



## Insolvency Relief in a Changed Business Environment

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It is well known that Australia has been referred to as the lucky country having not experienced a recession during times when many others have. The global coronavirus pandemic has however presented the world with new challenges and, for the first time in nearly 30 years, Australia is now in a recession with a recent media release on the monetary policy by the Reserve Bank of Australia stating "[t]he global economy is experiencing a severe contraction as countries seek to contain the coronavirus".<sup>1</sup>

With predictions of an "avalanche" of insolvency cases which would impact the country,<sup>2</sup> on 24 March 2020 the Australian Federal Government passed a range of regulatory relief for business and individuals<sup>3</sup> with the [Coronavirus Economic Response Package Omnibus Act 2020](#) (Cth) (**the Act**) to temporarily address and manage these inevitable impacts. On 7 September 2020, the Treasury and the Attorney General announced the temporary extension of this relief until 31 December 2020.<sup>4</sup>

These measures are radical and consist of various concessions and allowances designed to protect income and cash flow

within the economy and to assist managing the increased stress on businesses caused by the Coronavirus pandemic.

The question still remains as to how these economic impacts will be managed after the temporary measures have come to an end? Will it simply mean postponing the potential avalanche of insolvency and bankruptcy cases until the new year after struggling companies are kept alive for longer?

### Relief Measures at a Glance

The table below sets out a summary of the relief measures provided in the Act for companies and their directors.



|   | <i>Prior to 25 March 2020</i>   | <i>After introduction of the Act (to 31 December 2020)</i>  |
|---|---|---|
| <b>Minimum amount of debt to issue<br/>Creditor's Statutory Demand:</b>   | \$2,000   | \$20,000  |
| <b>Time for debtor companies to respond to a Creditor's Statutory Demand / time that must pass before a creditor may apply to wind up a debtor company:</b> | 21 Days   | 6 Months  |
| <b>Directors liability "Safe Harbour" regime:</b>   | Director personally liable for debts incurred by company if incurred while trading insolvent unless the director develops a course of action reasonably likely to lead to a better outcome for the company. | Personal liability of directors for debts incurred by company if insolvent effectively suspended where the debt incurred in ordinary course of business and incurred prior to 31 December 2020. |

### Debt Recovery from Companies

A mechanism to recover undisputed debts where there is a genuine concern about a debtor company's ability to pay the debt is through the issue of a Creditor's Statutory Demand against the debtor company. After the introduction of the Act, a Creditor's Statutory Demand may only be issued for debts exceeding \$20,000 (up from \$2,000) and require the debtor to pay the debt within 6 months (up from 21 days). If the debt is not paid or if the company did not apply to the Court to set the demand aside within the required time, the debtor company is deemed insolvent and the creditor may apply to wind up the company.

Although Statutory Demands are not intended to be used as a debt collection tool, in practice, when used appropriately, they assist parties to avoid lengthy court proceedings where liability for the debt is not disputed.

The measures in the Act assist struggling companies by providing more time in which to pay debts or consider options, however, may place an additional burden upon parties seeking to recover debts by greatly extending the time for payment.

### Director's Liabilities - "Safe Harbour"

Directors are typically liable for the debts of their company where they are found to have allowed the company to trade while insolvent. The "safe harbour" regime within the [Corporations Act 2001](#) (Cth) protects directors from liability in certain

circumstances.

The new safe harbour regime,<sup>5</sup> which may continue to operate alongside the existing safe harbour regime,<sup>6</sup> provides temporary relief to directors by limiting their liability for debts incurred in the "ordinary course of the company's business" including debts incurred "if it is necessary to facilitate the continuation of the business",<sup>7</sup> for example, if the company resolved to take out a loan to pay employee entitlements or to take the business online.

The long-term success of the additional safe harbour measures will however depend on directors' ability and willingness to steer their company through these uncertain times.

Directors must continue to comply with their duties to exercise diligence and care when incurring any liabilities and continue to consider what is proper in the circumstances.

### Changes to how Companies do Business

The overarching goal of Government for introducing and extending these changes was to support companies whilst they were analysing and assessing their options when dealing with creditors and other company obligations. The intention was to ensure businesses could survive (where appropriate) through any cash flow crises and "to prevent a further wave of failures before businesses have had the opportunity to recover".<sup>8</sup>



Regardless of the Government's intentions, there are valid concerns about an undesirable ripple effect. Creditors of and counterparties to transactions with financially stressed companies risk exposure to voidable transaction claims where the companies they transact with face insolvency. Creditors may also find it difficult to recover overdue invoices and payments, ultimately resulting in a lateral shift of liquidity pressure from debtors to suppliers and other creditors. As a means of avoiding such risks, companies should give serious consideration to re-evaluating their customer credit terms, re-negotiating with debtors and creditors and re-assessing their financial position and business priorities.

### Additional support available to Businesses

Companies should consider the additional support that may be available through the Government's economic stimulus package to assist with cash-flow and the retention of employees during these difficult times.

This includes the following:

1. JobKeeper – recently extended until March 2021 (to eligible employers albeit at a reduced amount to that previously payable);
2. Between 12 March 2020 until 31 December 2020, instant asset write-offs for eligible businesses has increased to \$150,000 (up from \$30,000);<sup>9</sup> and
3. Temporary cash flow boost payments between \$20,000 and \$100,000 for eligible small and medium businesses delivered through credits in their activity statement system when they lodge their activity statement up to the month or quarter of September 2020.<sup>10</sup>

### What happens after 31 December 2020?

While it is hoped that after the pandemic, things will return to "*business as usual*", the adage "*hope for the best, plan for the worst*" comes to mind.

The businesses which make it through these difficult times will be those that seek appropriate advice and assistance and implement strategies to manage cashflow and other obligations now.

Some businesses which are already struggling during this crisis, barely holding on and hoping for an upturn, may not survive the extended 31 December 2020 date for the end of these relief measures.

### Restructuring

Alternatives, including business restructuring need careful consideration. Companies should consider voluntary administration as a means of restructuring a faltering business. Maintaining regular lines of communication with creditors, supporters and customers is important to obtain the required support in any restructure.

### New Government Legislation

The Federal Government has also flagged changes to insolvency law for businesses. We await the publication of further details about this initiative.

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<sup>1</sup> Philip Lowe, 'Statement by Philip Lowe, Governor: Monetary Policy Decision' (Media Release, Reserve Bank of Australia, 4 August 2020).

<sup>2</sup> Matthew Cranston, "Avalanche" of insolvencies will force law change', *Australian Financial Review* (online, 22 March 2020) <<https://www.afr.com/policy/economy/insolvency-law-to-be-changed-as-avalanche-expected-20200322-p54con>>.

<sup>3</sup> Note: This article deals with changes affecting companies and its directors rather than individuals and bankruptcy proceedings.

<sup>4</sup> The Hon Christian Porter MP, 'Extension of temporary relief for financially distressed businesses' (Media Release, Treasurer of the Commonwealth of Australia, 7 September 2020).

<sup>5</sup> *Corporations Act 2001* (Cth) s 588GAAA.

<sup>6</sup> *Corporations Act 2001* (Cth) s 588GA.

<sup>7</sup> Explanatory Memorandum, Coronavirus Economic Response Package Omnibus Act 2020 (Cth) [12.18].

<sup>8</sup> The Hon Christian Porter MP, 'Extension of temporary relief for financially distressed businesses' <<https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/extension-temporary-relief-financially-distressed>>.

<sup>9</sup> 'Instant asset write-off for eligible businesses', *Australian Taxation Office* (Web Page) <<https://www.ato.gov.au/Business/Depreciation-and-capital-expenses-and-allowances/Simpler-depreciation-for-small-business/Instant-asset-write-off/>>.

<sup>10</sup> 'Boosting cash flow for employers', *Australian Taxation Office* (Web Page) <[https://www.ato.gov.au/Business/Business-activity-statements-\(BAS\)/In-detail/Boosting-cash-flow-for-employers/](https://www.ato.gov.au/Business/Business-activity-statements-(BAS)/In-detail/Boosting-cash-flow-for-employers/)>.