Insolvency Reforms to Support Small Business

Reforms to insolvency regulations introduced on 1 January 2021 aim to allow small businesses operating to restructure more quickly and easily than the previous statutory regime permitted.

In instances where restructuring is not feasible, the reforms also allow for businesses to be wound up faster which in turn, may result in higher returns for creditors.

The regulations have addressed one of the main deficiencies of the previous statutory regime which required that small business insolvencies follow the same process as complex large company insolvencies. This often resulted in the high costs of administration, consuming most, or sometimes all, of a small business' assets.

To be eligible to utilise the new regulations, businesses must be incorporated and have liabilities of less than $1 million.

The New Restructuring Process

There are a number of elements to the proposed new restructuring process including:

1. The business approaches and appoints a small business restructuring practitioner, whose role will be to:
   - assist in determining whether the business is eligible;
   - support the company to develop a plan;
   - certify and communicate the plan to creditors; and manage any disbursements if a plan is put in place.
2. Directors work with the restructuring practitioner over 20 business days to:
   - develop a restructuring plan;
   - identify creditors; and
   - provide supporting documents to creditors for consideration.
3. The business continues trading under the control of its directors while the restructuring practitioner develops a debt restructuring plan. Trade can continue in the ordinary course of business. However, trade outside of the ordinary course of business will require the prior approval of the restructuring practitioner.
4. Once the process commences, creditors cannot take action against the business until the process concludes. Any personal guarantee a director of the business has provided to a creditor is also not enforceable during this period.

The restructuring practitioner then sends the restructuring plan to creditors and certifies whether they consider the business can meet the proposed repayments. Creditors then have 15 business days to vote on the plan and the business must pay any employee entitlements due and payable prior to creditors voting on a restructuring plan.

The plan requires a vote of 50% or more (based on debt value) for the restructuring plan to become binding on all unsecured creditors. Secured creditors will only be bound to the extent that their debt exceeds the value of their security interest.

If the creditors approve the restructuring plan, the restructuring practitioner will administer the plan and make distributions to creditors. If the creditors reject the restructuring plan, the business may choose to:

- enter voluntary administration; or
- use the simplified liquidation process.

Simplified Liquidation Process

Regulatory obligations on liquidators have been simplified, to align with the asset base, complexity and risk profile of the company being wound up. This simpler process means that there is potential for more money to become available for distribution to creditors and employees.

Whilst the general liquidation framework will remain, key modifications should reduce both the time and cost of the process. These modifications include:

- reduced circumstances where a liquidator can take action to clawback an unfair preference payment from a creditor unrelated to the company;
- reduced reporting obligations on potential misconduct of directors, unless there are reasonable grounds to believe that misconduct has occurred;
- removing requirements to call creditors meetings;
- removing the ability to form committees of inspection; and
- simplifying the proof of debt and dividend processes.

The rights of secured creditors and the rules pertaining to the priority in which the company pays creditors have not however been changed.

What Protections are in place for Creditors?

The reforms also include a number of safeguards to prevent the misuse of the new process and ensure the protection of creditors' rights. These safeguards include:

- only making the process available to a business or directors once within a prescribed 7 year period;
- giving the restructuring practitioner the power to stop the process should they identify any misconduct;
- ensuring the independence of the restructuring practitioner;
- ensuring the rights of secured creditors do not change;

- maintaining creditors' right to vote on the business' restructuring plan, with a majority vote necessary before the plan will become binding;
- prohibiting creditors related to the business (such as subsidiaries) from voting on the restructuring plan; and
- giving creditors the ability to convert a simplified liquidation back to a 'full' liquidation process.

The reform to restructuring and liquidation of small businesses should simplify and streamline what was a complex process and provide greater certainty and better outcomes for both business owners and their creditors.

If you require further information about any of the matters addressed above or need advice about any business or company matter please contact Michael Battersby or John Bateman on 02 4731 5899 or email us at commercial@batemanbattersby.com.au.