McGrathNicol

McGrathNicol Restructuring
ABN 34 824 776 937
Level 6, 171 Collins Street
Melbourne VIC 3000, Australia
GPO Box 9986
Melbourne VIC 3001, Australia
T +61 3 9038 3100
F +61 3 9038 3199
mcgrathnicol.com

12 October 2020

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

Dear Sir/Madam

Insolvency reforms to support small business

McGrathNicol is a leading national restructuring and insolvency practice including 17 registered liquidators, the majority of whom are members of ARITA (the Australian Restructuring, Insolvency and Turnaround Association).

Our insolvency practice undertakes corporate engagements only (we do not practise in bankruptcy) and we operate in all market segments and business sizes from small engagements to large, more complex matters.

Thank you for the opportunity to provide comments on the proposed new insolvency processes. As there is a range of additional matters that are yet to be developed, we would also welcome the opportunity to provide further comments and assistance going forward.

Given the short timeframe for consultation, we have focussed on key high level issues pertaining to the new small business debt restructuring process rather than a more granular level of drafting inconsistences.

1 Registration of the persons who can undertake the formal debt restructuring process for eligible small companies

We are concerned that the high level of professionalism and competence that is currently required for registration and ongoing practice as a liquidator (recently enhanced by the Insolvency Law Reform Act 2016) could be undermined by allowing a new sub-class of registrants, with lower levels of qualifications, experience and skills, to undertake the debt restructuring process and simplified liquidations.

We are supportive of the insolvency profession being held to the high standards necessary to maintain creditor, stakeholder and public trust. For this reason it is our view that Registered Liquidators should undertake these new appointment types.

If the Government is intent on increasing the number of insolvency practitioners to undertake this work, by lowering standards, then we advocate that there be a basis for directors, creditors and others to differentiate the lesser qualified practitioners by means of a different designation. Alternatives include "Small Business Restructuring Practitioner" **(SBRP)** or "Small Business **Debt** Restructuring Practitioner" to better reflect the task being undertaken, rather than a sub-class of Registered Liquidators. Such an approach will reduce the risk of confusion about the roles of Registered Liquidators and SBRPs being the same or overlapping. In support of this suggestion, we observe that the new type of registrant would not be qualified to undertake liquidations more broadly (only the debt restructuring process and simplified liquidations), which tends against such registrations being termed as "Registered Liquidators".

2 Key elements of the new processes should be provided for in the Corporations Act rather than the regulations

The Exposure Draft Explanatory Materials **(EDEM)** contains numerous references to the regulations providing important details of the features of the new appointment types. For example, at EDEM 1.128:

> "The regulations may provide for matters relevant to appointing a small business restructuring practitioner for a restructuring plan… for the practitioner's appointment, their functions, duties, and powers for the restructuring plan, and their rights and obligations and liabilities of the small business practitioners arising out of the performance of their functions and duties and exercise of their powers."

In our view, matters such as the duties, powers and liabilities of the company, its directors and of the SBRP and the framework of the process, even if only at a high level, should be dealt with in the Corporations Act **(Act)**. This is consistent with all other significant reforms to substantive matters in insolvency law and would in our view greatly improve the clarity of the changes and confidence in the application of the law.

We note that it is very unusual to leave so many critical elements to the regulations, as is the provision that the regulations will take precedence over the Act in cases of inconsistency (EDEM 1.135).

We are concerned this creates a lack of clear rules for directors of insolvent entities and their creditors, which may be aggravated by the ease by which regulations may be amended. In our assessment the approach being taken puts at risk the stability of and confidence in Australia's insolvency regime which is a fundamental pillar of economic strength.

In summary, we support the substance of the new regimes being covered in the Act and the practicalities of executing that work being left to the regulations.

3 Clarity around the definition of 'small company' eligibility criteria

We note that the media coverage of the formal debt restructuring process for eligible small companies states that the limit of indebtedness for eligibility to utilise the new process will be $1 million. As this is not particularised in the proposed amendments to the Act, we assume that the details of the debt limit will be provided for in the regulations. As a matter of regulation rather than legislation, the indebtedness limit may be easily amended which is of concern because an increase of the indebtedness limit for eligibility to employ the formal debt restructuring process for eligible small companies to, say, $5 million would materially change our views on the appropriateness of this new process as a fit for purpose restructuring tool. In our opinion the limit should be provided for in the Act itself to engender certainty and the limit should be $1 million, although indexation would be acceptable.

Clarity is also required within the Act regarding the debts to be included in the calculation of the company's liabilities. For example we understand accrued employee entitlements will be excluded but it is not clear if Superannuation Guarantee Charge debts are 'in or out'. Related party debt is proposed to be excluded from voting rights but will it be counted as part of the threshold $1 million? We have also heard divergent views on whether fully secured debt is to be included in the calculation. If secured debt were to be excluded, we would have different views about the appropriateness of the new regime as a fit for purpose restructuring tool, given it could then extend well beyond what we understand to be the intended target of "small companies".

4 Lack of clarity about the concept of debt restructuring and the role of the SBRP

Related to our apprehension about the drafting structure addressed at (2) above, is our concern that the exposure draft does not clearly provide a framework for the new debt restructuring process nor does it define the responsibilities and importantly the limit of the responsibilities of the SBRP and the directors of the insolvent company respectively. The novelty of the debtor in possession model in the Australian

context only exacerbates the need for the rights and obligations of the parties involved to be clearly stated in the Act.

Illustrations of the types of matters that we consider should be expressly addressed in the Act include:

- It is implied in the exposure draft that there are two distinct phases, a restructuring plan development and then implementation phase but these are not clearly delineated. This is in contrast to the transition from voluntary administration to Deed of Company Arrangement or Creditors' Voluntary Liquidation where the transition is clearly defined). For example, is the company required to show the "Small Business Restructuring Practitioner Appointed" designation on its public documents in both phases?
- Given the SBRP will not be in control of the business, a number of responsibilities imposed on them following the voluntary administration model do not seem appropriate (for example notifying PPS security interest holders of the appointment, providing notices to various parties of the appointment and making Court applications, including to restrain the actions of secured creditors).
- The role of the SBRP in assessing or evaluating and then presenting the proposed debt restructuring plan to creditors should be specified to a much higher level. What is meant by the current terminology that the proposal be 'certified'? For example, does this involve a comparison with a hypothetical liquidation outcome? We consider that should be part of the requirement for any "certification" of the proposed restructuring plan.
- What are the possible outcomes of the process if it succeeds? Is there be a minimum return to creditors? Is there a maximum timeframe over which restructured debt can be repaid? Due to the potential limitation on enforcing personal director guarantees while the plan is being implemented, this limitation could be very important to credit providers.

Absent clear rules that deal with the above issues, we are concerned that an unintended consequence could be that the new process might substantially retard the provision of trade credit to small businesses.

5 The alternative outcomes of the debt restructuring process should be prescribed

In the current format the exposure draft does not provide for an immediate solution for the company if the debt restructuring plan is rejected by creditors or if it fails during implementation. Presumably then the control of the company, which we note the draft legislation deems to be insolvent on entering into debt restructuring, reverts to the directors and other formal insolvency processes could be enlivened, including any winding up applications held in abeyance during the process. However, that is not prescribed.

Given the target of these reforms is small companies in financial distress, we suggest that an automatic transition to liquidation on the failure of approval or implementation of the debt restructuring plan would give a desirable level of certainty for stakeholders. It would also ensure that only companies in genuine, insurmountable financial distress would avail themselves of it.

We have considered the independence implications of there being an automatic appointment of the SBRP as the simplified process liquidator. While we have some misgivings about the potential for abuse of this process given the lesser degree of scrutiny of director misconduct in the simplified liquidation model, on balance we favour this automatic solution as a means of ensuring a complete solution and minimising cost and complexity. We consider the protections in the simplified liquidation process enabling creditors to object to its use and to the SBRP continuing to act as the liquidator provide adequate protections to creditors' interest in this situation.

In closing we observe that given the necessary haste with which these reforms have been crafted, a sunset date would be a useful protective mechanism. We are aware that ARITA has advocated for such a provision

pending a comprehensive revision of the Australian corporate insolvency regime and we fully endorse the proposition that this new law be enacted for a 2 year period as an interim measure.

Thank you again for the opportunity to comment on these important proposed legislative amendments

If you have any queries or would like to discuss our submission further please contact me on 0408 028 422 or Rosemary Winser of my office on 0400 647 661.

Yours faithfully

Matthew Caddy
Partner