NEW TOOLS BRING NEW TRAPS FOR THE UNWARY

Why trade credit suppliers need to be up to speed on the Federal Government's recent Insolvency Law Reforms

The Insolvency Law Reforms come in two distinct parts.

Firstly, the reforms in the *Insolvency Law Reform Act* which are intended to improve the conduct of insolvency administrations, enhance transparency, and improve overall confidence in insolvency practitioners.

Secondly, the *Treasury Laws Amendment (2017 Enterprise Incentives No.2) Act* reforms are focused on company directors and, in particular, shifting the focus from stigmatising and penalising corporate failure and instead, promoting a culture of entrepreneurship and innovation.

The top 10 points arising out of these reforms (which are most relevant to trade credit suppliers) are summarised below.

1. One Year Bankruptcy Discharge Period

Up until 19 October 2017, it appeared that common sense had prevailed and the proposal to reduce the statutory three year automatic bankruptcy discharge period to one year had been scrapped.

Unfortunately for creditors, it appears that this proposal is now alive and well thanks to the *Bankruptcy Amendment (Enterprise Incentives) Bill 2017* which has now been introduced into Federal Parliament.

2. Safe Harbour

Safe harbour provisions are, in essence, about providing a new defence to directors for avoiding personal liability for an insolvent trading claim. These measures went live on 19 October 2017.

To succeed in raising the safe harbour defence, it is only necessary for a director to have started to develop a course of action which is reasonably likely to lead to a better outcome for the company. What courses of action may fall within the scope of this requirement remains to be seen, and will likely need court clarification.

Insolvent trading claims are already expensive and often difficult claims for liquidators to make against directors of insolvent companies. As a result of these reforms, insolvent trading claims will likely become even harder for liquidators to pursue.

3. Ipso facto

The effect of the ipso facto provisions is to prescribe that a creditor can no longer rely on a formal restructure or insolvency appointment as sufficient reason to terminate or modify the operation of a contract.

Currently, if the buyer under a contract becomes insolvent, or enters into a formal insolvency administration, the supplier can be deemed to be released from any remaining supply obligations. The forthcoming ipso facto provisions bring the continued availability of this 'deemed release' into question.

On their face, the provisions state that if a creditor is compelled to continue to supply due to the ipso facto provisions, they are not required to advance new credit to the insolvent customer. However, there is, arguably, some uncertainty as to what the term "new credit" means, and the impact on pre-existing credit contracts. Appropriately worded terms and conditions of trade are the best way to limit any risk in this regard pending clarification by the court.

4. Removal of external administrators

Under the reforms, creditors have the power to more easily convene meetings and, by resolution, remove and replace the external administrators/liquidators of companies and bankrupt estates.

These reforms have the effect of increasing the power available to creditors and provide an opportunity to better manage the conduct of an external administrator who is thought not to be acting in the best interests of creditors.

5. Request for information and documents

Creditors are now entitled to request the external administrator of a company give information, provide a report, or produce documents to the creditors. A request can be made by creditors passing a resolution, or making a request individually. External administrators must comply with the request unless:

(a) the information or document requested is not relevant to the external administration;

(b) compliance would amount to a breach of the external administrator's duties; or

(c) it would otherwise be unreasonable for the external administrator to comply with the request.

If the request is refused, ASIC may direct the administrator to comply with it.

These provisions may be a particularly helpful tool for creditors in responding to, for instance, an unfair preference claim brought by an insolvency practitioner. This is particularly the case in circumstances where an insolvency practitioner is making bald unfair preference demands in circumstances where he or she cannot fully substantiate a case.

6. Requesting a Meeting

Creditors can now request that the external administrator convene a meeting of creditors at any time.

Creditors (unrelated to the insolvent company) representing 5% in value of the company's debts can compel the external administrator to convene a meeting by providing security for the costs of the meeting.

Where creditors representing 25% in value request the meeting, no security for costs requirement is imposed.

7. Power to give directions to external administrators

Creditors may now, by resolution, give directions to the external administrator.

The external administrator must have regard to the directions, although they are not required to comply with them.

If the external administrator refuses to comply, however, they must make a written record noting that they have refused to comply and the reasons why. It is not immediately apparent what type of directions were envisaged by the reforms.

8. Appointment of reviewing administrator

Under the reforms, creditors have the power to appoint a registered liquidator to undertake a review of the remuneration and any costs incurred by an external administrator.

If the creditors pass a resolution for the appointment of the reviewing administrator, the costs of the review will form part of the costs of the external administration.

Even without holding sufficient numbers to pass a resolution, one or more creditors can still appoint a reviewing liquidator provided that they pay for the costs of carrying out the review.

9. Strengthened voting position

The Insolvency Law Reforms take positive steps to strengthen the position of creditors unrelated to the insolvent company.

This is particularly valuable given the rise of "pre-insolvency advisors" and the risk of creditors being compelled to accept a proposal in a director-friendly administration, such as a deed of company arrangement that is controlled by related parties, but will not benefit them.

Under the reforms, the court is given power to, amongst other things, set aside a resolution in circumstances where the vote would have been different if the votes of creditors related to the company were disregarded.

The legislation also provides that, if a resolution at a creditor's meeting was passed because of a casting vote, anyone who voted against that resolution can apply to the court for an order setting the resolution aside.

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10. What's missing?

Unfair preference laws

Insolvency Law Reforms have brought about a new defence to insolvent trading for company directors. Why have the reforms not set about strengthening the defence for unfair preference claims against trade creditors?

Pre-Insolvency advisors

The reforms are broadly focused around either pointing the finger at insolvency practitioners and further regulating their conduct, or encouraging company directors to be more entrepreneurial by further limiting the consequences of business failure.

Arguably the biggest challenge facing creditors, and the insolvency system more broadly, is the rise of pre-insolvency firms whose business model is to help unscrupulous people avoid paying their debts, often through blatant and systematic asset stripping and illegal phoenix activity.

Until the pre-insolvency industry is squarely dealt with, it is difficult to see how the ultimate cost of insolvency and "innovation" will not continue to be met by creditors.

If you would like to discuss the impact of the Insolvency Law Reforms or require any insolvency law advice, please contact our specialist team on 1300 757 534 or info@resultslegal.com.au.

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