



Government economic response—new insolvency rules What's the impact on you and your business?

Part of the government's economic response to Covid-19 is temporary relief for financially distressed businesses. It aims to provide a safety net by reducing the threat of actions against businesses and attempting to provide confidence to directors to continue to trade during this difficult time.

To create that safety net, the government is temporarily changing elements of how creditor actions commence and director's exposure to personal liability in an insolvency scenario, which include the following new insolvency rules.

1. Creditor action relief:

- **Statutory demands against companies:** threshold amount increased and time to respond extended.
- **Bankruptcy notice against individuals:** threshold amount increased and time to respond extended.
- Moratorium period for a '**declaration of intention**' to present a debtor's petition extended.

2. Director personal exposure relief:

- **Directors' personal liability** for insolvent trading paused.

These legislative amendments received royal assent on 24 March 2020 and will be in place for six months—ending on 25 September 2020.

This Guide explains the technical operations of these new insolvency rules and gives an overview on how it could impact on your business—from both perspectives: the director's and the creditor's. It concludes with our view on the government's new insolvency rules and how we can help. To distil the plethora of information and advice out there, we've created **a custom model** to build the 'big picture' and show how to break the challenge down into three facets to guide actions as part of a robust crisis management strategy.

1. CREDITOR ACTION RELIEF

Statutory demand against companies

Issuing a statutory demand is a typical way for a creditor to take action to wind up (liquidate) a company. Once a statutory demand expires, the creditor can commence court proceedings to wind up a company.

Under the temporary measures, the minimum debt to issue a statutory demand will increase from \$2,000 to \$20,000 and the company's time to pay or respond will increase from 21 days to six months.



Bankruptcy notice against individuals

Issuing a bankruptcy notice allows a creditor to take steps to bankrupt an individual. Once a bankruptcy notice expires, the creditor can commence court proceedings to seek a sequestration order to bankrupt an individual.

Under the temporary measures, the minimum debt to issue a bankruptcy notice will increase from \$5,000 to \$20,000 and the individual's time to pay or respond will increase from 21 days to six months.

Moratorium extension on intending to go bankrupt

Under the *Bankruptcy Act 1966*, individuals can lodge a 'declaration of intention' to present a debtor's petition with the Australian Financial Security Authority (AFSA) to temporarily restrain creditors taking further action. This allows an individual to make arrangements with creditors and if not successful, proceed to declare themselves bankrupt.

The period for this temporary restraint will increase from 21 days to six months. Be aware, if those individuals do not make themselves bankrupt at the end of the period, a creditor can use the declaration as a basis to apply to court to make the person bankrupt.

What does the above mean for you and your business?

Ultimately, it appears the intention of these changes are to allow businesses the opportunity to take a breather.

For a director (for the next six months) if you have outstanding debts owing to suppliers, the suppliers' scope and powers to quickly move to wind up the company have been greatly reduced. Firstly, the debt now needs to be above \$20,000 as opposed to the previous minimum amount of \$2,000. Secondly, directors now have six months instead of 21 days to look at paying the amount under the statutory demand or attempt a settlement with that supplier.

Practically, this means that directors now have greater power to negotiate and potentially defer some existing debt—to be paid over time without the risk of the company being wound up. To avoid the unknown of how your suppliers will react to these changes, it is important to get on the front foot and have an **open** and **transparent** discussion about the difficulties you are facing and communicating your **business plan** over the coming months. This allows suppliers to appreciate your circumstances and gives them confidence that you're proactively dealing with these unprecedented impacts on your business. And give you greater prospects in negotiating better supply terms to your business.

Before speaking to your suppliers, work through a **crisis management framework** ([click here](#)) and specifically identify which supply lines are essential to your business. This clarity will frame what discussions you'll have with each supplier. The suppliers themselves may also be having some difficulty, so assessing if they can deliver and give favourable supply terms that fits within your business plan is critical.

The opportunities to seek new benefits are not limited to suppliers. Give the same considerations to financiers/banks, landlords and statutory bodies (e.g. rates, leases, ATO, payroll tax, etc.) Many **relief packages** are being offered by several of these stakeholders, which can critically advance your cash-flow forecasts.



Remember this chance for some **breathing space** goes both ways and will be equally applicable to customers. Again, assess your customer base and gauge how they are faring during this difficult time. Maintaining relationships with loyal customers during this period is critical (80/20 rule may apply here i.e. 80% of revenue comes from 20% of customers). Once this crisis ends, you can maintain and service your customer base and hopefully pick up revenue as quickly as it may have dropped off.

We welcome these temporary changes by the government and hope that businesses take the opportunity to **communicate** their challenges and discuss ways forward amicably with all stakeholders. This will ensure that businesses can work together and come out the other side of this crisis together as financially healthy as possible.

2. DIRECTOR PERSONAL EXPOSURE RELIEF

Personal liability for insolvent trading paused

Insolvent trading rules are being 'paused' to give directors time and space to make business decisions without the pressure of personal liability during this troubled economic time. Directors will be relieved of the personal liability that would be otherwise associated with insolvent trading for a period of six months incurred in the ordinary course of the company's business. Egregious cases of dishonesty and fraud will still be subject to criminal penalties.

The government has also advised that the Australian Taxation Office (ATO) will work with business owners/directors to find viable solutions, including temporary reduction of payments/deferrals, or withholding enforcement actions e.g. director penalty notices (under the DPN regime) and ATO winding up applications in court.

What does the above mean for you and your business?

To say this is a fundamental change or a 'game changer' to the insolvency framework is an understatement.

The relief being granted allows directors to explore opportunities in terms of dealing with their financially distressed business without being concerned about trading while insolvent. Concerned directors, particularly in a heightened state of stress, could prematurely place a company into voluntary administration or liquidation to protect themselves personally from an insolvent trading claim by a liquidator.

Readers may be aware of the ['safe harbour' provisions](#) introduced in September 2017. For directors to seek this protection, material eligibility criteria must be met. This temporary change means that the government has effectively provided a 'blanket safe harbour protection' for all directors without needing to meet the eligibility criteria. And if a company is wound up in the future, a director will not be personally liable for any debt that is incurred in the next six months.

The government's secondary aim here is to stimulate spending and investment. Directors should use this time **wisely**, and **responsibly**. Now is the time for directors to prepare detailed cash-flow forecasts on various 'what-if' scenarios to see how they impact on the business and its long-term viability. These scenarios may include:



- **Restructuring its debts**, which may include refinancing with banks. The Reserve Bank of Australia (RBA) reduced interest rates even further¹ and financial institutions are providing plenty of attractive deals for business loans. In the interim of any restructuring, if facing financial hardship contact the hardship team for your financial institution immediately. The Australian Banking Association CEO, Anna Bligh said "Banks stand ready to support customers, and if anyone is in need of assistance, they shouldn't wait but come forward as soon as possible." [Click here](#) for the hardship teams' contact details (22 financial institutions listed).
- **Exploring new ways to bring in business to adapt to the sudden change**. This crisis not only changes how many businesses operate now, but into the future. Considering how your business can find new opportunities to market and bring in new customers.
- **Reassessing current and exploring new supply chains** to see whether more favourable supply terms could potentially be reached.

Finding the right balance between fundamental and adaptive changes in your business is critical. Making too many hasty and drastic changes can be risky and ultimately lead to the business's demise. Any changes should be calculated and leveraging cash-flow forecasts on various 'what-if' scenarios is ideal in this climate. The key message is that **now** is the time to be playing out and potentially testing these scenarios while the protection is provided.

However, directors must remain vigilant as to how they use these temporary changes. The safe harbour provisions mandate that directors engage an appropriately qualified advisor to facilitate a turnaround of a business—to protect vulnerable directors and underpin the goal of the regime: *"reasonably likely to lead to a better outcome"*. Like safe harbour, we strongly recommend that directors seek advice first before triggering material changes to the business.

Critically, this temporary change does not provide protection to other personal exposures including:

- personal guarantees (some with charging clauses)
- director penalty notices
- director loan accounts
- unreasonable director related transactions.

Just to name a few. Therefore, considering the quantum of future debt incurred in the next six months must be done so responsibly. With these temporary changes in place, suppliers may be hesitant to extend credit without personal guarantees. And directors must ensure realistic cash-flow forecasts demonstrate that revenue can pay off those debts. Should directors overextend on credit and push boundaries in respect of how debt is incurred, they run the risk of the companies failing in 6-12 months' time.

[Click here](#) for the government resources on this topic (and more).

¹ 19 March 2020: <https://www.smh.com.au/politics/federal/reserve-bank-cuts-rates-to-record-low-in-emergency-action-20200319-p54bso.html> "The Reserve Bank of Australia cut official interest rates to a record low of 0.25 per cent as it forecasts "significant job losses" and attempts to shield the economy from the financial fallout of the coronavirus pandemic."



Big picture summary

These government and legislative measures give people (businesses and individuals alike) time and space to consider their financial positions and the exposure to bad/unmanageable debt.

All parties in business—on both sides of the ledger—must consider their needs to ensure that they get the best protection available to ensure revenue/income flows. The new insolvency rules above cannot be viewed in isolation, as insolvency practitioners we understand the implications from a 360-degree perspective. The following approach should be considered as part of a robust crisis management strategy.

Worrells' view on the government's new insolvency rules have created an environment where we can help distil the plethora of information and advice in a framework that breaks the challenge down into three facets:

1. **Relaxed regulation:** Explained throughout this Guide.
2. **Professional advice:** We are qualified, regulated insolvency practitioners with over 47 years' experience helping all types of businesses, in all industries—regardless of size and location.
3. **Proactive communication:** Open and transparent discussions with all stakeholders, externally and internally builds a solid foundation for people to appreciate your circumstances, creates buy-in to being part of the solution, gives them confidence in your approach, and fosters goodwill. It also helps people on an emotional level where they feel a sense of pressure being relieved in being able to be honest about their position. While also getting some respite in knowing that their conduct within their business is not contributing to other people's stress i.e. creating more uncertainty and fear for those connected to your business operating.

Increased business resilience



The Worrells' approach combines the three facets of relaxed regulation, professional advice, and proactive communication during this crisis.

It uses the intersections of **support**, **strategy**, and **strength** to create a dynamic for directors and their advisors that works towards **Increased Business Resilience**.



Speak to a restructuring adviser

The current environment can be very daunting and Worrells partners and staff are available to assist business owners that find themselves in a distressed position. We are experts in providing restructuring advice and can provide the guidance that may be needed in these difficult times. Worrells has 29 insolvency experts across Australia ready to assist. Our advice is qualified, regulated and experienced to help all types of businesses, in all industries. If you have a contact within Worrells please call them direct or through your accountant or lawyer.

Worrells has been providing formal and informal insolvency solutions (including voluntary administration, liquidation, and bankruptcy) services for over 47 years. We pride ourselves on approaching sensitive financial challenges through “Plain Talk, Straight Answers, and Fast Results” when people need it the most.

Worrells has 34 offices across Qld, NSW and the ACT, Vic, South and West Australia as part of our ethos of being *focused locally, resourced nationally*. [Contact us here](#).

Resources

Link	Information
Safe Harbour Regime	The ‘safe harbour’ regime’s aim is to provide company directors with an opportunity to seek proper advice to develop and implement an action plan to achieve a better outcome for the company and its stakeholders compared to simply closing the doors and appointing an administrator or liquidator.
ATO reporting business tax debt information	ATO reports business tax debt information to registered credit bureaus when certain criteria is met.
Managing a business crisis	To assist business owners (or your clients) through these difficult times, we offer a simple and practical approach that business owners can implement during such a crisis. Worrells can also assist business owners with this assessment.
Worrells Guide to Personal Insolvency	Answers the FAQs on personal insolvency topics and considerations.
Worrells Guide to Corporate Insolvency	Answers the FAQs on corporate insolvency topics and considerations.

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