

Temporary Relief to Insolvency Laws and Directors Duties during COVID-19 Pandemic

August 2020

The Australian Government has passed the *Coronavirus Economic Response Package Omnibus Act 2020* ('COVID Act') that makes temporary amendments to existing provisions in both the *Corporations Act 2001* (Cth) and *Bankruptcy Act 1966* (Cth) to lessen the financial impact of the pandemic on individuals and businesses. The Bill came into effect on 25 March 2020 for a six-month period.

In the Treasury's three month review, it stated that 'over the four weeks to 31 May 2020, company insolvencies were down by 38% when compared to 2019'.¹ Although this is not an indicator of financial stress for business' being low but rather an indication of support amendments introduced by the Government in response to COVID-19.

The recent case of *Sunstate Land Pty Ltd v Hiview Design & Construction Pty Ltd* [2020] QSC 181, is one of the few judgements nationally applying the provisional amendments. Callaghan J applied the extension of statutory demands from 21 days to 6 months and pointed to the intention of Parliament to provide 'flexibility to temporarily adjust legal obligations' and 'facilitate the continuation of businesses'.

The temporary relief/ changes will remain effective until 25 September 2020.

For the benefit of the reader a further outline of these changes is discussed below.

1. Insolvency and the Bankruptcy Act

The 'COVID Act' makes the following amendments to the *Bankruptcy Regulations 1996* (Cth) & *Bankruptcy Regulations 1996* (Cth):

4.02AA Temporary increase to the statutory minimum and statutory period

- (1) For the purposes of paragraph (a) of the definition of statutory minimum in subsection 5(1) of the Act, the amount prescribed is \$20,000.
- (2) For the purposes of paragraph (a) of the definition of statutory period in subsection 5(1) of the Act, the period prescribed is 6 months.
- (3) This regulation is repealed at the end of the period of 6 months starting on the day this regulation commences.

¹ Reserve Bank of Australia, *Financial Stability Review*, April 2020, accessed at <https://rba.gov.au/publications/fsr/2020/apr/>

4.10A Temporary increase to the default period

(1) For the purposes of paragraph (a) of the definition of default period in subsection 5(1) of the Act, the period prescribed is 6 months.

(2) This regulation is repealed at the end of the period of 6 months starting on the day this regulation commences.

The minimum threshold amount of debt that is required for a creditor to initiate bankruptcy proceedings has been increased from \$5,000 to \$20,000.

There is a temporary extended period of time to respond to a statutory demand, being six months. (Which is an increase from the previous period of 21 days)

2. Statutory Demands

The failure to comply with a statutory demand is a presumption of insolvency under the *Bankruptcy Act 1996* (Cth). By both increasing the minimum debt required and increasing the time in which a creditor has to comply with a statutory demand, the Government is seeking to provide 'breathing space' for individuals to deal with their creditors. Creditors will still have a right to enforce debts against individuals in court, however, creditors will not be able to rely upon a failure to pay, to initiate winding up proceedings until the end of the six-month period.

These amendments will only apply to statutory demands served after 25 March 2020. The increased threshold and time frame will only be in place for a six-month period.

3. Changes to Corporations Act 2001 (Cth)

The 'COVID Act' makes the following amendments to the *Corporations Regulations 2001* (Cth):

5.4.01AA Temporary increase to the statutory minimum and statutory period

(1) For the purposes of paragraph (a) of the definition of statutory minimum in section 9 of the Act, the amount prescribed is \$20,000.

(2) For the purposes of paragraph (a) of the definition of statutory period in section 9 of the Act, the period prescribed is 6 months.

(3) This regulation is repealed at the end of the period of 6 months starting on the day this regulation commences.

A creditor wanting to issue a statutory demand under the amended temporary provisions may only do so for debts that are \$20,000 or more (this is increased from the previous \$2,000). It also temporarily amends the statutory period to 6 months. (from 21 days)

4. Personal Relief for Directors for Insolvent Trading & 'Safe Harbour'

The 'COVID Act' makes the following amendments to the *Corporations Act 2001* (Cth):

588GAAA Safe harbour—temporary relief in response to the coronavirus

Safe harbour

- (1) Subsection 588G (2) does not apply in relation to a person and a debt incurred by a company if the debt is incurred:
 - (a) in the ordinary course of the company's business; and
 - (b) during:
 - (i) the 6 month period starting on the day this section commences; or
 - (ii) any longer period that starts on the day this section commences and that is prescribed by the regulations for the purposes of this subparagraph; and
 - (c) before any appointment during that period of an administrator, or liquidator, of the company.

In 2017 'safe harbour provisions' were introduced to the 'Corporations Act' which are intended to provide directors with protection from insolvent trading liability whilst pursuing a "turnaround plan". To state it another way, the 'safe harbour' will apply where a director who suspects a company may be or become insolvent, starts developing one or more courses of action that are 'likely' to lead to a better outcome for the company rather than the appointment of a liquidator or administrator. Debts that are subsequently incurred in undertaking this course of action are excluded from the director's liability for insolvent trading under the Act.

The addition of the 'safe harbour' provision is to provide a Director the ability to continue to trade during the COVID-19 period, as long as it is consistent with its 'ordinary' course of business.

Paragraph 12.18 of the Explanatory Memorandum for the 'COVID Act' says that a director; *'is taken to incur a debt in the ordinary course of business if it is necessary to facilitate the continuation of the business during the six month period that begins on commencement of the subparagraph'*.

This temporary reforms are not prescriptive in terms of what debt is incurred in the 'ordinary' course of business. It focuses on the primary principle outlined in paragraph 12.18 above, examples of this could include, for example, debts that are incurred in the continuation of the company's payroll during COVID-19 pandemic and could also include a director taking out a loan to move some of its business operations online.

Directors will need to make critical decisions in regards to incurring company debt. The temporary 'safe harbour' of amendments to s 588G of the *Corporations Act 2001* is designed to give directors the confidence to continue trade, continue to pay their bills and also retain staff through the COVID-19 crisis without the pressure to enter their company into administration if there is a chance they might be insolvent.

This amendment is temporary, and may be the subject of recourse if the company is still insolvent following the cessation of the crisis and/or lapsing of the six month period.

However, the kicker being that whilst this may provide relief in some cases, companies will remain liable for debts they incur and dishonest or fraudulent actions will continue to be subject to severe penalties.

Directors should be weary and not see these temporary reforms as offering them *carte blanche* in regards to their general director's duties, directors should continue to mitigate the risk of insolvent trading.

5. What It Is Not

Despite these changes to debt recovery and insolvent trading, the temporary changes are not a suspension on 'normal' debt recovery. In this instance a creditor will still have the right to enforce debts against companies or individuals through the courts.

These temporary amendments will not operate as a limitation on the exercise of other contractual rights available to a creditor, for instance these may include rights to charge default interest, the right to terminate a contract, rights to retake possession of certain assets in the debtor's possession.

6. Federal Treasurer Temporary Powers

Part 9.11 of the Corporations Act establishes a temporary mechanism to provide regulatory relief to classes of persons who are unable to meet their obligations under the Corporations Act or the Corporation's Regulation.

Classes of persons have not been specifically identified, giving flexibility to the Federal treasurer to offer relief to various persons who are subject to the Corporations Act. The power could be used to grant relief where the regulatory requirements would interfere with the ability of companies to manage their businesses through the impacts of the coronavirus.

This power to grant relief is available from 25 March 2020 for a maximum of 6 months, and available where the Federal Treasurer is satisfied that:

1. it would not be reasonable to expect the persons in the class to comply with the provisions; or

2. the exemption or modification is necessary or appropriate, in circumstances relating to COVID-19, to facilitate continuation of business or to mitigate the economic impact of the coronavirus.

7. **ATO Enforcement May be Suspended**

Business may seek tailored reductions in, or deferrals of, payments owing to the ATO. Consistent with the temporary relief on time to comply with Statutory Demands and Bankruptcy Notices, the ATO may also defer enforcement action including Director Penalty Notices and winding up action.

This may take the form of the following actions to assist impacted business:

- Deferring up to six months, the payment date of amounts due through the business activity statement (including PAYG instalments), income tax assessments, fringe benefits tax assessments and excise;
- Allowing businesses to vary Pay As You Go (PAYG) instalment amounts to zero for the March 2020 quarter. Businesses that vary their PAYG instalments to zero can also claim a refund for any instalments made for the September 2019 and December 2019 quarters;
- Remitting any interest and penalties, incurred on or after January 2020, that have been applied to tax liabilities.