Mills Oakley
ABN: 51 493 069 734

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Australian Government, The Treasury
GPO Box 89
SYDNEY NSW 2000

Your ref:
Our ref: NAZM/ACB

All correspondence to:
PO Box 453
Collins Street West
MELBOURNE VIC 8007
DX 558 Melbourne

Contact
N kita Angelakis +61 3 9605 0956
Email: nangelakis@millsoakley.com.au
Fax: +61 3 9605 0933

Partner
Ariel Borland +61 3 9605 0015
Email: aborland@millsoakley.com.au

By Email: MCDInsolvency@Treasury.gov.au

Dear Treasury

Submission of Mills Oakley: Insolvency reforms to support small business.
Exposure Draft Bill Corporations Amendment (Corporate Insolvency Reforms) Bill 2020

Introduction

1. We refer to the Exposure Draft Bill and Exposure Draft Explanatory Materials for the *Corporations Amendment (Corporate Insolvency Reforms) Bill 2020* (respectively, the **Bill** and **EM**). We note that the consultation period for the Bill expired yesterday, 12 October 2020, and request that this submission be accepted late.

2. Mills Oakley supports the regime which may be an effective form of rescue for distressed small to medium enterprise companies (**SMEs**) with viable businesses that could not otherwise bear the cost of the voluntary administration process. We note that much of the detail of the proposed regime will be left to amendments to the *Corporations Regulations 2001* (Cth) (**Regulations**).

3. This submission identifies aspects of the Bill that may undermine the efficacy of the restructuring regime, as well issues surrounding a lack of clarity on the powers, functions, and potential liabilities of the small business restructuring practitioner (**Restructuring Practitioner**).

The General Framework

Eligibility Criteria

4. The Government has indicated that the restructuring procedure under section 453A (**Restructure**) is available only to SMEs with 'non-complex' liabilities with a value of less than $1 million.[1] No guidance has been provided as to how contingent or prospective liabilities (such as rent under a shopfront lease) or unliquidated claims (such as a claim for damages relating to the sale of defective goods) are to be assessed for that purpose.

[1] EM, [1.20]

5. In our view, the test ought to factor in the probability that the SME *will* be required to satisfy the liabilities that are assessed. This test may assess values on a discounted present value basis, or according to whether liabilities are 'due and payable' (being, the traditional test of assessing insolvency under the Act). If probabilities are not factored in, then it is likely that the $1 million cap may exclude many SMEs which have long-term or uncertain liabilities (such as leases, or unfounded legal claims made against them).

6. An alternative to this may be to exclude such contingent or uncertain liabilities from the liabilities compromised under a restructuring plan (**Plan**), however such an approach may leave entities with substantial long-term liabilities that could undermine the effectiveness of any restructure. In these cases, it is likely to be cleaner for any restructure to proceed through a voluntary administration.

7. We also note that in order to propose a Plan to creditors, the SME must ensure that all tax lodgements are up to date, and that employee entitlements have been paid in full.[2] It is not clear whether all tax liabilities must have been remitted (or merely lodged) and whether superannuation contributions must have been paid in full. Each of these is rare in our experience with SMEs (and particularly so in the COVID-19 environment). This is likely to exclude many SMEs from the regime.

Personal Liability & Extension of Credit to SME in Restructure

8. Unlike a voluntary administrator, the Restructuring Practitioner is not personally liable for debts incurred whilst the SME is in Restructure. This reflects a traditional debtor in possession model.

9. However, the Bill does not provide that directors or officers of the SME shall be personally liable for debts incurred in the ordinary course or a super priority for these debts. This may undermine the effectiveness of the Restructure regime. Debts incurred by the SME during Restructure are provable debts (and are not paid in priority) in a winding up. Creditors (and in particular, suppliers of goods or services) may be hesitant to extend credit to companies in Restructure, and may instead demand cash on delivery, given the risk of non-payment. The SME may not have cash on hand to do business on that basis.

10. On the other hand, it is likely that directors and officers would be hesitant to enter a Restructure if they assumed personal liability for all debts incurred in the period of Restructure. This is likely to be a major commercial impediment to many Restructures.

Director Penalty Notices

11. It is unclear how the Restructuring reforms will interact with the director penalty notice (**DPN**) regime by which the Commissioner of Taxation (**Commissioner**) can issue a notice on directors requiring them to personally remit PAYG or SGC liabilities. Presently, the recipient of a DPN has 21 days to pay the debt, come to a payment arrangement, or place the company in liquidation or voluntary administration.

12. Consequential amendments have not been proposed that permit the recipient to place the SME into Restructuring within 21 days, or that stay the Commissioner from issuing a DPN during a Restructure. It is possible that the DPN regime will effectively provide the Commissioner with a power to 'veto' any proposed Restructure. In our view, such amendments are necessary so that the Commissioner is not provided with disproportionate power over the process compared with other creditors.

13. Moreover, the Bill provides that a Restructuring Practitioner may terminate a Restructure,[3] but does not specify whether directors can resolve to terminate the Restructure without the consent of the Restructuring Practitioner. This should be clarified in the Regulations, particularly if the DPN regime is not affected by these reforms.

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[2] See Bill, s 500AA.
[3] Bill, s 453J.

Court Oversight

14. Finally, the Bill provides the Court with an oversight role. This role extends to authorising or validating transactions outside of the ordinary course of the SME's business, authorising a dealing in the shares of the SME, granting leave for a creditor to proceed with a claim against the company or enforce their security interest, to restrain a secured party or receiver from undertaking certain acts, or to vary or terminate a Plan.[4]

15. However, the reforms are geared specifically at low-asset, low-liability SMEs. We doubt whether it will be commercial to apply to the Court in most, if not all, Restructurings or Plans. Likewise, this will generally dissuade a Restructuring Practitioner from making an application to the Court for directions on questions or controversies that arise in the Restructure pursuant to section 90-15 of the *Insolvency Practice Schedule (Corporations)* (being Schedule 2 to the Act).

16. This is an issue wider than the scope of these reforms, however, there may well be merit in considering a US-style 'Bankruptcy Court' system at the Federal level which deals only with insolvency-centric issues (both personal and corporate) in an expedient, streamlined and cost-effective manner.

The Restructuring Practitioner

17. Unfortunately, the Bill and EM fall short of providing practitioners with the clarity they need to take an appointment as a Restructuring Practitioner come 1 January 2021. Section 453E of the Bill sets out the functions of the Restructuring Practitioner in broad descriptive terms, however, the draft legislation does not clearly specify the tasks required of them, or the powers and potential liabilities associated with that office.

Advising the Company

18. The directors of the SME, rather than the Restructuring Practitioner, will prepare and proposes the Plan to the SME's creditors.[5] The function of the Restructuring Practitioner is "to provide advice to the company on matters relating to restructuring".[6]

19. There is a risk that Restructuring Practitioners will be characterised by the Courts as a 'shadow director' of the SME. The engagement involves providing advice directly to directors, with the intention that they will follow it. This is consistent with the indicia relied on to show that a person is a shadow director.

20. We note the definition of the shadow director "does not apply merely because the directors act on advice given by the person in the proper performance of functions attaching to the person's professional capacity".[7] Nonetheless, the definition of 'director' and 'officer' should be amended to specify whether the Restructuring Practitioner is included within them (and by extension, whether the directors' duties regime applies to Restructuring Practitioners).

21. Section 453H provides that: "When performing a function or duty, or exercising a power, as restructuring practitioner for a company under restructuring, the restructuring practitioner is taken to be acting as the company's agent." The EM expands upon this by way of example: "the practitioner acts as an agent of the company where they sell company property to raise funds to pay debts or make an application to the Court on behalf of the company."[8]

22. While the Bill stipulates that the Restructuring Practitioner is an agent of the company, it does not specify what the Restructuring Practitioner has authority to do, and what they cannot do, on behalf of the SME. Without further clarity there is a risk that practitioners may unknowingly act in excess of that authority.

23. Moreover, a Restructure will generally involve a trade-on during the period that a Plan is being formulated. Section 453K of the Bill provides that the company retains control of its

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[4] Bill, ss 453L, 453N, 453Q, 453R, 453S, 454F, 454M, 458A.
[5] EM, [1.48] and Bill, s 455A(1).
[6] Bill, s 453E.
[7] Corporations Act 2001 (Cth) s 9, definition of 'director'
[8] EM, [1.138].

business, property and affairs for the duration of the Restructure. Management of the SME retain authority to enter into transactions on behalf of the company in the ordinary course of business but require the consent of the Restructuring Practitioner for any transaction outside of that.

24. The extract from the EM above indicates that the Restructuring Practitioner will be permitted to deal with the property of the SME. The legislation does not provide that the Restructuring Practitioner has a duty of care in exercising its power of sale (such as to achieve market value or the best price reasonably obtainable, like the duty imposed on a receiver).[9] This should be clarified.

25. It also is not clear whether the Restructuring Practitioner may enter into transactions or sell property on the company's behalf without the consent of management (whether or not it is in the ordinary course of business), or whether their role is solely to advise and give consent to management where appropriate.

Assessment of Eligibility Criteria

26. In order to enter into the simplified liquidation procedure, the liquidator must assess whether the eligibility criteria are satisfied.[10] By contrast, there is no express obligation on a Restructuring Practitioner to do this. The Restructuring Practitioner has power to, and "may" terminate the Restructure by written notice to the SME.[11] They also are not liable for any loss occasioned by a decision to terminate or not to terminate a Restructure.[12]

27. While that immunity is welcome, we consider that clarity is needed in two respects. Namely, whether the Restructuring Practitioner has a duty to investigate whether the criteria are satisfied, and whether they must terminate the Restructure in circumstances where they doubt that the criteria are satisfied.

28. The EM indicates that it is the directors of an SME who "are responsible for ensuring that they comply with the legislative requirements of the debt restructuring process".[13] However, the Restructuring Practitioner is only immune from liability if they make a "decision" to terminate or not to terminate. That would not seem to encompass a scenario where the Restructuring Practitioner does not turn their mind to, or investigate, the eligibility criteria. If the Government intends that practitioners will audit the decision of the directors in relation to the eligibility criteria, then this should be clearly expressed in the legislation.

Declaration to Creditors

29. Section 453E of the Bill provides that another function of the Restructuring Practitioner is to "make a declaration to creditors in accordance with the regulations in relation to the restructuring plan proposed to the creditors". As indicated, the form of the declaration will be prescribed by the Regulations.

30. It is likely that the declaration will incorporate aspects of the report provided by voluntary administrators ahead of the second meeting of creditors held pursuant to section 439A of the Act. The EM suggests that the declaration will require an "opinion on [the] feasibility of a proposed plan" to restructure the SME.[14] Government commentary has also suggested that the Restructuring Practitioner must certify whether "the business can meet the proposed repayments and has properly disclosed its affairs."[15]

31. We note, however, that the regime contemplates that the Restructuring Practitioner will undertake very limited investigations during the period of the Restructure. As a result, they are not likely to have as great of an understanding of the voidable transaction claims, or other claims, available to the SME compared with a voluntary administrator in their same

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[9] Corporations Act 2001 (Cth) s 420A.
[10] Bill, s 500A.
[11] Bill, s 453J.
[12] Bill, s 456H.
[13] EM, [1.47].
[14] EM, [1.50].
[15] See Government Fact Sheet.

position. Likewise, Restructuring Practitioners must rely on the information provided by the SME and material misstatements in the Plan or SME's disclosures are not likely to be readily apparent.

32. In those circumstances, we consider that it would be difficult for a Restructuring Practitioner to express a wide-ranging opinion as to whether it would be in the interests of creditors to either adopt a Plan or enter into liquidation. To overcome this, we recommend that the immunity in section 456H of the Bill be extended to encompass opinions expressed in good faith within the declaration.

If you have any questions or require further information, please do not hesitate to contact Ariel Borland on +03 9605 0015 or aborland@millsoakley.com.au, or Nikita Angelakis on +03 9605 0956 or nangelakis@millsoakley.com.au.

Yours sincerely

ARIEL BORLAND
PARTNER