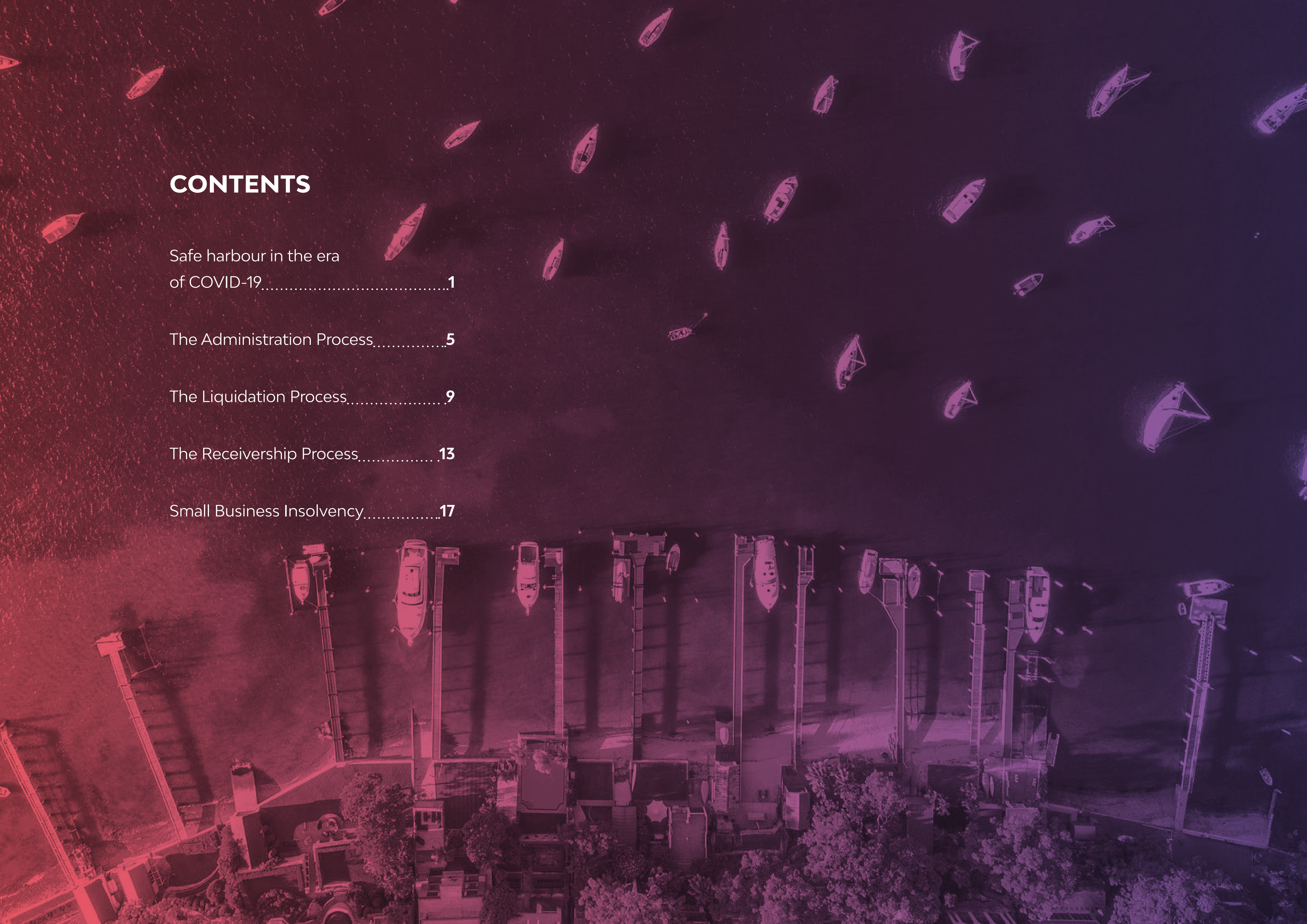
DEMYSTIFYING INSOLVENCY

What you need to know

Bartier Perry
LAWYERS



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DEMYSTIFYING SAFE HARBOUR IN THE ERA OF COVID-19

COVID-19 is and will continue to have severe financial impacts on individuals and on small to medium businesses alike for some time yet. Employees, customers and clients of many small businesses across the country have retreated into their homes for both work and self isolation. Businesses have been the subject of Government directions.

On 23 March 2020, the NSW State Government issued a Public Health Order under the *Public Health Act 2010* directing that businesses such as pubs, food and drink premises, entertainment facilities, amusement centres and indoor recreation facilities must not be open to members of the public. These directions were expanded to confining people to their place of residence and limiting gatherings to 2 people only on 30 March 2020. Other businesses such as retailers, have since closed their doors.

How long COVID-19 and its effects on our lives and businesses go on for is anyone's guess at this stage. With little or no revenue, but with rent and other fixed costs still needing to be paid (if not now, some time in the future), together with businesses desperate to retain staff so that experience and expertise is not lost, company directors are no doubt conscious of trading whilst insolvent and personal liability that may be attached.

The Federal Government has introduced temporary measures to reduce some of these financial pressures on businesses and the risk of personal liability for company directors for insolvent trading.

These temporary changes to the insolvency regime will cease on 31 December 2020. After then, a new regime will come into place that differentiates 'small businesses' from other businesses for the purposes of insolvency related options. The last article in this publication deals with these aspects.

These temporary measures may not be enough to support businesses and protect directors from personal liability beyond COVID-19. Whilst there may be short term relief from the Government and some financiers, landlords and suppliers, the debts continue to accrue.

It is vital that directors turn their attention to and develop plans that will not only see their company through the current COVID-19 period, but will also put their company on a reasonable footing to allow it to continue trading successfully post COVID-19 once normal trading conditions are resumed and businesses open their doors again.

The Government's response to Covid-19

The Federal Government has introduced a package of reforms through the *Coronavirus Economic Response Package Omnibus Bill 2020* (Coronavirus Bill), designed to assist businesses in financial distress as a result of the economic impacts of COVID-19.

Some of these reforms include changes to the *Corporations Act 2001* (Cth) (Corporations Act), to provide temporary relief for directors from their duty to prevent insolvent trading and temporary relief for businesses at risk of insolvency, including through increasing the statutory minimum amount and time period for creditor's statutory demands.

The reforms also provide for a temporary safe harbour for directors from liability for insolvent trading with respect to debts incurred during the COVID-19 pandemic. Section 588GAAA of the Corporations Act provides that a director will not be liable for insolvent trading if the debt is incurred in the following circumstances:

1. in the ordinary course of the company's business; and
2. during the six-month period starting on the day the section commences, being 24 March 2020 (or any longer period prescribed by the regulations).

The onus of proof lies with the director to document and be able to produce evidence of the above circumstances (s588GAAA(2)).

The Government has also provided a number of stimulus packages to support eligible small to medium sized businesses, including access to funding to continue paying employees, cash flow support to continue business operations, and assistance from the ATO with temporary reduction of payments or deferrals, or withholding enforcement actions including Director Penalty Notices and wind-ups.

A company is insolvent if it cannot pay its debts as and when they fall due. This is principally a test of a company's cashflow and whilst funding and debt moratoriums provide immediate relief by the deferral of a requirement to pay, debts continue to accrue on the company's balance sheets and will become due and payable at some point in time.

While the Government has provided significant temporary relief to assist businesses and directors through the COVID-19 pandemic, it is our view that these measures alone will not be enough for many businesses, particularly those struggling prior to COVID-19, to return to solvent trading at the end of the pandemic.

For these companies, directors should consider whether they qualify for the 2017 safe harbour provisions under section 588GA of the Corporations Act and if so, develop and implement a recovery plan from the impacts of COVID-19.

What is Safe Harbour

We explained the safe harbour provisions in detail in our April 2018 bulletin, which can be accessed here: https://www.bartier.com.au/insights/articles/an-insolvency-safe-harbour-for-company-directors/

To briefly recap, on 19 September 2017, new legislation came into force providing "safe harbour" protection for company directors against insolvent trading claims while they develop and implement plans to restructure the company.

In particular, s588GA of the Corporations Act provides protection for company directors from personal liability for insolvent trading if, at a particular time after the director starts to suspect that the company may be insolvent, he or she develops and implements a course of action that is reasonably likely to lead to a better outcome for the company, and the relevant debt is incurred in connection with that course of action.

A director will not qualify for "safe harbour" protection if the company has not:

- paid its employee entitlements, including superannuation by the time they fall due; or
- provided its returns, notices, statements, applications or other documents to the ATO more than once during the 12 month period prior to a debt being incurred from which the director seeks the protection of the safe harbour.

Why is Safe Harbour still important?

It is almost certain that the financial impact on businesses as a result of COVID-19 will continue beyond the six-months currently allowed for by the Government's reforms.

The Government's temporary relief measures and the six month protection from insolvent trading for directors may prove sufficient for a healthy business with a viable cash flow to enable it to return to solvent trading at the end of the six month period.

But for many businesses facing working capital difficulties arising prior to and as a result of COVID-19, sole reliance on these Government measures without a turnaround strategy for when the pandemic ends will not be enough.

For these businesses, steps should be taken so that directors can take advantage of the "safe harbour" protections in the Corporations Act. The company should pursue a course of action that:

- will allow it to continue to trade once normal trading conditions are resumed in a manner that affords directors protection from insolvent trading liability; and
- is assessed with the input of an appropriately qualified adviser to be reasonably likely to lead to a better outcome for the company than administration or liquidation once the pandemic ends.
- We suggest that directors take this opportunity to:
- stay informed about the company's financial position, and what government support is available to support businesses through the COVID-19 period;

- revisit credit and debt arrangements for the company, and ensure cashflow is maximised by focussed debt recovery;
- liaise with company financiers to obtain deferrals and other support as appropriate and determine whether any form of financial restructure is possible;
- ensure costs are contained and reduced where appropriate, bearing in mind the ability of the company to rebound once the COVID-19 period is over will depend largely on its workforce;
- ensure the company is keeping appropriate financial records;
- prevent misconduct by company officers and employees that could adversely affect the company's ability to pay its debts;
- obtain advice from an appropriately qualified adviser on whether the threshold matters for entering the "safe harbour" are complied with and the development of a restructure plan, ensuring it is reasonably likely to lead to a better outcome for the company than administration or liquidation; and
- implement the plan for restructuring the company to improve its financial position for when the pandemic ends.

Bartier Perry has extensive experience and a wide range of networks to assist directors seeking safe harbour protection. Please contact us for a no obligation discussion.

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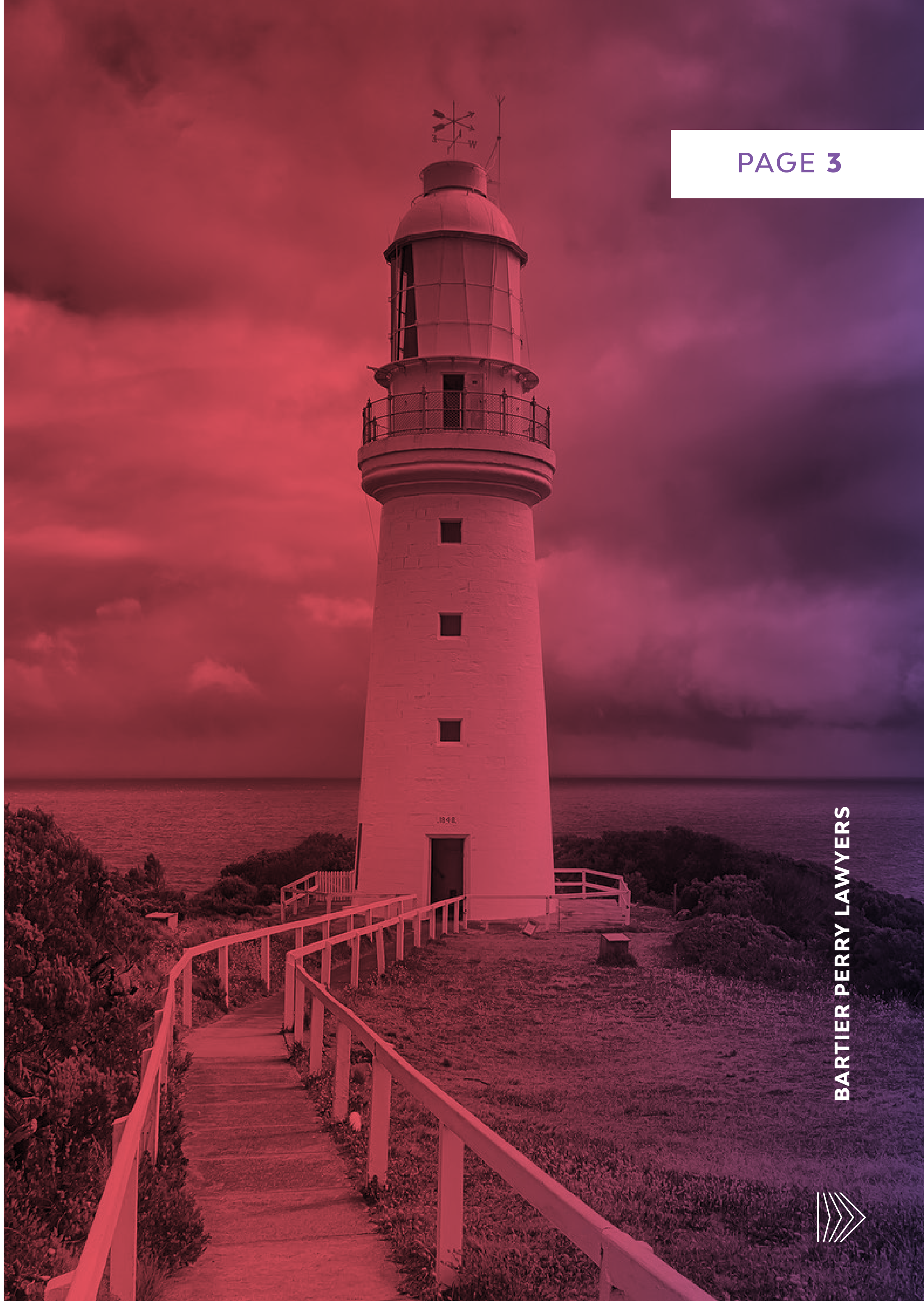

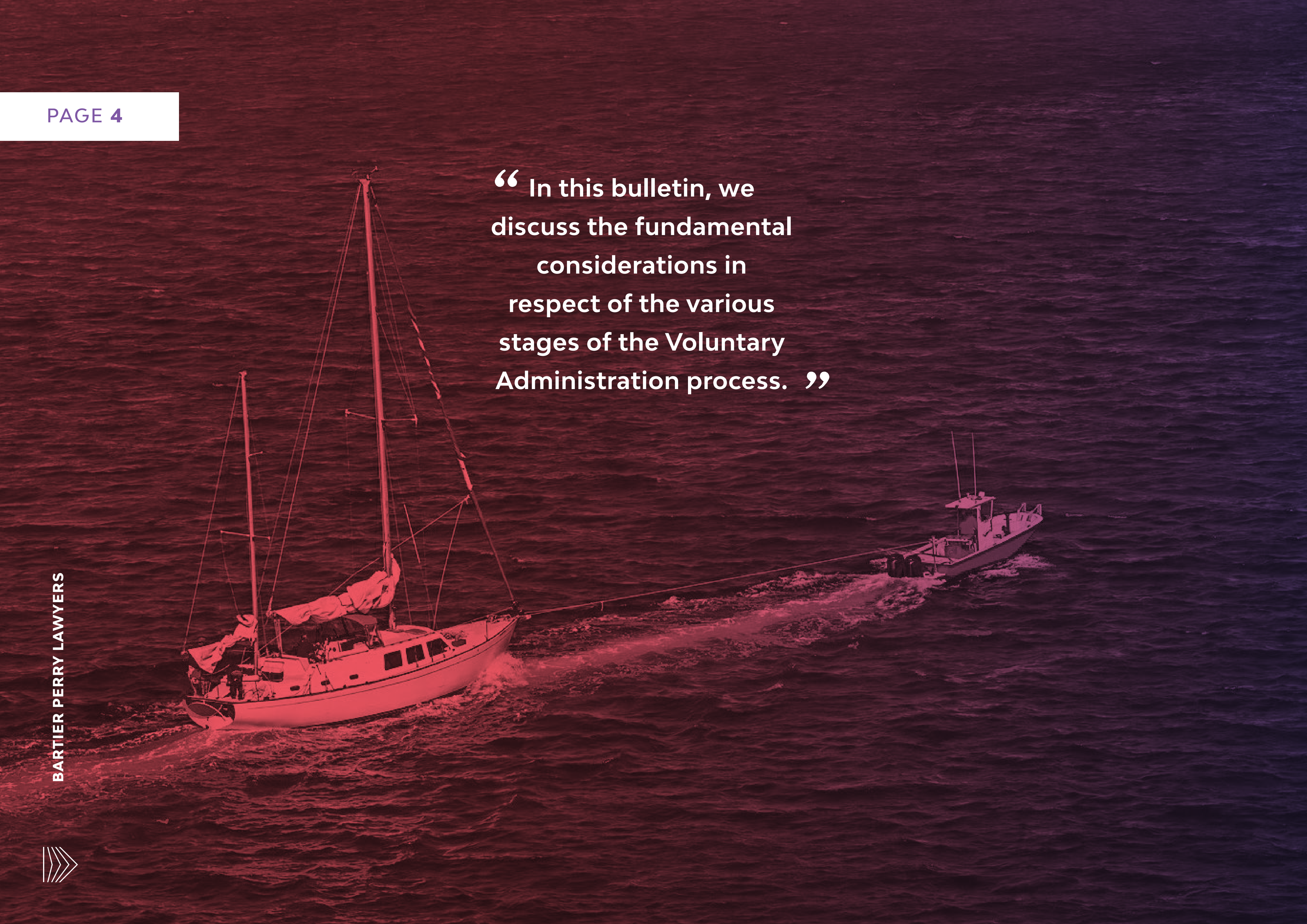

"In this bulletin, we discuss the fundamental considerations in respect of the various stages of the Voluntary Administration process."

DEMYSTIFYING THE ADMINISTRATION PROCESS

In this second instalment of the Demystifying Insolvency series, we focus on the company Administration process, which to many can seem confusing given the required steps in the process that are dictated by statute.

From 1 January 2021, a new regime will be in place that differentiates between 'small businesses' with debts below $1 million, and other businesses with debts above that level. Businesses that fall into the 'small business' category will have different options to restructure and liquidate, which we cover in the last article of this publication.

Voluntary Administration is a process regulated by the *Corporations Act 2001* (Cth) (Act), that can be utilised by directors where they believe a company is insolvent or likely to become insolvent as a result of an imminent event. The process provides a regime for an Administrator to take control of a company's business, property and affairs to ensure that:

(a) the prospect of the continued operation of the business is maximised; and

(b) if at all possible a better return for stakeholders is achieved than if the company was immediately placed into liquidation.

Often when directors of a company are considering the merit of a Voluntary Administration, they will also consider whether the 'safe harbour' provisions of the Act may provide a preferable process for managing the financial position of the company.

In this bulletin, we discuss the fundamental considerations in respect of the various stages of the Voluntary Administration process.

The Appointment

A company may be placed into Voluntary Administration if it is determined that the company is insolvent or is likely to become insolvent some time in the future. Generally, there are three classes of people who would seek to place a company into Administration, being:

1. The directors;
2. A creditor; or
3. A liquidator.

Whilst a Liquidator may appoint an Administrator to the company, they can only appoint themselves (pursuant to section 436B(2)(f) of the Act) if:

(a) the creditors pass a resolution approving their appointment as Administrator; or

(b) the appointment is made with leave of the Court.

A key consideration for directors when determining whether to place a company into Administration is funding. If there is funding available within the company then this can be set aside for the Administrator's costs. If not, then directors will generally need to be prepared to provide an agreed amount of funding to the Administrator so that the process can be implemented. In either case, the Administrator will generally require an indemnity from the directors in respect of their personal exposure for the Administration.

The First Meeting

The Administrator must convene two meetings of creditors. The Administrator must convene the first meeting of creditors within eight business days of their appointment. The purpose of the first meeting is to consider:

(a) whether or not to appoint a committee of creditors; and

(b) whether there is any motion to replace the Administrator.

The Report

Prior to the second meeting, the Administrator is required to prepare a comprehensive report to creditors (pursuant to subsection 439A(4) of the Act). This report, commonly called the "439A Report", must contain the following:

(a) the results of the Administrator's investigation into the business, property, affairs and financial circumstances of the company;

(b) the Administrator's opinions, and reasons, on each of the alternative options available to be voted on;

(c) any other information that will enable creditors to make an informed decision in relation to the alternative options available to be voted on; and

(d) a statement setting out the details of any Deed of Company Arrangement (DOCA) that may have been put forward by the directors.

The DOCA Proposal

A DOCA is a binding agreement between the company and the creditors which allows the company to continue trading under specific terms in order to pay the company's creditors, as opposed to being placed into liquidation.

The DOCA will generally specify how the company's affairs and assets are to be dealt with so that the business (or as much of it as possible) can be operational again. Therefore, entering into a DOCA is one of the best chances creditors have for recovery on their debts.

The DOCA proposal should include, at the minimum, the following information:

1. Who the administrator is and what their role and powers are;
2. The property of the Company and external funding (generally provided by owner directors) that is offered to pay the creditors some portion of their debts;
3. The duration of the DOCA period and the moratorium period;
4. To what extent the company will be released from its debts;
5. The conditions under which the DOCA will come into effect and continue to remain in effect;
6. The circumstances under which the DOCA terminates; and
7. The cut-off date for creditors to make their claims, noting that this is usually no later than the day the Administration began, meaning any debts claimed after this date won't be considered.

The Second Meeting

The second meeting is much more important than the first and is where the outcome of the Administration is determined by the creditors. The second meeting must be convened within five business days before or after the end of the convening period. The convening period is usually twenty business days beginning on the day after the Administration began.

The administrator is required to attach a copy of the 439A Report to the notice for the second meeting.

In addition to the Report, the Administrator will provide the creditors with his or her opinion and recommendations in relation to the following:

(a) the estimated return to creditors if the company is placed into liquidation;

(b) any voidable transactions which may be recoverable;

(c) any DOCA proposals that have been received, including sufficient details to enable the creditors to understand the entire proposal. This should include:

 (i) the estimated return to creditors;

 (ii) the likely timing of any returns to creditors;

 (iii) the identity of the deed administrator;

 (iv) the likely remuneration payable to the deed administrator; and

 (v) any relevant monitoring and reporting arrangements.

After the Administrator has provided the above information along with notice of the second meeting, the creditors will be required to vote on the future of the company. There are only three options available being:

1. the company executes a DOCA; or
2. the Administration should come to an end and the company be returned to the directors; or

3. the Company be placed into liquidation.

A resolution of the creditors passes only when:

(a) At least half the creditors have voted for a resolution; and

(b) The creditors whose debts makes up at least half of the total debts of the company support that resolution. See our article: https://www.bartier.com.au/insights/articles/insolvency-meetings-casting-a-shadow-over-voting-rights/

Administering the DOCA

If the creditors vote to enter into a DOCA, then they must also pass a resolution specifying the terms of the DOCA. These terms can be in addition to the terms proposed in the Second Meeting.

Importantly, the terms of the DOCA will bind all creditors, including unsecured creditors who may have voted against the entry into the DOCA.

Usually, the Administrator will be the deed administrator for the DOCA, unless the creditors choose to appoint someone else. Once the terms of the DOCA and the identity of the deed administrator are clear, the deed administrator will then prepare the instrument containing all the terms of the DOCA agreed to in the resolution.

The company must sign the instrument within fifteen business days of the Second Meeting, unless an extension is sought and granted by the Court. The administrator must also execute the instrument as soon as practicable. Failure of these things to occur may result in the company being placed into liquidation, with the Administrator becoming the liquidator.

Once the company complies with its obligations under the DOCA, it will then be released from the debts proved in the Administration. At this point, the deed administrator will cease monitoring the performance of the DOCA and the company will be handed back to the directors to continue to trade subject to all the usual rules and obligations that apply to companies in Australia.

> “Entering into a DOCA is one of the best chances creditors have for recovery on their debts.”

DEMYSTIFYING THE LIQUIDATION PROCESS

Background

In this third instalment of the Demystifying Insolvency series, we focus on the company liquidation process.

Commonly, although not always, a company goes into liquidation when it is insolvent (i.e. when it cannot pay its debts as and when they become due and payable). During the liquidation process, a company and its affairs are wound-up in a fair and orderly manner, and the company's assets are utilised to pay money owing to creditors of the company, along with the costs associated with the winding-up. Prior to the company then being de-registered, any surplus funds are returned to shareholders, although this is rare.

A liquidator, being an independent third party, is appointed to oversee the winding-up process of the company aiming to maximise the possible returns to creditors.

In this bulletin, we discuss the types and various stages of the liquidation process, including what it means to place a company into provisional liquidation.

What are the types of Liquidations?

Generally speaking, there are three different ways that a company can be placed into liquidation being:

1. Court Appointed Liquidation - when the Court orders that a company be wound up and a liquidator be appointed, usually on application by a creditor, director or shareholder of the company or the Australia Securities and Investments Commission (ASIC);
2. Creditor's Voluntary Liquidation - which is usually initiated by:

   (a) directors and shareholders who agree to place a company into liquidation on the basis that it is insolvent; or

   (b) creditors after a company has been in Voluntary Administration or following the termination of a DOCA; and
3. Member's Voluntary Liquidation - which is only available to solvent companies and is usually utilised to wind-up the company and return capital to shareholders. A common reason for doing this is when a company is part of a group of companies and a decision is made to wind-up an entity to simplify the group and lower administrative costs.

Ultimately, the decision as to what type of liquidation is required will depend on a number of factors including whether:

1. the company is solvent or insolvent;
2. there is a dispute between directors, shareholders and creditors as to whether a company should be wound-up; and
3. there is a risk that the assets of the company will dissipate (this is discussed in detail below).

This bulletin will explore the role of a liquidator in Court Liquidations and Creditor's Voluntary Liquidations in detail below.

Provisional Liquidation

In circumstances where there is an application for a Court Appointed Liquidation, the moving party may seek orders that a provisional liquidator be appointed for the period between:

1. when the application is made to the Court; and
2. the winding up application is heard by the Court.

A provisional liquidator may be appointed to a company in circumstances where there is a dispute between shareholders, or where a company is insolvent and:

1. there is a real danger that the assets of the company will dissipate;

2. the applicant wishes to provide stability to the company while an application to wind-up the company is on foot; and
3. it is urgent that an independent third party be appointed to preserve and control the assets of the company while an application to wind-up a company is on foot.

The Court has the power to appoint a provisional liquidator to carry on the company's business pursuant to sections 472(2) and 472(4) of the *Corporations Act 2001* (Cth) (Corporations Act).

The appointment of a provisional liquidator is not permanent and can be reversed if the company is not wound up or the company is placed into liquidation and an alternative liquidator is appointed. During its appointment, a provisional liquidator may carry on the company's business and is required to prepare a detailed report to the Court in relation to the solvency of the company.

How is a Liquidator Appointed?

The process of appointing a liquidator will ultimately depend on who wishes to place the company into liquidation.

If:

1. the directors and shareholders of a company agree to place the company into liquidation, the directors and shareholders simply need to pass a resolution appointing a liquidator. Prior to a liquidator being appointed, the directors of the company will need to contact the liquidator to obtain a Consent to Act from the liquidator and ensure that there is no conflict of interest with the liquidator being appointed to the company;
2. the creditors decide to place a company into liquidation after a company has been in Voluntary Administration or following the termination of a DOCA, the creditors decide who will be the liquidator. The administrator is often appointed as liquidator, given they are already aware of the affairs of the company. However, creditors may prefer an alternative liquidator in certain circumstances. For further commentary on this issue, see: https://www.bartier.com.au/insights/articles/appointment-from-administrator-to-liquidator-in-a-winding-up-guiding-principles-that-the-court-will-consider/; and
3. the company is placed into liquidation by an order of the Court, the Court will appoint the liquidator pursuant to section 472(1) of the Corporations Act. The applicant to the proceeding may suggest a liquidator and obtain a Consent to Act from the liquidator to provide to the Court. Generally speaking, the Court will appoint the suggested liquidator, unless there are circumstances where an alternative liquidator may be more suitable.

The Liquidation Process and the Role of a Liquidator

Once a liquidator has been appointed to an insolvent company, it owes a duty to the creditors of the company. It's role during the liquidation process includes:

1. undertaking an investigation into the affairs of the company and reporting to creditors as to the findings of the investigations. This may include any recoverable unfair preference payments or possible claims against the directors of the company;
2. finding, collecting and protecting any assets of the company;
3. reporting to ASIC as required; and
4. distributing proceeds from the realisation of assets to creditors and potentially shareholders, after payment of the costs of the liquidation have been made.

Investigations and Reporting to Creditors

During the course of the liquidation, the liquidator will provide creditors with:

1. an Initial Report about their rights as creditors during the liquidation. This is usually done within 10 business days after the liquidator's appointment in a creditors' voluntary liquidation or within 20 business days following a court appointed liquidation;
2. a Statutory Report within 3 months after the appointment of the liquidator; and
3. any further reports required to provide creditors with an update in relation to the liquidation.

The Initial Report informs creditors of the appointment of the liquidator, their rights to request information, their rights to request that a meeting of creditors be held and their rights to provide directions to the liquidator.

The Statutory Report provides detail to creditors about the estimated value of the company's liabilities and assets, provides an update as to the investigations undertaken by the liquidators including a summary of the affairs of the company and the likelihood that a dividend will be paid at the end of the liquidation.

Creditor's Meetings and Approval of Liquidator Fees

During the course of the liquidation, a liquidator may call a meeting of creditors to provide them with an update on the liquidation, ascertain their position on particular matters during the liquidation process and seek approval regarding the liquidator's fees. See: https://www.bartier.com.au/insights/articles/insolvency-meetings-casting-a-shadow-over-voting-rights/

While the liquidator does not require creditor approval for all decisions made during the liquidation process, the liquidator's fees (which are generally paid from the assets of the company) must be approved by creditors or the Court. Prior to voting on the liquidator's fees, creditors must be provided with a report containing sufficient information to allow creditors to assess the reasonableness of the liquidator's fees.

> "... the liquidator's fees must be approved by creditors or the Court."

Payment of Dividends

After the realisation of the company's assets, secured creditors will be paid in priority from the assets of the company. Generally speaking, funds will be distributed from the assets of the company as follows:

1. costs of the liquidation, including the liquidator's fees;
2. wage, superannuation and leave payments to the company's employees;
3. secured creditors;
4. unsecured creditors; and
5. shareholders.

Once each category is paid in full, the next category of creditors is paid. If sufficient funds are not available to pay out a certain category, the creditors within that category are paid on a pro-rata basis and the balance of the creditors are not paid anything. It is rare that a dividend is payable to shareholders in an insolvent liquidation.

Unsecured creditors are required to lodge a proof of debt with the liquidator which provides sufficient information for the liquidator to be able to decide whether the debt from the company exists, and the amount of it.

Unsecured creditors generally will not know the exact amount of the dividend payable, if any, until the conclusion of the liquidation.

Finalisation of Liquidation

Once the assets of the company are realised, debts paid, payments are made as outlined above and liquidators report all things necessary to ASIC, the liquidation effectively comes to an end and the company will be de-registered.

> “Once the assets of the company are realised, debts paid, payments are made as outlined above and liquidators report all things necessary to ASIC, the liquidation effectively comes to an end and the company will be de-registered.”

DEMYSTIFYING THE RECEIVERSHIP PROCESS

In this fourth instalment of the Demystifying Insolvency series, we focus on the receivership process.

A company goes into receivership when an independent and suitably qualified person (the receiver) is appointed by a secured creditor or the court and is tasked with taking control of some or all of the company's assets in order to protect the interests of the appointing creditor.

In this article we will focus primarily on receiver appointments by secured creditors and seek to clarify the interactions between receivers and other types of external administrations.

Receivership often occurs at the same time as other insolvency appointments such as provisional liquidation, liquidation, voluntary administration or when a company is subject to a deed of company arrangement.

Importantly, entering into receivership does not always spell the end of a company. Often companies will trade successfully at the end of the receivership period.

Who is a secured creditor?

A secured creditor is someone who holds a security interest over some or all of the company's assets, such as a mortgage (over a non-circulating asset such as real property) or a PPS registration (over a circulating asset such as debtors or stock).

The security interest provides the creditor with security for the debt owed by the company. In order for the secured creditor to have the power to appoint a receiver, or a receiver and manager, the security document needs to have been prepared in a way which allows for the appointment.

A secured creditor needs to be careful:

1. when drafting the security documents, to ensure that issues with appointment are minimised; and
2. not to inadvertently waive its rights under the security document, for instance by lodging a proof of debt or voting at a creditor's meeting in a manner that unintentionally surrenders its rights.

Purpose of Receivership

The main purpose of receivership is to allow a secured creditor to recover the debt owing to it by appointing a skilled and independent person to enter the business and realise assets that are subject to the security. In contrast to other insolvency processes, directors are able to remain in office during the course of a receivership, however their powers (in respect of the secured assets) are limited.

If a receiver is appointed with the power to manage the company's affairs they then become a receiver and manager. The powers of the receiver and manager are found in the security document under which the receiver was appointed.

It is important to keep the distinction between 'receiver' and 'receiver and manager' in mind not only when drafting and entering into a security document but also, as the creditor, when choosing to enliven the provision in the security document which allows you to appoint a receiver.

In addition to the powers found in the security document, a receiver is also provided with specific powers under the *Corporations Act 2001* (Act). Specifically, the receiver's '*power to do all things necessary or convenient to be done for or in connection with, or as incidental to, the attainment of the objectives for which the receiver was appointed*' comes from section 420 of the Act.

The receiver has a wide discretion when disposing of the charged property in the company. If another creditor also has an interest over charged goods it is necessary to remain informed about the actions of the receiver and, in some circumstances, seek independent legal advice.

Interactions between receiver and other appointments

It is important to understand the interaction between receivership and other insolvency appointments.

Administration

Where a company is already in administration, the general rule is that securities are not enforceable whilst the administration exists.

There are, however, limited classes of secured creditors that can enforce their security in an administration, such as:

1. creditors with security over perishable property;
2. creditors with security over the whole (or substantially the whole) of the company's property (who have 13 days from appointment of the administrator to make a decision about enforcing their security);
3. secured creditors with the consent of the administrator; and
4. secured creditors with leave of the court.

A receiver appointed before the company goes into administration is generally allowed to continue enforcing their security throughout the administration.

Liquidation

A liquidator does not have any power to disturb a secured creditor's right to appoint a receiver once the winding up of a company has been commenced. Indeed, in certain circumstances a secured creditor may look to appoint a receiver over a major asset of a company in liquidation in order to preserve it whilst steps in the liquidation process take place.

If the security interest is over the whole (or substantially the whole) of the company's property, the liquidator will have no recourse to those assets until the receivership has concluded. However, in some circumstances, having a liquidator appointed may be a useful way for another creditor to obtain information about the receivership that would otherwise be unknown, and also access company property out of the reach of the receiver.

If a liquidator is appointed to a company that already has a receiver appointed, the receivership will usually continue undisturbed. The commencement of winding up a company does not affect the receiver's power to collect, hold and dispose of property that is the subject of a security or their power to continue trading the company incidentally to the beneficial disposal of the assets.

Obligations to creditors

Unlike administrators and liquidators, receivers have no obligation to report to unsecured creditors about the receivership and unsecured creditors are not entitled to see any report prepared by the receiver for the secured creditor who appointed them. The only obligation that a receiver has to an unsecured creditor (except employees) is to take reasonable care to sell any assets of the company for not less than market value, or the best price reasonably obtainable.

When non-circulating assets of the company are sold, the receiver can apply the proceeds to pay the debts of any creditors secured by the asset (in order of priority), after the costs and fees of the receiver are paid.

When circulating assets of the company are sold, the proceeds are distributed first to the receiver's costs and fees in collecting the money, then to priority claims and then to pay the secured creditors' debt. The most common priority claim is employee entitlements. There are specific rules that govern payments to employees, which are not covered in this article.

"It is important to understand the interaction between receivership and other insolvency appointments."

Continuing to trade with a receiver and manager

In most cases, a receiver and manager will continue to trade the company whilst the receiver investigates the affairs of the company and seeks to realise the relevant security. In this scenario, a receiver will usually communicate with the other creditors and ask them to advise if they wish to continue trading with the company.

It is important that the receiver's directions to a creditor in respect of continuing to trade are followed. This is to ensure that the creditor begins trading with the receiver appointed for the company and does not simply continue to trade with the company itself.

Any debts arising from the receiver authorising the purchase of goods or services during a receivership are required to be paid from the realised assets. These form part of the costs of the receivership. The receiver will be personally liable for the shortfall between the amounts realised from assets and the costs of the receivership.

Conclusion of Receivership

A receivership will usually end when the receiver has:

- collected and sold enough of the company's collateral to satisfy the debt owing to the secured creditor that appointed them;
- paid the liabilities incurred during the receivership; and
- completed all other duties, such as reporting to ASIC any irregular matters or offences.

Following the receiver's retirement, unless a liquidator or administrator has been appointed to the company, the company and any remaining assets is handed back to the directors.

> "The introduction of these changes and reforms by the Federal Government have been implemented to ensure that small businesses survive the COVID-19 pandemic."

DEMYSTIFYING SMALL BUSINESS INSOLVENCY

Background

In this fifth instalment of the Demystifying Insolvency series, we focus on the insolvency reforms to support small businesses.

On 24 September 2020, the Federal Government announced that from 1 January 2021, changes will come into effect which will have a significant impact on the current insolvency framework for small businesses. The changes will reduce the complexity, timing and costs for small businesses that are associated with the current insolvency framework.

The changes will be introduced in circumstances where:

- The regulatory changes that the Federal Government has already implemented are due to expire on 31 December 2020.
- The economic impact of COVID-19 is likely to continue into 2021, especially for small businesses.
- The current system in place imposes the same obligations on all businesses, regardless of the size or complexity of the administration.
- Small businesses are often reluctant to engage insolvency practitioners early due to the costly and lengthy processes which reduces their opportunity to restructure and survive.

This bulletin explores theses recent changes and sets out the key elements from the reforms.

Key Changes

The reforms have introduced three key changes:

- A new formal debt restructuring process for small businesses which provides financially distressed but viable businesses with a quicker and simpler mechanism to restructure debts and survive.
- A new and simplified liquidation pathway for small businesses to allow faster and less costly liquidation.
- Complementary measures to ensure the insolvency sector can respond effectively to the needs of small businesses in both the short and long term.

We explore each of these elements below.

A New Formal Debt Restructuring Process

Who does it apply to?

Incorporated businesses with liabilities less than $1 million.

How will the new process work?

Step 1 A financially distressed business approaches an insolvency practitioner to discuss the situation and obtain advice.

Step 2 The board of the small business resolves to appoint the insolvency practitioner as their small business restructuring practitioner. Once a practitioner is appointed, creditors cannot take action against the business or personal guarantors.

Step 3 Over a 20 business-day period, the business owner and practitioner work together to develop a restructuring plan for the business' debts and prepare supporting documentation for the plan. This will include a remuneration proposal for the practitioner. During this time the business owner continues to run the business. This is set out in further detail below.

Step 4 The practitioner sends the plan and supporting documents to creditors and certifies whether they believe the business will be able to comply with the plan, make proposed payments on time and has made proper disclosure. Creditors have 15 business days to vote on the plan and consider the proposed practitioner remuneration.

Step 5 If more than 50% of creditors by value endorse the plan, it is approved and binds unsecured creditors and secured creditors.

Step 6 Once a plan is approved, the business continues to trade, and the practitioner makes distributions to the creditors in accordance with the plan. If the plan is not approved by creditors, the process ends, and the business may consider an alternative insolvency process.

Debtor in Possession Model

The reforms allow all small businesses to keep trading under the control of the actual owners while a debt restructuring plan is voted on by creditors. Businesses can continue to trade in the ordinary course of business during this time while the business owner works with an insolvency practitioner.

Role of the insolvency practitioner

The practitioner will work side by side with the business owner to develop a restructuring plan, determine if the small business is eligible for the new process, assist the business in developing a plan and reviewing its financial affairs, seek approval from creditors in relation to a restructuring plan and manage costs once a plan is in place.

Protection for Creditors

- The insolvency practitioner remains independent.
- Creditors vote on the plan.
- Key creditor rights (e.g. payment of distribution in priority) are preserved.
- Related creditor voting on a plan is prohibited.

Simplified Liquidation Pathway

The unfortunate reality for some small businesses is that plans will not be approved by creditors and the business will need to consider whether or not to place the company into liquidation.

Currently, the costs of liquidation can be extensive and may consume most or all the remaining value of the company.

The reforms have attempted to provide a simplified liquidation procedure which aims to cut costs and streamline the process. These key changes include:

- A reduction in investigative requirements of liquidators.
- Removal of requirements to call creditor meetings.
- Requirement to only report to ASIC on potential misconduct.
- Simplify the payment of dividend and proof of debt processes.
- Utilising technology in voting and other communications

This option is also only open to incorporated businesses with liabilities of less than $1 million

Further Measures to Support the Insolvency Sector

To assist in implementing these reforms as at 1 January 2021, the Federal Government will introduce the following measures:

- The establishment of a new classification of insolvency practitioners who deal solely with the simplified restructure process set out above.
- Waiving registration fees for liquidators for approximately 2 years until 30 June 2022.
- Removal of rigid requirements for the registration of insolvency practitioners.
- Embracing technology to allow external administrations to be carried out more efficiently.
- Provision of temporary relief for eligible businesses who wish to access the simplified restructure process. The business can announce its intention to access the simplified restructure process which will provide it with temporary insolvency relief for up to 3 months until the process commences.

Conclusion

The introduction of these changes and reforms by the Federal Government have been implemented to ensure that small businesses survive the COVID-19 pandemic. In light of the uncertainty surrounding how long the pandemic will last, it remains to be seen whether these reforms will be successful in helping small businesses survive in the current economy. Over the next few months, small businesses and insolvency practitioners should endeavour to familiarise themselves with the reforms to ensure they are well equipped to deal with any issues that may arise.

Note: This publication has been prepared from the initial information provided by the Federal Government of Australia as at the date of publication and may be subject to change following the passing legislation to give effect to the Small Business Insolvency regime.

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