Treasury
PARKES ACT 2600

Via email: MCDInsolvency@Treasury.gov.au

Dear Sir/Madam

Exposure Draft Bill Corporations Amendment (Corporate Insolvency Reforms) Bill 2020

We thank Treasury for the opportunity to make a submission on the proposed reforms which, if legislated, will have a significant impact on the members of the Association of Independent Insolvency Practitioners ("AIIP"). We make the following submissions on behalf of our members and thank the members of the AIIP for providing their thoughts which assisted in preparation of this submission.

The AIIP

The AIIP is an organisation that was established by insolvency practitioners to assist fellow practitioners meet the challenges prevailing in the profession. The AIIP was formed in 2016 and it now has in excess of 185 members. It is the only professional insolvency practitioner association which requires its members to be either registered liquidators or registered trustees in bankruptcy. Its members primarily practise in the small to medium enterprise (SME) market, and many members are also members of ARITA.

On behalf of AIIP, I now provide the following feedback and comments in relation to the Exposure Draft Bill Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 (Cth) (EDB).

The feedback relates to the following eight issues:

1) General acknowledgment of the positive aspects of the reform
2) Concern regarding the level of detail available to properly assess the practical elements of the reform from the material made available;
3) Small business restructuring practitioner (SBRP) powers, duties and obligations;
4) Eligibility criteria for SME's to utilise the process;
5) Structure of the SME;
6) Suggestions to ensure the desired liquidation process achieves savings by dispensing with unnecessary compliance;
7) Anecdotal comments and points; and
8) Conclusion.

In order to assist with this submission, the following abbreviations have been used throughout the document:

SME – small to medium enterprise
SBRP – small business restructuring practitioner
RL – registered liquidator
VA – voluntary administration
CVL – creditors' voluntary liquidation
EDB – exposure draft bill
EDEM – exposure draft explanatory materials
ET – eligibility test
ARITA – Australian Restructuring Insolvency & Turnaround Association

1. General acknowledgment of the positive aspects of the reform

Insolvency practitioners generally are welcoming of any attempts to streamline what can be a complex, expensive and time-consuming process. We acknowledge that many business owners, as well as employees and creditors, struggle to understand the copious amounts of information that we are required by law (as well as accounting standards such as APES 330 and the requirements of the ARITA Code of Professional Practice where applicable) to provide to them. Therefore, any attempts to simplify this process are welcomed.

2. Concerns regarding the level of detail available to properly assess the practical application of the reforms

We make note of the fact that it has been difficult to properly consider and comment on the proposed reforms because much has been left to the regulations which are yet to be finalised, and because of the relatively short time frame allowed for parties to provide their submission.

The EDB (specifically S. 500AA(2)(a)) states that the tests for eligibility for the simplified liquidation process will be included in the regulations. As these regulations have not been released for public review, we do not know what the liabilities threshold (or any other thresholds) will be. Based on earlier releases, it is assumed that the ET is $1m in creditors. Will that be calculated considering actual creditors due and payable now? What about contingent, secured, or accrued employee entitlements on the balance sheet but presently not due or payable? What about claims against the company currently being disputed – should they be included in the total when determining eligibility? Will creditors have the right of set-off against any amounts they may owe to the company?

Will related parties also be limited in the amounts they can claim for employee entitlements?

These are issues we commonly find in insolvencies generally, including SMEs.

The proposed changes provide for the proposal to be approved by creditors with at least 50% in value, and no mention of any majority in number. In our experience, employees are often relatively low in value but higher in number, so these changes would potentially benefit trade creditors above employees. The employees' claims would also likely be reduced further if all entitlements had been paid out by the company. It is noted that no details are yet available on the extent of entitlements that would need to be paid, so any employees claim may be negligible.

Section 500AE(3)(b) of the EDB states that the regulations may provide for circumstances in which a transaction is not voidable despite Section 588FE of the Corporations Act 2001 (Cth) ("the Act"). However, the regulations have not been provided, hence there is uncertainty as to whether or not the simplified liquidation process will enable a liquidator to recover funds on behalf of creditors by having declared void antecedent transactions (such as unfair preferential payments or unreasonable director-related transactions). It is presumed that these recoveries will not be available under the simplified liquidation.

Part 1.120 of the EDEM refers to eligibility criteria (ET) for presenting a restructuring plan and states that the regulations could require the company to firstly pay any employee entitlements which are due and payable. As noted above, regulations have not been provided and hence the actual position of this aspect of the draft legislation is unknown. In particular, SMEs generally do not account well for employee entitlements such as annual leave and long service leave and book values for these liabilities are generally understated. From our experience, many SMEs also pay unreported cash wages or wages below award – how would these be taken into account in considering the ET? A restructuring proposal may (and is likely to) include retrenchment of staff – are additional obligations such as retrenchment payments also required to be paid in full to meet the ET?

We also note that provisions regarding the termination of restructuring plans are to be covered by the regulations, yet to be published. We would consider that any such regulations need to properly consider the risks associated with any delays in transitioning from a restructuring plan to liquidation, especially protection of assets, since the SBRP may not have access to assets in a debtor-in-possession model.

3. SBRP qualifications, powers, duties and obligations

Will a SBRP be required to pay the current Industry Funding Levy imposed on all formal administrations, at a similar metric rate? If so, how would this levy be imposed given that the current metrics are related to processes linked to formal administrations such as lodgement of proposals, etc.?

We do not see a need for the conditions and criteria for the registration of liquidators to be "softened" in any way, and we do not agree that flexibility in approving the applications for registration will lead to "greater diversity of practitioners into the field and greater resilience of the sector" as described in Part 4.6. Indeed, we do not understand what is meant by greater resilience. The body of registered liquidators in Australia at the present time is ready, able and prepared to take on the expected influx of work over the next few months and years. They already have a great range of experience, knowledge and skills, with many of the senior members having gone through recessions in the 1980s and 1990s as well as the global financial crisis in the 2000s. We note that ARITA has already made a clear statement that a SBRP must be licensed and regulated to the same standards of education and competency as that of registered liquidator and trustees and we support that stance.

The proposed changes to the Insolvency Practice Rules s.60-18 in regard to remuneration are currently without a framework and we cannot see whether it is envisaged that there will be limits or caps on remuneration, and if so at what levels. While we agree that costs are able to be reduced in a restructuring plan, the desired outcomes of these reforms will not be achieved unless there is fair and reasonable remuneration for a SBRP to be willing to accept the appointment. This assumes, of course, that the SME has sufficient remaining funds after payment of employee entitlements to pay the remuneration.

The regulations and rules around the duties of a SBRP are not yet defined. In particular, we do not see any consideration of the stakeholders to whom a SBRP may owe a fiduciary duty. These are generally well outlined in formal insolvency administrations through legislation and case law, and we would expect that there would be some guidance as to how this may be managed or legislated. In particular, we believe you need to clearly articulate whether the practitioner owes duties to the company, the directors, the secured creditors, the shareholders or the unsecured creditors.

Furthermore, small businesses are often intrinsically linked with the owners as directors and shareholders – personal assets are used as capital and/or security and personal guarantees of directors are in place with creditors. Dealing with a restructuring proposal for such a company will inevitability require involvement and restructuring of personal affairs as well, and then the SBRP faces a dilemma over to whom he or she owes that duty.

Another issue which is commonly faced by liquidators is around the provisions of Section 561 of the Corporations Act, which give priority to employees over circulating security interests. Would this priority need to be considered in a restructuring plan? Again, our comments are dependent on more knowledge of what would be required to be paid out for employee entitlements, and therefore the value of any remaining debts or claims.

4. Eligibility criteria for SMEs

Generally, we support the eligibility criteria. However, if a company is going to use these proposed insolvency regimes, which will short-cut existing corporate insolvency administration processes and related "checks and balances", it is important that the reforms include some protections through eligibility criteria, so that creditors are not unnecessarily disadvantaged, or at least that risk is reduced.

We would suggest that providing creditors with a restructuring proposal, without the benefit of a full analysis of estimated outcomes as provided in the current 75-225 report, leaves creditors short-changed in terms of the information available. While acknowledging that detailed investigations would be costly and defeat the purpose of these reforms, it is argued that providing creditors with at least an estimate of what they may likely recover in a liquidation would provide them with more substantial grounds for comparison and the ability to make a more informed decision.

5. SME Structure

There is presently no guidance around how these proposed reforms will work with different business

structures, particularly around the use of trusts in conjunction with a corporate trustee. These types of structures are very common among SME businesses. Some trust structure can be very complex and although they meet the ET for restructuring in terms of liabilities, they may still not be appropriate for the simple insolvency process. For example, the need to seek Court approval for dealing with trust assets generally increases costs substantially and is therefore likely to defeat any cost or time savings from the proposed reforms. Alternatively, if the trust and trustee meet the ET, there could be some regulated circumstances in which the SBRP is permitted to deal with the assets of the trust without the need to seek Court approval.

6. Concerns about intended time savings of simplified liquidation

The EDEM states that the intention of the proposed simplified liquidation process is to provide a faster and lower cost liquidation to increase returns for creditors. The existing creditor voluntary liquidation ("CVL") framework offers effectively many of the proposed time saving measures contained in the proposed simplified liquidation process, including:

- A creditor meeting need not be held in a CVL, and it is (in our experience) highly unlikely for a liquidator to be compelled to hold a creditor meeting during a CVL.

- The simplified liquidation process outlined is unclear as to whether, or when, a liquidator is required to provide information to the Australian Securities and Investments Commission ("ASIC") about matters such as alleged company officer misconduct. Typically, the primary report submitted by a liquidator to ASIC in a CVL is pursuant to Section 533(1) of the Act.

- Given the important information contained in a Section 533(1) report from the perspective of each winding-up, but also more generally in respect to the data provided to ASIC to assist it determine how best to allocate its resources to promote good corporate governance, the likely potential time saving appears immaterial and not in the public interest.

- From a practical perspective, the types of investigations which a liquidator typically undertakes (in our experience) that form the basis of the content of a Section 533(1) report are likely to be undertaken irrespective of whether a traditional CVL or simplified liquidation is used. That is, the liquidator will irrespectively undertake tasks such as reviewing a company's financial records and making enquiries with the company's officers about the company's affairs and past activities. That minimum level of investigation would still need to be done to be able to inform ASIC whether any offences appear to have been committed.

It is stated in the EDEM in part 3.72 that "…in the liquidation of a small company with limited assets, these [unfair preferences and voidable transactions] proceedings can take up time, money and resources, and have the potential to outweigh any benefit that might flow through to creditors". While it is acknowledged that some recoveries can take considerable time and costs, many are in fact settled on a very commercial and pragmatic basis and that already ensures a cost-effective approach to such realisations. That approach may be consistent with the explanation in Part 3.73 that some voidable transactions may have some eligible criteria attached to them.

There are also concerns about the timeframe to make an election for the simplified liquidation. In our experience, 20 days to make an election to convert from a standard CVL to a streamlined CVL is too early. Practically speaking, it can take several months to get the important information required to make an informed decision. We believe a more realistic timeframe would be 90 days, and therefore would be no prejudice to creditors with this extended timeframe as the processes up to this point in time would be very similar if not identical.

7. Anecdotal Comments and Points

By way of observation, we gathered together some of the feedback from our members to the proposed amendments, to give some more insight into responses, and more in terms of practical application of the reforms. These include:

- "potentially makes a VA style appointment cheaper and more accessible"
- "the SBRP has a bigger role in helping directors, could have positive outcomes"
- "SMEs struggle to pay superannuation let alone have cash left over for SBRP fees"
- "related parties can't vote so why would directors hand over control to creditors?"
- "directors have to do the heavy lifting to get creditors' approval"
- "ATO will likely be the deciding creditor since they will have value – will that encourage jobs, and reduce payment of preference recoveries?"
- "creditors get low average returns from liquidations, they are likely to take a chance on getting a better return, especially in a trial period – likely to have their support"
- "from the RLs' perspective, this means substantial work in getting precedents and templates up to scratch"

8. Conclusion

We once again thank Treasury for the opportunity to provide feedback on the Corporations Amendment (Corporate Insolvency Reforms) Bill 2020. Our responses have been based on the experiences of our members and given the small size of the AIIP and the fact the majority of our members are small business themselves, and given the relatively short time allowed for this submission, they regretfully do not have significant time to prepare more detailed commentary on proposed changes.

If you have any questions regarding this submission please do not hesitate to contact us. If there is to be any consultation with the profession, we would ask that AIIP be invited to participate.

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Yours faithfully

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