Commercial Insights

Major Insolvency Law Reform Enacted

Small to medium businesses can now restructure their way out of financial distress without having to 'throw the baby out with the bathwater'. On 1 January 2021 the *Corporations Amendment (Corporation Insolvency Reforms) Act 2020* (Cth) was passed, resulting in Australia's most major insolvency law reform of the past 30 years.

Restructuring Process

The main feature of the reforms is a new debt restructuring process which creates a 'debtor in possession' model. The process is targeted at businesses that have the capacity to restructure debt and trade out of difficult times. During the process, directors retain control of their company (with some restrictions) while the business continues to operate, with the assistance of a small business restructuring practitioner (SBRP). The SBRP helps the company to develop a restructuring plan of its debts, which is then voted on by the company's creditors (related party creditors are not entitled to vote). If approved, the plan is administered and the business continues to operate.

Eligibility

Small and medium incorporated enterprises with total "liabilities" less than $1 million are eligible for the scheme. "Liabilities" is defined broadly by the Regulations and includes unpaid rent, tax debt, employee entitlements, bank or other loans and contingent liabilities. Directors must not have used the debt restructuring process previously, and companies already under restructuring, liquidation or administration, or where a deed of company arrangement has been executed but not yet terminated, are ineligible.

Advantages

This process enables the company to continue to trade under its current management and avoid being wound up or placed into administration, is relatively quick and cost effective (compared to administration), and protects the company from action by secured creditors and other key stakeholders (such as landlords and other asset owners). The restructuring plan need only be approved by 50% of the creditors (by value), and actions by the company that are approved by the SBRP (such as the sale of an asset other than in the ordinary course of business) are valid and cannot be set aside if the company is subsequently wound up. Directors are also relieved of some of their obligations under the Corporations Act.

Disadvantages

The legislation was introduced and passed quickly, and there are some concerns. There is less capacity to reduce indebtedness by selling assets, the process is less flexible than a deed of company arrangement used in administration, and if the restructuring process is unsuccessful the costs incurred may be wasted.

In addition, the SBRP is not personally liable for debts incurred by the company during the process, which may discourage suppliers from dealing with the company.

It will be interesting to see the extent to which this new restructuring process is utilised by small businesses and insolvency practitioners.

This article was written by Principal Mark Fitzgerald. If you have any questions about the insolvency law reform, please contact Mark Fitzgerald.

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