Temporary Relief
From Financial Distress

The Government of Australia recognizes that COVID-19 could cause financial distress for profitable and viable businesses. To counteract this, they've revised legislation having to do with insolvency.

The following is an outline of the safety net that they've created.

Increase of Statutory Demand Threshold and Timeline for Responding

The Government has temporarily increased the amount at which creditors can issue a statutory demand as well as the time that companies have to respond to that demand. The threshold has been increased from $2,000 to $20,000 and the timeline for responding has increased from 21 days to 6 months. These changes will apply for six months.

Increase of Threshold for Initiating Bankruptcy

A creditor cannot initiate bankruptcy proceeding against a debtor until that debt has reached $20,000. This is an increase from $5,000 and it will apply for six months.

Increase in the Timeline for Responding to Bankruptcy Notice

Debtors will now have 6 months to respond to a bankruptcy notice rather than 21 days. This applies for six months. This extension also applies to the period of protection after a debtor makes a declaration of intention to present a debtor's petition.

Temporary Relief from Personal Liability

Directors will be absolved of personal liability for trading while insolvent. This will apply for six months.

What Is Insolvency?

Despite these relief efforts, many organizations may find themself in a state of insolvency as a result of COVID-19. **Insolvency** is the inability of an organization to pay their debts when those debts become due.

Insolvency is more of a financial state than a legal term. As in, it insolvency only turns into a legal financial problem when creditors seek to collect their debts and the organization cannot pay

The three most common corporate insolvency procedures are:

1. Voluntary administration:
2. Liquidation: and
3. Receivership.

Voluntary administration

This insolvency procedure is designed to resolve a company's future direction quickly whereby an independent and suitably qualified person, known as the voluntary administrator, takes full control of the company to try to work out a way to save either the company or its business.

If it isn't possible to save the company or its business, the aim is to administer the affairs of the company in a way that results in a better return to its creditors than they would have received if the company had instead been placed straight into liquidation. A mechanism for achieving these aims is through a Deed of Company Arrangement.

A voluntary administrator is usually appointed by a company's directors, after they decide that the company is insolvent or likely to become insolvent. Less commonly, a voluntary administrator may be appointed by liquidator, provisional liquidator, or a secured creditor.

Liquidation

If a company is in financial difficulty, its shareholders, creditors or the court can put the company into liquidation.

The purpose of liquidation of an insolvent company is to have an independent and suitably qualified person, known as the liquidator, take control of the company so that its affairs can be wound up in an orderly and fair way for the benefit of all creditors.

There are two types of insolvent liquidation:

1. Creditors' voluntary liquidation; and
2. Court liquidation.

Creditor's voluntary liquidation is occurs when:

1. Creditors vote for liquidation following a voluntary administration or a terminated deed of company arrangement; or
2. An insolvent company's shareholders resolve to liquidate the company and appoint a liquidator.

A court liquidation is one in which a court appoints a liquidator to wind up a company following an application that has been made by a director, a shareholder, ASIC, others, but it is usually by a creditor.

Once a company has entered into liquidation, unsecured creditors cannot commence or continue legal proceedings against the company, the exception being where the court permits.

Receivership

A company enters into receivership when a secured creditor or a court appoints an independent and qualified 'receiver' to take control of some or all of the company's assets.

The receiver will:

1. Collect and sell charged assets to repay the debt owed to the secured creditor;
2. Pay out the money collected in the order required by law; and
3. Report to ASIC any possible offences or other irregular matters they come across.

The receiver's leading duty is to the secured creditor who appointed them, and their subsequent duty is owed to unsecured creditors of ensuring that reasonable care is taken during the sales process not to sell for less than its market value, or if there is no market value, the best price reasonable obtainable.

Personal insolvency procedures

Personal insolvency procedures that apply to a person, that aren't a company, are bankruptcy and personal insolvency agreements.

What Is Bankruptcy?

Whereas insolvency is a financial state of distress, bankruptcy involves financial law. The two are linked, though, because you'll need to demonstrate that you're insolvent before you can make a claim for bankruptcy.

In bankruptcy, a court order decides how a debtor will deal with creditors that they're unable to pay. They'll be appointed a trustee who helps the debtor sell all of their assets in order to pay some creditors, though likely not all. This trustee will also look into all of your financial affairs, especially if you've transferred money prior to claiming bankruptcy.

After a business or individual goes into bankruptcy, they have a permanent record with the National Personal Insolvency Index (NPII). These records can be accessed by anybody wishing to access them. Any income earned over a certain amount and for a specified number of years (usually 3 but it can be extended) will be recovered.

Insolvency, Bankruptcy, and COVID-19

Bankruptcy has a severe impact on a debtor's credit rating. It affects their ability to borrow money for years following the bankruptcy. And it costs money to become bankrupt.

It's just a short step from insolvency to bankruptcy for some businesses. And in the current state of economic uncertainty, those steps are even shorter. This is why the Government is updating the rules – at least temporarily – to help.

One of the most important changes to these rules regards the right to trade when a company is insolvent. Usually, directors have personal liability if they trade a company with the knowledge that it's insolvent.

But directors do have some options here. In 2017, the Corporations Act has section 588GA added. Under this section, directors have a safe harbor if they trade while insolvent, as long as they followed certain conditions. As long as directors accessed the safe harbor criteria before trading, they could trade their business while undergoing a challenging period.

How We Can Help

COVID-19 most certainly represents a challenging period. As mentioned, the government has already introduced measures in the economic package to deal with insolvency. This package includes temporary relief for directors from personal liability for trading while insolvent.

But navigating that legislation takes expertise and experience. The rules have changed, and you'll need a professional to help you understand

why you can forego the need for a formal insolvency appointment. And in the case of bankruptcy, you might be able to save your businesses with some of the cash flow measures being provided by the Government.

Before taking any drastic measures, seek advice. We can help you understand the new options available to you and introduce you to an experienced, qualified support network of professionals equipped to help navigate these uncertain times.