



AUSTRALIA'S POST-PANDEMIC PURSUIT of ENTERPRISE RESCUE AND REFORM

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Australia's federal government has instigated the first major legislative review of its corporate insolvency and restructuring regimes in more than 30 years. This review comes after decades of only piecemeal amendments, resulting in one of the most complex insolvency legislative regimes in the world.

The time for such a review is ideal with Australia's exit from the COVID-19

pandemic being something of a soft landing due to the government's temporary policies that were introduced during the pandemic, which sought to alleviate enterprise solvency pressure, and the period of low interest rates and cheap capital which followed.

Through 2022, Australia's economy rebounded from pandemic conditions,¹ with GDP in early 2023 projected to be 6.7% higher than pre-COVID

figures in 2019 and unemployment at 3.5% in December 2022.² To put Australia's post-pandemic unemployment rate into context, it is currently the lowest since 1974.³

Even so, it has not been entirely smooth sailing in Australia, and restructuring industry participants expect rougher seas ahead. That is due at least in part to the rise in inflation across Australia caused by a number

of factors, including global economic policies, the impact of the war in Ukraine on fuel and commodities markets, and global supply chains.

While business distress is expected to increase in Australia, it is difficult to ascertain just how much work is being done by Australia's formal enterprise rescue legislative regimes, such as receivership, voluntary administration, schemes of arrangement, and

liquidation. Of those, only voluntary administrations and schemes (and in limited circumstances, receiverships) resulted in a "rescue" in some cases. Those figures can be tracked due to the various reporting and court process requirements embedded in those forms of restructuring.

Australia also has a "safe harbour" statutory mechanism designed to protect directors from potential

insolvent trading liability while seeking to save an enterprise, which allows them to explore informal or out-of-court restructuring. This legislative mechanism gives directors time to assess, plan, and implement a restructure of their company, generally guided by an appropriate qualified advisor. Such restructures often rely on informal

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bilateral and multilateral contractual rearrangement and capital injections and are not formally reported.⁴

Structural and Legislative Changes

Australia has been subject to a number of COVID-19-related structural and

legislative changes through the pandemic, which have now been unwound. It remains to be seen through 2023, whether such unwinding will result in an increase in distress. If there is an increase in distress, the key question then becomes, are those distressed businesses capable of restructuring in a manner that preserves value, or is Australia about to face, in effect, a cull of “zombie”

companies through increased rates of company liquidations?⁵

Key changes in Australia during the pandemic included travel restrictions which resulted in extremely low levels of immigration throughout the pandemic period.⁶ The impacts of those restrictions are being felt now, as labour shortages and the nation’s unusually low unemployment rates indicate

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a skills and labour shortage.⁷ While travel restrictions were lifted some time ago, the low levels of immigration will take time to correct. This issue is compounded by cost-of-living inflation and housing stock shortages, an issue which is itself exacerbated by the pressure the Australian construction sector has been under due to rising input costs and supply chain delays since the pandemic.⁸

Key policy changes post-pandemic include the winding back of the Australian government's temporary supports, which included JobKeeper, which provided payments to support businesses in retaining employees; modifications to the statutory demand process to increase monetary and temporal thresholds; and temporary COVID-19-specific relief from insolvent trading that was provided to directors through the pandemic period. Of the OECD countries, Australia was one of only a few to in effect suspend the effect of insolvency laws.⁹ It remains to be seen whether this approach has allowed businesses to survive or resulted in a period of life support for businesses

that would otherwise have failed, and which, due to a lack of underlying value capable of being preserved, will now fail.

A key policy factor which has been reset as Australia has resumed business as usual following the pandemic, and which is likely to be a tipping point for businesses which have been limping along on life support, is the Australian Taxation Office's approach to collection of tax. The latter part of 2022 has seen a shift by the tax office from a passive approach, which saw collectable debt balloon from \$26.5 billion on 30 June 2019 to \$44.8 billion as of 30 June 2022. The tax office describes one of its key focuses for 2023 as "implementing targeted strategies to address collectable debt."¹⁰

Increased Restructuring Activity

In 2022, the Asia-Pacific region experienced a year-on-year increase in debt restructuring. Debtwire reported 322 debt restructuring advisory mandates in the period. While the regional figure appears to be returning to pre-pandemic levels, the vast majority of those mandates were in

relation to Chinese-based mandates. Australia only accounted for 21 of the recorded restructuring mandates (overall, a year-on-year decrease of 14).¹¹

Australia has not yet seen a return to pre-pandemic volumes of restructuring activity. It has been submitted to a recent Australian parliamentary inquiry that the government, by introducing COVID-19 reactive legislative amendments instead of highlighting the existing legislative options for businesses to restructure, missed an opportunity to conduct widespread education of the business community on how directors can engage safe harbour protections to undertake restructuring.¹²

A majority of respondents to the 2022 KordaMentha and TMA Turnaround Survey anticipated that Australia would undergo a recession within 24 months, with one-third anticipating a recession would occur in 2023. Interestingly, while 70% of the respondents expected that insolvency appointments would

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return to pre-pandemic levels in 2023, 88% considered that lenders and owners responding to distress would explore options outside of formal insolvency appointments. Unsurprisingly, the respondents also expected an uptick in M&A transactions relating to distressed assets in 2023.¹³

Predictions of increased distress and therefore restructures are supported by the Reserve Bank of Australia's current program of interest rate increases, which pushed rates to 3.35% in February 2023 and are expected to continue to increase through the course of 2023. Industry participants also expect the availability of finance to tighten, with both debt and equity access becoming more challenging. Approximately two-thirds of the respondents to the survey noted a view that ESG (environmental, social, and corporate governance) considerations have impacted companies seeking refinancing or recapitalisation.

Some fintech and blockchain companies, as well as some forms of retail reliant on a cheap borrowing environment, may see distress ahead. The receiverships of OpenPay, a fintech of the buy now, pay later variety, as well as certain crypto platforms, suggests de-risking in those sectors should be happening now.

Australia's saving grace, primary industries, should continue to backstop the economy from fiscal disaster. Even if this is not what journalist Donald Horne meant by the title of his book, Australia remains "the lucky country."

It is difficult to ascertain the true number of informal or out-of-court restructurings which have taken place in Australia because a company undertaking such a process is not required to disclose it, even when such a company is a listed entity.¹⁴ A government review of the safe harbour regime undertaken in 2021 described the lack of disclosure as being for "good reasons," noting that publicising a company's financial distress during a period of safe harbour can have dire consequences for its liquidity and ongoing ability to trade.¹⁵

While the safe harbour regime has been in place for approximately five years, having been introduced several years before the pandemic, the regime is expected to play an increasing role

in enterprise rescue in Australia. The 2021 Safe Harbour Report observed:

The impact of safe harbour in terms of shifting the distribution of risk between stakeholders has likely not yet been seen in full. The lack of recent insolvencies is primarily due to the unprecedented developments that have taken place over the past 2 years, including the introduction of the COVID-19 moratorium, government stimulus packages, the National Cabinet Mandatory Code of Conduct: SME Commercial Leasing Principles during COVID-19, reduced ATO recovery initiatives, interest and loan repayment holidays offered by the major banks, and the general forbearance of creditors throughout the pandemic.

While informal or out-of-court restructures are expected to increase over time, as access to liquidity decreases—as industry participants expect will occur this year—it is anticipated that restructures will increasingly also utilise a formal process. Such an approach allows the company to access certain statutory moratoria which are available in a voluntary administration or scheme of arrangement.¹⁶

Recommended Reforms

Australia's bankruptcy, restructuring, insolvency, and turnaround regimes are seen to be among the most complex in the world¹⁷ and have been described as "an impenetrable quagmire that is scary, complex and unknown."¹⁸

Further, the piecemeal approach to legislative change in the area has resulted in inconsistencies and conflicts within existing law. For example, the amendments to remove director liability for insolvent trading if safe harbour was invoked did not also remove director liability to the commissioner for taxation if the restructuring attempt was ultimately unsuccessful and tax paid by the company was later set aside as an unfair preference.¹⁹

The rescue mechanics exist, though to appreciate how and when to trigger those processes, companies can benefit from the advice of turnaround professionals regularly engaged in the role of helping troubled enterprises survive.

Australia, like many countries around the world, has undergone significant

economic and social change since the publication in 1988 of the last holistic review into its insolvency laws, the Harmer Report, which resulted in the introduction of the voluntary administration process. These changes include advances in technology, regulation around data collection and privacy, international trade and access to foreign markets, the way in which capital (both public and private) is sourced, and the globalisation of debt and equity capital markets. As such, the present reform agenda in Australia is broad, and a "root and branch" review is supported by all key corporate insolvency stakeholders.

One such stakeholder, TMA Australia, has recommended that the following matters be specifically considered in any review:

- A thorough review of the administration and deed of company arrangement regime
- An introduction of a more developed priority funding regime for Australian insolvency processes (sometimes misdescribed in Australia as debtor-in-possession funding) and providing incentives and/or removing barriers to funding/investing in distressed businesses, including:
 - Providing tax breaks for the provision of equity or debt for investors in distressed situations
 - Accelerating capital raisings by allowing for "low-doc" raisings
 - Offering clearer valuation principles around debt-for-equity swaps
 - Specifying clearer tax loss rules in DOCAs
 - Clarifying the tax rules around change of control transactions
 - Reducing transaction taxes in distressed situations
- A review of the Personal Property Securities Act 2009 (Cth) (PPSA) rules to ensure efficiency
- The Safe Harbour rules, including taking on the recommendations of the 2021 review committee
- Cross class cramdown rules for creditor schemes of arrangement



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Jennifer Ball is a partner with Clayton Utz. She has extensive experience in restructuring and insolvency, debt recovery, general commercial litigation, and alternative dispute resolution, working with major corporations in mining, industrial manufacturing, telecommunications, and construction. Her commercial litigation work covers all forms of dispute resolution, including court litigation (obtaining urgent freezing orders), negotiation, and mediation. Ball is a director and a former chair of TMA Australia and former chair of the NSW TMA Committee.



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(similar to those introduced in the UK as part of the new restructuring plan procedure)

- Pre-packaged sales in an administration in appropriate circumstances and pre-packaged creditors' schemes of arrangement (similar to that introduced in Singapore)
- Consideration and clarification of conflict rules applying to insolvency practitioners who have been involved in advising the company prior to a formal insolvency appointment

Overall, Australia is well placed to learn from the lessons in other jurisdictions which have undertaken similar reviews and reform, and to implement even stronger legislative support for enterprise rescue. ■

Decision" (Media Release, 1 February 2022).

⁴ But see Turnaround Management Association of Australia submission to the Treasury of the Government of the Commonwealth of Australia, "Review of the insolvent trading safe harbour" (1 October 2021), in which 55 case studies were submitted from 20 TMA member firms: Appendix B.

⁵ The Australian Government Treasury, "Review of Insolvent Trading Safe Harbour Report" (Final Report, 23 November 2021) noted industry stakeholder concern that the COVID-19 Insolvent Trading Moratorium, combined with other liquidity support measures, resulted in Australian companies not yet experiencing the full economic consequences of COVID-19 from an insolvency perspective, and that many companies are continuing to trade despite underlying financial distress. The government report considered that much of this concern was summation and conjecture: as there is insubstantial data available on the current broad economic health of Australia's corporations, and whether there is, indeed, an increase in "zombie companies." Whether or not this fear is well-founded will only be revealed once creditor enforcement action resumes and external administrations are "forced" on companies: at 34.

⁶ But see that there has been a strong pickup in net arrivals from overseas with an increase in the arrival of international students and low levels of departures from Australia: "Statement on Monetary Policy," Reserve Bank of Australia (February 2023), rba.gov.au/publications/smp/2023/feb/domestic-economic-conditions.html

⁷ See "Statement on Monetary Policy,"

Reserve Bank of Australia (February 2023), rba.gov.au/publications/smp/2023/feb/domestic-economic-conditions.html

⁸ Ibid.

⁹ See Australian Government, "Temporary relief for financially distressed businesses" (Fact Sheet, 2020), treasury.gov.au/sites/default/files/2020-03/Fact_sheet-Providing_temporary_relief_for_financially_distressed_businesses.pdf

¹⁰ Commissioner of Taxation, "Commissioner of Taxation Annual Report 2021-22" (Report, 2022) III.

¹¹ See "APAC (ex-Japan) restructuring advisory mandate report 2022: PRC roles surged but opportunities were scarce elsewhere," Debtwire (23 February 2023), debtwire.com/intelligence/view/intelcms-brrrnv

¹² See Turnaround Management Association of Australia, Response to Questions on Notice to the Treasury of the Government of the Commonwealth of Australia, Review of the insolvent trading safe harbour (10 February 2023) 15 [3.8].

¹³ See "2022 KordaMentha & TMA Australia Turnaround Survey" (Report, 17 November 2022) 3.

¹⁴ See 2021 Safe Harbour Report (n 6) [14.3].

¹⁵ See 2021 Safe Harbour Report (n 6).

¹⁶ See Turnaround Management Association of Australia, Submission to the Treasury of the Government of the Commonwealth of Australia, "Review of the insolvent trading safe harbour" (1 October 2021) 7.

¹⁷ Ibid.

¹⁸ Ibid 79.

¹ See "Statement on Monetary Policy," Reserve Bank of Australia (February 2023), rba.gov.au/publications/smp/2023/feb/domestic-economic-conditions.html.

² See "Debt Market Update" (February 2023), KPMG Insights.

³ See Reserve Bank of Australia, "Statement by Philip Lowe, Governor: Monetary Policy