Model Behaviour: the Australian version of America's Chapter 11 Bankruptcy Scheme - Key Points

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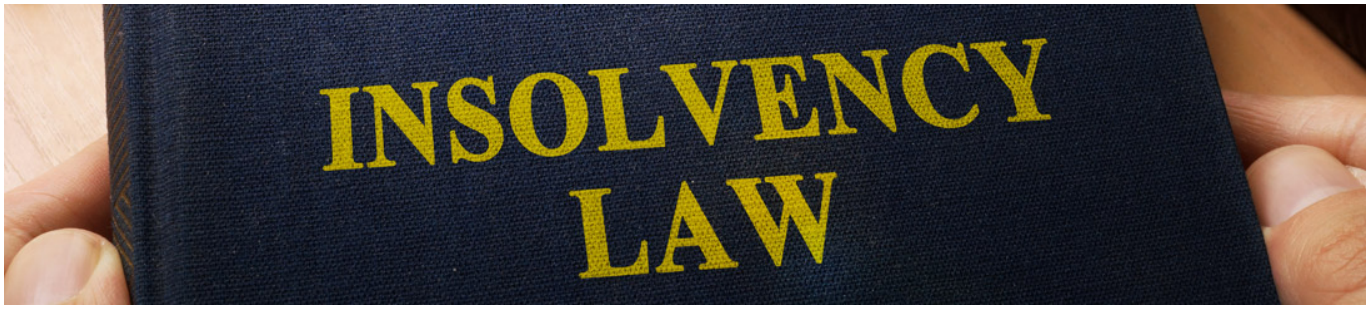

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Part 1: The Key Points

On 24 September 2020, the latest instalment in Australia's insolvency reforms was announced. These reforms have been branded "the most significant reforms to Australia's insolvency framework in 30 years".

And yet the plan, apparently, is to have these reforms in place in 3 months.

Under the Morrison government's proposal, Australia would adopt a framework modeled on parts of Chapter 11 of America's Bankruptcy Code. The proposed system would provide two alternative forms of insolvency administration for small businesses with liabilities of up to $1,000,000:

1. A 'debtor in possession' restructuring plan, allowing thirty-five business days to obtain creditor approval for a debt restructure; and
2. A simplified form of corporate liquidation, is restructure is not possible.

Restructuring Process

From 21 January 2021, small businesses with liabilities of less than $1,000,000 will have access to a debtor-controlled restructuring process in which there will be:

- A twenty business day period to consult with a "small business restructuring practitioner" and develop a restructuring plan;
- A further fifteen business days to put the restructuring plan to creditors for approval;
- A moratorium on creditor enforcement (including in respect of personal guarantees from

directors; with ipso facto protection against termination of contracts) for at least thirty-five business days; and
- A flat fee for the practitioner to assist in developing the restructuring plan followed by a percentage fee of disbursements made under any accepted plan.

Notably, the plan can only be put to creditors once all due and payable employee entitlements have been paid.

Unlike voluntary administration, which requires a majority of creditors in number and value to agree, a restructuring plan will become binding on all unsecured creditors if approved by more than 50% of creditors by value only. Secured creditors are only bound in respect of the value of their debt which exceeds the realisable value of the security interest. Critically, related party creditors will not be able to vote on the plan.

Simplified liquidation process

In addition to the proposed restructuring process outlined above, the new measures will also pave the way for a 'simplified liquidation pathway' for small business. At face value, the simplified liquidation pathway appears much the same as the existing liquidation provisions, with less opportunity for the recovery of voidable transactions.

The simplified liquidation process appears to involve a normal liquidation but with:

1. Reduced scope for a liquidator to claw back unfair preference payments (to non-related creditors);
2. No creditor meetings and committees of inspection;
3. 533 reports to ASIC (s533 *Corporations Act 2001* (Cth)) only required where there are reasonable grounds to believe that misconduct has occurred;
4. Simplified proof of debt and dividend processes; and
5. Normative electronic voting and communication.

Transitional Provisions

The insolvency provisions have been proposed as a corollary to the existing temporary insolvency and debt recovery relief for companies and directors.

As a transitional measure, eligible small businesses need only declare their intention to access the proposed scheme through ASIC's published notices website and are then protected by the temporary three month relief for insolvent companies. Companies have until 31 March 2021 to declare their intention to invoke the proposed scheme and the three month relief period.

Read more about the existing temporary relief for insolvent companies here.

Safeguards

The Government proposes to try and avoid abuse of the simplified processes. Creditors can

convert the process to a ‘full’ liquidation, and directors cannot use the simplified processes more than once in a prescribed perdio (presently intended to be seven years). Company directors will also be required to make declarations about their eligibility to participate and their conduct i.e. avoiding illegal phoenix activity.

Stay tuned to find out about how the insolvency regulations may affect you as a creditor or liquidator!

Matthews Folbigg Lawyers has a specialist team dedicated to Insolvency, Restructuring and Debt Recovery. If you would like more information or advice in relation to Insolvency, Restructuring or Debt Recovery practice and procedure, please contact Stephen Mullette or Jeffrey Brown on (02) 9806 7459 or (02) 9806 7446, or email stephenm@matthewsfolbigg.com.au or jeffreyb@matthewsfolbigg.com.au.