SQUIRE PATTON BOGGS

The Future Remains Uncertain as Australia Introduces Its New Debtor-in-Possession Insolvency Laws

In late September 2020, the federal government announced that it would be introducing changes to Australia's Corporations Act (Act) and the most significant amendments to the corporate insolvency regimes in decades. The main objective is to help the small business sector deal with and overcome the economic, financial and trading challenges posed by the ongoing pandemic. Since then, the government has released its new laws via the Corporations Amendment (Corporation Insolvency Reforms) Bill 2020 (Cth) (New Laws).

The New Laws represent a monumental shift in the mindset underpinning Australia's restructuring and insolvency regime from a predominantly creditor-led system to now a hybrid of creditor-led and debtor-in-possession processes.

The haste with which the government is fast-tracking these laws is self-evident. Despite the significance of the laws, the proposed go-live date of 1 January 2021 and the fact that relevant regulations have still not been released, stakeholders were only permitted seven days to make submissions.

Although the New Laws are intended to apply only to small businesses, the reality is that they will likely impact a broad range of companies because of counterparty, director, creditor, debtor, supplier or subcontractor risks.

Some Key Elements

The New Laws are extensive and they warrant close assessment before any significant decisions are made by directors. For the time being, however, they raise a number of issues, including the following:

- **Safe harbour** – Australia's recent obsession with safe harbours continues. The New Laws introduce a new safe harbor under s 588GAA (B). Directors will continue to benefit from protection against insolvent trading claims in relation to transactions entered into during a restructuring process and that are in the ordinary course of their company's business.
- **A new appointee** – The term for the appointee under the New Laws is "restructuring practitioner" (RP).
- **Voidable transactions** – There are a number of major changes regarding voidable transactions. In particular, there is carve out for transactions entered into by a company whilst it is under a restructuring process, in the ordinary course of its business or with the express consent of the RP. Some of these changes cut both ways. On the one hand, they promote economic activity by reducing voidable transaction risks. On the other hand, any future liquidator will be within his or her own rights to determine whether transactions were, in fact, in the ordinary course of business, consistent with the restructuring plan or had the RP's consent such that they should not be unwound.
- **Court oversight** – The government is clearly still grappling with what role the court is to play in the restructuring process and the extent to which stakeholders may have recourse to court interventions. The government has the unenviable task of coming up with new court-related mechanisms that reasonably and adequately protect creditor and stakeholder rights from abuse but, at the same time, promote efficient, cost-effective restructurings. In fact, cost is a key driver behind the new laws. The draft legislation does not make clear the extent to which the court will play a role – the government is still to determine that issue and any solution it proposes will likely be the subject of some criticism.
- **Eligibility unknown** – Although the government has foreshadowed an AU$1 million debt ceiling applying to eligibility rules, a number of questions still remain about how that ceiling is to be determined, the make-up of the debts and even the threshold itself.
- **Notice to counterparties** – The New Laws require that a company subject to a restructuring process must add the words "(restructuring practitioner appointed)" to its name in official documents, including in execution clauses to deeds, contracts and agreements.
- **Act of insolvency** – A company that proposes a restructuring plan under the New Laws is taken to have committed an act of insolvency and is, therefore, deemed insolvent.
- **Transfer to external administration** – The New Laws permit the transfer of a restructuring process into a voluntary administration or liquidation phase. That would primarily occur in the event that a plan is not approved by creditors, or if the process is terminated by the RP or perhaps by the court. Precisely what that path to external administration will look like and what the requirements will be are not yet known.
- **Termination of process** – The New Laws permit the RP to terminate a restructuring process on various grounds. Ordinarily, those grounds would include if a company fails to meet the eligibility criteria, if it would not be in the interests of creditors to embark upon, or continue with, a restructuring plan, or perhaps if the court gives the RP relevant guidance inviting or ordering a termination.

A New Part, But the Devil May Be in the Regulations

Rather than adapting the existing processes for voluntary administration under the Act, which has been the *modus operandi* for governments of both persuasions in recent years, the current government has elected to insert a whole new Part 5.3B into the Act. The new part provides the overall framework for a restructuring under the debtor-in-possession model. However, it is by no means complete. In fact, on any fair assessment, it seems the New Laws are no more than 70% complete and that they will require extensive input from corresponding regulations.

The government is clearly concerned about the spate of insolvencies that appear on the horizon. Given that concern and the fact that we are fast approaching the end of the year, it seems the legislators are trying to buy time by rushing through a new legal framework in time for the go-live date but leaving themselves the option to develop other critical aspects on the run.

Key Takeaway

Our note by no means covers all the key aspects of the New Laws in an exhaustive manner, but we hope it demonstrates what is on the horizon. Concerns have already been registered, in written submissions, with the government as to the proposed go-live date, the incomplete nature of the New Laws, the foreshadowed liability threshold and "phoenixing" risks. It remains to be seen if those concerns will really be heard in time for 1 January 2021.

For the time being, all company directors should act quickly in considering the impact of the New Laws on their duties and liabilities, as well as counterparty, director, creditor, debtor, supplier or subcontractor risks.

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