# CREDIT ISSUES

## WOODGATE & CO.

*Turnaround & Insolvency*

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## 2017 A YEAR OF CHANGE FOR INSOLVENCY

### Introduction

2017 has been a year of legislative change for personal and corporate insolvency in Australia. It commenced with the staged introduction of the *Insolvency Law Reform Act 2016* (Cth) ("ILRA") on 1 March 2017 and on 1 September 2017 amending the *Corporations Act 2001* (Cth) ("the Corporations Act") and the *Bankruptcy Act 1966* (Cth) ("the Bankruptcy Act") by adding Insolvency Practice Schedules to both Acts. This was followed by the introduction of industry supervision cost recovery charges by the Australian Securities and Investments Commission ("ASIC"). Subsequently, this was then followed by the introduction of the safe harbour and ipso facto clause amendments to the Corporations Act. The pace of change is likely to continue in 2018.

### ILRA

On 1 March 2017 the first part of the ILRA became law. Those amendments were designed to align the registration and disciplinary frameworks applicable to Registered Liquidators and Trustees in Bankruptcy. The amendments provide further powers to ASIC to regulate Registered Liquidators. Other significant changes to the Corporations Act amended the definition of the relation back day and required Deed Administrators to give notice to creditors of material contraventions of Deeds of Company Arrangement.

According to the Explanatory Memorandum, the amendments arising from the second part of the ILRA, which became law on 1 September 2017, were intended to:

- remove unnecessary costs and to increase efficiency in insolvency administrations;
- align a range of rules relating to the handling of personal and corporate insolvencies;
- enhance communication and transparency between stakeholders; and,
- promote market competition on price and quality.

The ILRA amounts to 389 pages of legislation. The *Insolvency Practice Rules (Corporations) 2016* and the *Insolvency Practice Rules (Bankruptcy) 2016* total a further 112 pages of rules, which were introduced as a consequence of the ILRA. With so many changes, a disinterested observer might expect radical change, such as the introduction of the voluntary administration regime in 1993. However, the main changes resulting from the second part of the ILRA deal with procedural matters such as:

- the remuneration of external administrators;


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- duties in respect of funds handling;
- conflicts of interest;
- duties to keep records, report to government regulators and provide information, documents and reports to creditors;
- meetings of creditors;
- Committees of Inspection;
- rights of creditors to review insolvency administrations;
- rights of creditors to remove external administrators; and,
- reviews of administrations by the Court.

One commentator has described the ILRA as changing everything, but changing nothing. Many of the amendments appear to be change for the sake of change. For example, there was no apparent need to remove the rules for meetings of creditors from the Corporations Regulations to the Insolvency Practice Schedule (Corporations) and the *Insolvency Practice Rules (Corporations)*.

As a consequence of the ILRA, there are now four sources of authority for corporate insolvency practitioners, being the Corporations Act, the Insolvency Practice Schedule, the Insolvency Practice Rules and the Corporations Regulations. This is also the case in personal insolvency. The level of complexity has increased, rather than decreased.

It is doubtful whether the objectives set out in the Explanatory Memorandum will be achieved.

**Industry supervision cost recovery**

On 1 July 2017 the *ASIC Supervisory Cost Recovery Levy Regulations 2017* came into effect. The regulations aim to recover the cost to ASIC of regulating company auditors, financial advisors, Registered Liquidators and security dealers, amongst others. ASIC expects to recover $246.4M from industry. This represents 64% of ASIC's total budget of $387.7M. ASIC appears to be a cash cow for the government, as its annual report for 30 June 2017 stated that it collected fees and fines on behalf of government totalling $920M. Those funds became part of consolidated revenue.

ASIC's budget for regulating Australia's 713 Registered Liquidators (as at 30 June 2017) amounted to $10.2M, which it proposes to recover from Registered Liquidators. It is naive to expect that those costs will not be passed onto creditors. Further, in a corporate insolvency environment that can best be described as flat, it is likely that levies payable by Registered Liquidators will result in a decrease in the number of Registered Liquidators. This will have obvious effects on competition.

By contrast, ASIC's budget for regulating Australia's 4,365 company auditors (as at 30 June 2017) amounted to $6M. Whilst it may be politically expedient to recover charges from insolvency practitioners, the reality is that, at least for larger enterprises, audit failures often precede corporate insolvencies. This suggests a worrying lack of forward thinking by ASIC.

**Safe harbour and ipso facto amendments**

On 18 September 2017 the Corporations Act was amended by the *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017*. This provides a safe harbour for directors from the insolvent trading provisions of the Corporations Act, in certain circumstances. The new Sections 588GA and 588WA of the Corporations Act provide directors with protection from the insolvent trading provisions, if there is a course of action under way that is reasonably likely to lead to a better outcome for the company. There are a number of examples that set out whether a course of action is reasonably likely to lead to a better outcome, including whether the director has properly informed himself or herself about the company's financial

position and whether the director is obtaining advice from appropriately qualified advisors. There is no requirement for directors to consult a Registered Liquidator.

However, there are a number of restrictions to the safe harbour defence, including:

1. if the directors have failed to deliver up all of the books and records of the company to the Liquidator;
2. if the company has not paid employees' entitlements, including superannuation, by the time they fall due; and,
3. if the company did not file returns, as required by tax laws.

Whilst Australia's insolvent trading laws can be criticised, the reality is that very few cases of insolvent trading ever result in judgments. The average was two per year, according to an empirical study prepared in 2004 by Professor Ramsay and others. Further, in the small and medium sized enterprise sector ("SME") most corporate insolvencies feature limited assets, overdue tax debts, outstanding tax lodgments and often overdue and unpaid employees' entitlements. Therefore, whilst there may be some benefit to public company directors from the safe harbour defence, most SME directors will be unable to utilise it. Further, many SME directors become bankrupt following corporate insolvencies, due to the prevalence of personal guarantees.

An apparently invisible hurdle to the success of safe harbour will be the attitude of insurers regarding directors and officers' insurance policies and regulations concerning listed company continuous disclosure.

On 1 July 2018 the Corporations Act will be amended so that there will be a stay on so-called ipso facto clauses, which provide rights to terminate contracts, merely because the company is subject to an insolvency administration. From 1 July 2018 the restriction on ipso facto clauses will apply if a company is subject to a scheme of arrangement, controllership (including receivership) or voluntary administration. The contractual right to terminate contracts in a liquidation will continue.

**One year bankruptcies**

On 19 October 2017 the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 ("the Bill") was introduced into the Australian Parliament. The principal change will be that a bankrupt will be automatically discharged one year after the date of filing of his or her Statement of Affairs, assuming the Trustee has not filed an objection to discharge. Currently a bankrupt will be discharged three years after filing his or her Statement of Affairs. Australia will then join the global trend to reducing the term of personal insolvencies.

According to the Explanatory Memorandum, the aim of the Bill is to foster entrepreneurial behaviour and reduce the stigma associated with bankruptcy. However, according to statistics (as at 30 June 2017) released by the Australian Financial Security Authority ("AFSA") 83% of personal insolvencies were consumer related and only 17% were business related. Therefore, the boost to entrepreneurial activity is likely to be limited. Further, this is not the first time that Australia has reduced the term of personal insolvency. Between June 1992 and May 2003, the Bankruptcy Act provided for the early discharge of bankruptcies. The early discharge provisions were removed in May 2003 because, it was thought bankruptcy was seen as being too easy. The Bill's Explanatory Memorandum forecasts cost savings at AFSA of $4M per year, which as AFSA administers most consumer bankruptcies, may result in staff reductions at AFSA.

The Bill has been referred to a Senate Committee which is to report in March 2018.

## Anti-phoenixing

In September 2017 the Australian Government released a consultation paper setting out various proposals to address illegal phoenix activity. At this stage, it is difficult to determine the likelihood of which proposals may become law. However, there is political pressure on both major political parties to be seen to be doing something about illegal phoenix activity. Therefore, it would be unrealistic not to expect some of the proposals to publicly result in further legislation.

## Tax transparency

In November 2017 the Australian Taxation Office ("ATO") commenced consultation regarding the government's proposal in the mid-year economic forecast to publicly report overdue business tax debts to credit reporting agencies.

At this stage, the proposal is that the ATO will be permitted but not required, to report tax debt information to credit reporting agencies, where the entity meets the following criteria:

1. the entity has an Australian Business Number and is not an excluded entity such as charity or a government business; and,
2. the entity has a tax debt, which is at least $10,000 overdue by more than 90 days; and,
3. the entity has not effectively engaged with the ATO to manage its tax debt.

We understand that the measure has support in the credit management community and in the ATO.

## Conclusion

2017 has been a year of significant change for Australia insolvency law. In the past, insolvency law was not a topic of great interest to our parliamentarians. It was normal for 10 to 15 years to pass before there were further amendments to insolvency laws. This no longer appears to be the case. It is likely that 2018 will result in further changes to Australia's insolvency laws.


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