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Australia's Federal Government Embraces a Debtor-in-possession Mindset as Part of Its Further Insolvency Reforms Amid the Pandemic

Asia Pacific – 24 September 2020

The Australian federal government has continued introducing temporary and potentially permanent insolvency law reforms intended to assist the economic repair efforts during, and following, the pandemic. In the latest development, which occurred in somewhat strange circumstances, the federal government has announced that it will shortly introduce new laws into parliament, which are intended to reduce complexity, time and the costs for small businesses to restructure their financial affairs.

Despite acknowledging that the new laws are the most significant changes to Australia's insolvency regime under the Corporations Act (Act) in almost 30 years, the federal government has not yet engaged with the restructuring and insolvency (R&I) profession or other key stakeholders, including secured and non-secured creditor groups, R&I industry bodies and directors' and officers' organisations, on the suitability and implications of the new laws prior to their release.

The New Laws

The new laws are intended to come into effect on 1 January 2021, by which time the existing temporary changes to the Act concerning a secondary safe harbour against insolvent trading and increased thresholds for winding up actions will cease operating.

The reform package will include:

- A new formal debt restructuring process for small businesses to provide a faster and less complex mechanism for financially distressed but viable firms to restructure their existing debts, maximising the chance of them surviving and contributing to economic and jobs growth.
- A new, simplified liquidation pathway for small businesses to allow faster and lower-cost liquidation, increasing returns for creditors and employees.
- Complementary measures to ensure the insolvency sector can respond effectively both in the short and long term to increased demand and to the needs of small business.

The government intends that the measures will reposition Australia's existing R&I regime to reduce access costs for small business, to reduce the time they spend during insolvency processes, to ensure greater economic dynamism and, ultimately, to help more small businesses to survive.

Embracing Chapter 11 at the Expense of Voluntary Administration

The overriding rationale for the new laws seems to be a focus on permitting small businesses to access a simplified, cost efficient and speedy restructuring process that enables them to remain in control of their affairs, while endeavouring to reorganise their affairs with the assistance of outside R&I counsel.

The federal government's new mindset signifies a clear shift away from the traditional voluntary administration regime under the Act. That shift has been premised on the government's understanding that the requirements around voluntary administration in Australia are more suited to large, complex company insolvencies. Further, that the high costs of voluntary administration can also consume most or all of the value of a small business's assets, making it harder for the business to restructure and reducing the business's willingness to engage with the system. Interestingly, the government considers that despite the relative success of the voluntary administration processes, small businesses may be deterred from seeking R&I assistance from experts such that they should be entitled to access a different system.

The proposed new regime draws on key features of the US Chapter 11 bankruptcy processes with the most significant different being that the long established Chapter 11 regime is by no means limited to company debts not exceeding AU$1 million.

The Role of the Small Business Restructuring Practitioner

The changes will permit business owners to remain in control of their affairs while a debt restructuring plan is developed and voted on by creditors. Trading in the ordinary course of business can be continued without any external approvals; however, any trade outside of the ordinary course of business will require the approval of a small business restructuring practitioner (SBRP).

The office of SBRP is foreign to the existing R&I regime under the Act and the precise remit of the SBRP and the limitations of the role it will play is not yet known.

The Known Unknowns

There are obvious, and sometimes very significant, risks in implementing legislative changes in a very limited timeframe, which the federal government points out can potentially impact over 75% of all external administrations. In particular, the impact on existing creditors continuing to bear the financial burden of transacting with insolvent entities who may soon be ostensibly preparing a restructuring plan with the help of an SBRP will likely be significant. At the very least, forcing existing creditors to continue to trade and take on risk in circumstances where their counterparties are in obvious distress may have wider unintended financial consequences.

There are many things we do not presently know about the new laws and their potential implications. For the time being, the following are some of the key issues that are presently unknown:

- The extent to which, if any, the SBRP may be liable for the restructuring and any losses arising from its implementation.
- The limitations of any restructuring plan and whether, for example, it will permit the compromise of all types of claims.
- The extent to which stakeholders may be permitted to intervene the process by, for example, seeking the appointment of an alternate SBRP, negotiating changes to the restructuring plan or taking court action.
- Whether causes of action against directors and officers (or third parties) may be preserved as part of the restructuring plan and subsequently pursued via a liquidation process.

We will continue to monitor and report on developments in the R&I space. In the interim, given the level of uncertainty, the significance of the legal, financial and operational changes on foot and the economic environment in general, all directors, boards and entities exposed to, or dealing with, distressed entities would be best advised to seek R&I counsel as early as possible.

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