

This process is a 'debtor-in-possession' model that enables directors to remain in control of the company.

In brief

- Liabilities must be less than \$1m (excluding employee entitlements)
- Companies must be up to date with payment of all employee entitlements, and all tax lodgements
- On appointment of a small business debt restructuring practitioner (SBRP), there are protections for directors and the company against creditor actions
- There is a short 20 day period for a company to work with a SBRP to plan to restructure company debts and prepare documents for consideration of creditors
- Creditors then have 15 days to submit proof of debt and vote on the restructuring plan
- Secured creditors may still have a right to pursue their interest via receivership
- An approved plan requires support by at least 50% of creditors (by debt value)
- If approved, the directors continue to operate the business, in accordance with the plan
- The SBRP monitors/administers the plan
- The plan terminates if it is not complied with
- If not approved, other external administration avenues may proceed.

Detail

As part of insolvency law reforms aimed at assisting small businesses facing financial distress to survive following the impact of COVID-19, the Australian Government announced a new, simpler formal debt restructuring process. Incorporated small businesses that are insolvent or at risk of insolvency may use this process to restructure their debts and maximise their chance to remain viable. An alternative to traditional insolvency administration pathways, the process draws heavily on the established voluntary administration framework and shares many of its features. However, it is intended to serve as an easier, cheaper, faster and more flexible model catering specifically for small businesses.

The new process commenced from 1 January 2021 and is available to all companies with liabilities of less than \$1 million (excluding employee entitlements). However, a range of criteria need to be met for a company to access the process.

Key aspects of the small business restructuring process

Key aspects include:

- An eligible small business facing financial distress approaches a new class of independent external advisor called a small business restructuring practitioner (SBRP) to discuss options. All registered liquidators can act as an SBRP and there is also a special registration for people who can only act as an SBRP. The SBRP advises whether the company is eligible for a restructuring plan and proposes a flat fee to develop the plan.
- Directors of the company then pass a resolution to formally appoint the SBRP to their business and approve the fees for the restructuring. Once this occurs, the company and its directors are protected by a moratorium on actions by creditors while the restructuring process is underway. Unsecured and some secured creditors are restricted from taking legal action against the company, personal guarantees may not be enforced against directors or their relatives during the restructuring, and the business is protected from ipso facto contract clauses which allow creditors, such as suppliers or landlords, to terminate contracts because of an insolvency event. A notice that the process has commenced is provided to creditors with details on how they may access further information.
- The company directors/business owners have **20 days** to work collaboratively with the SBRP to develop a plan to restructure business debts (including a remuneration proposal covering the SBRP's fees to manage the plan once it is in place) and prepare documentation to be considered by creditors. During this time period, the business is able to continue trading in the ordinary course of business under the control of the directors.
- **Companies must ensure all employee entitlements that are due and payable have been paid in full, and all tax record lodgements are up to date** before the plan can be put to creditors. Directors must make a declaration confirming this before the plan can be sent to creditors. This may prove to be a significant obstacle to some financially distressed businesses seeking to access the process.
- The SBRP certifies that the business can meet the proposed repayments and has properly disclosed its affairs, and sends the plan and supporting documents to creditors.
- Creditors then have 15 business days to submit a proof of debt and vote on the plan and, if necessary, dispute the amount that the company states is owing. Related creditors (such as directors, shareholders, relatives or their associated companies) are not entitled to vote.

Understanding small business debt restructuring

- If a 50% majority of all creditors (by \$ value of debt owed) vote in favour, the restructuring plan is approved and binds all unsecured creditors. Secured creditors are only bound to the extent that their debt exceeds the realisable value of their security interest (this means that secured creditors may still have a right to initiate a receivership or other claims relating to secured assets).
- The directors then continue operating the business and the SBRP administers the plan by collecting payments under the plan, and making periodic payments to creditors in accordance with its terms, but control of the company's management and day to day trade remains with directors.
- If the plan is not approved by creditors, the small business restructuring process ends and the company's directors may choose to undertake an alternative form of external administration – namely either voluntary administration or creditor's voluntary liquidation. The company may be eligible for a simplified small business liquidation process.
- The plan can continue for a period of up to three years and can terminate if the company fails to comply with the terms of the plan. If the restructuring plan is terminated, creditors' debts unpaid under the plan become payable immediately. The company's directors may choose to place the company into an alternative form of external administration.
- To prevent misuse of the small business restructuring process for phoenix activity, unfair preference payments or creditor-defeating dispositions, the SBRP will have power to stop the restructuring process if corporate misconduct is identified.

Pros and cons of the small business restructuring process

This new small business debt restructuring process has a number of advantages over voluntary administration:

- Rather than handing control over to the administrator, as in the case of voluntary administration or liquidation, it permits directors to retain control of the company and business operations during the process – this is called a debtor-in-possession model.
- It allows the business owners (ie. company directors and management) to continue operating the business and trading as usual while a restructuring plan is developed and implemented – this minimises potential disruption and further losses and maximises the potential for the business to trade out of difficulties and remain viable.

Understanding small business debt restructuring

- The process may have a lower cost than voluntary administration (although there will still be a cost involved in engaging the SBRP and the law requires the SBRP to undertake a variety of tasks).
- The process may be quicker than a voluntary administration – 20 business days for the development of a restructuring plan followed by 15 business days for creditors to vote on the plan. However, some voluntary administrations could be finalised within 20 business days from appointment if creditors made a decision at the second meeting.
- The options to go into a voluntary administration or liquidation (including the option to use the simplified small business liquidation pathway) still exist as backups if the restructuring plan is voted down by creditors.
- Only 50% of creditors must agree to the plan.
- During the debt restructure process the directors don't have to worry about insolvent trading and personal guarantees cannot be enforced (without leave of the court).

Against these perceived advantages, the main limitations of the scheme are:

- All employee entitlements that are due and payable must have been paid in full, and all tax record lodgements must be up to date.
- There is a very short period of time (20 days) for the directors and the SBRP to finalise a plan to go to creditors, particularly for more complex businesses.
- The fees to be charged by the SBRP to develop the plan, and then to oversight implementation of the plan, are difficult to determine in advance, which may make SBPRs reluctant to commit to such a process.
- The company can only deal in their normal trade unless they seek permission from the SBRP.
- The company may have limitations on how they can deal with their assets.
- Secured creditors may be hesitant to engage with the SBRP.