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legal update

SMALL BUSINESS RESTRUCTURING

A review of the Corporations Act's provisions to adjourn winding-up applications following entry into the SBR process.

Part 5.3B of the *Corporations Act 2001* (the Act), which commenced on 1 January 2021, permits small businesses in financial difficulties to engage in a new formal debt restructuring process.

In many ways, this new restructuring process is similar to the existing voluntary administration process. However, the restructuring process is intended to be a streamlined process and designed to be adopted by small businesses. Companies are only eligible to participate in the restructuring process if (among other requirements) their liabilities do not exceed $1 million.

A company is generally considered to be 'under restructuring' while it is developing a restructuring plan, with the assistance of its 'small business restructuring practitioner' (SBRP). Ordinarily the company will propose a restructuring plan to its creditors, via the SBRP.

The exercise of various third parties' property rights is restricted during the restructuring period, including the stay of existing court proceedings and enforcement proceedings.

Importantly, s 453Q(1) of the Act provides that during the restructuring period the court must adjourn the hearing of an application to wind up the company if the court is satisfied that it is in the interests of the company's creditors for the company to continue under restructuring, rather than be wound up.

This article considers two cases in which companies have relied upon s 453Q(1) of the Act to seek adjournments of winding-up applications.

Courts have proved willing to order adjournments to permit the restructuring process to continue, so long as the applicant companies establish that they are eligible to participate in the restructuring process, and that it is in the interests of creditors for the restructuring process to be allowed to continue.

In the course of determining these applications, the courts concerned were required to consider issues including the obligations of SBRPs when determining a company's eligibility to participate in restructuring at an early stage, and the test to be applied when determining whether it was in the interests of the company's creditors for the company to continue under restructuring, rather than be wound up.

PART 5.3B: THE SMALL BUSINESS RESTRUCTURING PROCESS

Part 5.3B is intended to provide eligible small businesses with an opportunity to restructure their debts, while maximising their chances of survival.

It provides an alternative to the more complex voluntary administration process, in the event of financial difficulty, and draws on key features of the Chapter 11 bankruptcy process in the United States.[1]

Part 5.3B is intended to allow eligible companies to:

- retain control of their business, property and affairs while developing a plan to restructure, with the assistance of a small business restructuring practitioner, and
- to enter into a restructuring plan with creditors (s 452A).

1 https://ministers.treasury.gov.au/sites/ministers.treasury.gov.au/files/2020-09/Insolvency-Reforms-fact-sheet.pdf

Consequently, Pt 5.3B adopts a 'debtor in possession' model, to ensure that eligible companies can keep trading in the ordinary course of business under the control of their owners, while a debt restructuring plan is developed and voted on by creditors.[2]

Eligible companies may appoint an SBRP if:

- eligibility criteria are met, and
- the board resolves to the effect that the company is insolvent, or is likely to become insolvent at some future time, and that a restructuring practitioner should be appointed.[3]

The eligibility criteria to appoint an SBRP include a requirement that the total liabilities of the company must not exceed $1 million.[4]

The SBRP's role includes providing advice to the company in relation to restructuring, assisting the company to prepare a restructuring plan and making a declaration to creditors in accordance with the regulations after the company proposes a restructuring plan.[5] In the declaration, the SBRP must address (inter alia) whether the company meets the eligibility criteria, and whether the company is likely to be able to discharge the obligations created by the restructuring plan.[6]

A restructuring plan must be proposed within the "proposal period", which is generally the period of 20 business days beginning on the date the restructuring begins (i.e. the date upon which the SBRP was appointed).[7] The SBRP may extend the proposal period for a further 10 business days,[8] and the court may also order an extension of the proposal period.[9]

Affected creditors may accept a restructuring plan during the "acceptance period" of 15 days after proposal of the plan.[10] The restructuring plan is made if a majority of creditors in value accept it.[11] Related party creditors may not vote.[12]

A company is considered to be "under restructuring" during the proposal period and until the company makes a restructuring plan, or the process otherwise terminates.[13]

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Importantly, s 453Q(1) of the Act provides that while a company is "under restructuring", the court is to adjourn the hearing of an application for an order to wind up a company if the company is under restructuring, and the court is satisfied that it is in the interests of the company's creditors for the company to continue under restructuring rather than be wound up.

Once a restructuring plan is made, it binds creditors with an admissible debt or claim, the company, the company's officers and its members and the SBRP,[14] although secured creditors are generally only bound to the extent that they agree to be bound, and to the extent that their admissible debt or claim exceeds the value of their security interest.[15]

DAVEY v DESSCO PTY LTD [2021] VSC 94

In this case, the defendant company successfully sought orders that a winding up application be adjourned, pursuant to s 453Q(1).

The plaintiff's winding-up application was based on the defendant's failure to comply with a statutory demand.

2 Ibid. **3** Section 453B(1). **4** The eligibility requirements are prescribed by s 453C and reg 5.3B.03. They are also targeted at preventing abuse of the Pt 5.3B process via repeated use of the restructuring process, or use of the simplified liquidation process in Pt 5.5 Div 3, Subdiv B. **5** Section 453E and reg 5.3B.18. **6** Reg 5.3B.18(2). **7** Section 453A, reg 5.3B.02(1)(b) and reg 5.3B.17. **8** Reg 5.3B.17(2) and (3): the SBRP may only extend the proposal period once. **9** Reg 5.3B.17(4). **10** Reg 5.3B.21. **11** Regs 5.3B.25 and 5.3B.26. **12** See the definition of "excluded creditor" in reg 5.3B.01. **13** Reg 5.3B.02 sets out the circumstances in which a restructuring terminates. **14** Reg 5.3B.29(2). **15** Reg 5.3B.29(3) and (4).

Debt restructuring

The statutory demand, in turn, was based on a judgment of the Magistrates' Court in favour of the plaintiff. The judgment of the Magistrates' Court required:

- the defendant to pay amounts to the plaintiff totalling $117,092.61, and
- the defendant, and two other persons, jointly and severally to compensate the plaintiff pursuant to the terms of a Practitioner Remuneration Order.

The plaintiff contended that the amount payable pursuant to the Practitioner Remuneration Order was $607,951.19. The quantification of the costs claimed by the plaintiff pursuant to the Practitioner Remuneration Order formed the subject of disputes in separate proceedings between the plaintiff and the defendant.

The defendant company appointed an SBRP and, on the same day, filed an interlocutory application seeking an adjournment of the winding up application for a period of 50 days, pursuant to s 453Q(1) of the Act.

The plaintiff opposed the adjournment sought, for reasons including that the defendant was ineligible for restructuring, as its liabilities exceeded the $1 million maximum.

This directs attention to the obligations of SBRPs when determining whether a company is eligible to participate in restructuring.

In his affidavit, the SBRP appointed to the defendant company estimated that the admissible debts or claims against the defendant as at the date of his appointment totalled $750,592. This estimate included an amount of $200,000 for contingent liabilities, which referred to the defendant's liability to compensate the plaintiff pursuant to the Practitioner Remuneration Order.

In the SBRP's view, therefore, the defendant was eligible to participate in restructuring, as its liabilities did not exceed $1 million. But if the plaintiff's quantification of the company's liability pursuant to the Practitioner Remuneration Order was correct, the defendant would not be eligible to participate in restructuring.

In his affidavit the SBRP gave a number of reasons why, in his view, the amounts claimed by the plaintiff pursuant to the Practitioner Remuneration Order were overstated, and his estimate of $200,000 should be preferred. Those arguments were contested by the plaintiff for the purposes of opposing the adjournment application.

Irving JR expressed the view that an adjournment application cannot be an appropriate forum to quantify a company's contingent liabilities, particularly where there are separate proceedings on foot for such a purpose. Although the Judicial Registrar accepted that the definition of "admissible debt or claim" requires an SBRP to take contingent liabilities into account, when determining whether a company is eligible to participate in restructuring the Judicial Registrar concluded that when quantifying claims for the purpose of determining eligibility:

- the SBRP is required to make a just estimate of the value of the claim, based on the factual material available, and
- the SBRP is required to have reasonable grounds for ascribing a particular figure to a claim but is not, at this early stage, required to carry out a comprehensive detailed enquiry. The Judicial Registrar noted that the Regulations establish a separate process for a creditor to challenge a company's assessment of the amounts claimed by a creditor.

Consequently, the court accepted that the SBRP had provided a just estimate of the plaintiff's claim (similar to the requirements of s 554A of the Act, for a liquidator to value claims of uncertain value in a winding up), and therefore accepted the SBRP's assessment of the defendant's eligibility for restructuring.

As required by s 453Q(1), the court turned to consider whether it was in the interests of the defendant's creditors for it to continue under restructuring, rather than be wound up.

Irving JR considered this test to be analogous to the test employed under s 440A(2) of the Act.[16] He therefore considered that it required him to determine whether creditors could hope to get more by way of payment of their debts from the restructuring rather than liquidation.

The Judicial Registrar determined that the restructuring process offered creditors the best chance of receiving some payment for their claims. The defendant company indicated that it intended to offer a dividend of 5 cents in the dollar to creditors via the restructuring; it was not in contention that there would be no return to creditors in a winding up.

16 That section is in similar terms to s 453Q(1), but deals with the adjournment of winding up applications following the appointment of voluntary administrators.

Consequently, the Judicial Registrar granted the adjournment sought, to permit the restructuring to continue.

REDHILL BRICKLAYING PTY LTD v DST PROJECT MANAGEMENT AND CONSTRUCTION PTY LTD [2021] VSC 108

In this case, the defendant company also obtained an adjournment of a winding up application, pursuant to s 453Q(1).

The factual background was similar to *Davey v Dessco Pty Ltd* in that the winding-up application was based on a statutory demand, and the statutory demand was based on a judgment debt. In this case, however, there was no dispute concerning whether the defendant company met the eligibility criteria for restructuring under s 453C, or concerning the validity of the SBRP's appointment.

The dispute in this case principally concerned whether an adjournment would be in the interests of creditors, as required by s 453Q(1). The plaintiff contended that it was not, principally because it argued that "friendly" creditors had unfairly used their voting power to approve the restructuring plan.

The defendant company had proposed a restructuring plan which would yield a dividend of 7.62 cents in the dollar. The three largest affected creditors (over 85% of admissible debts) had already voted in favour of the restructuring plan, although as at the date of hearing of the adjournment application, creditors were still entitled to change their vote.[17]

17 Reg 5.3B.24 permits creditors to change their vote until the end of the acceptance period.

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In his evidence, the SBRP estimated that the return to creditors in a liquidation scenario would be between zero and 3.78 cents in the dollar.

The defendant's largest creditor was a company controlled by the wife of one of the defendant's directors, which had voted in favour of the restructuring plan. The plaintiff's allegations of a connection between the defendant and the other two main creditors were more speculative, and the SBRP's investigations had not been able to establish any connection between these other creditors and the defendant. The plaintiff's evidence was not sufficiently cogent to convince the court that the SBRP's investigations in this regard were not reliable.

Having regard to the better return to creditors payable under the terms of the restructuring plan, the Judicial Registrar was satisfied that it was appropriate to adjourn the winding up application to allow the restructure acceptance period to expire.

GOING FORWARD

It is to be expected that, in future, courts will face more applications to adjourn winding up applications, in reliance upon s 453Q(1), to allow the restructuring process established by Pt 5.3B to proceed.

It is likely that questions of eligibility to participate in the restructuring scheme will play a key role in courts' assessment of such applications, particularly concerning the appropriate quantification of the contingent liabilities of companies that seek to participate in its benefits.

As shown by the cases under consideration in this article, an application for an adjournment of a winding up application may well be made at an early stage of the restructuring process. Consequently, it is likely that if an application is made at an early stage of the restructuring process the SBRP will only be required to make a just estimate, upon reasonable grounds, as to whether the company is eligible to participate.

But as part of the restructuring process the SBRP is required to investigate, and ultimately make a declaration that will accompany the restructuring plan, concerning whether the company meets the eligibility criteria. Regulation 5.3B.18(4) points to the more detailed analysis that will be required to satisfy this subsequent obligation. This suggests that a more detailed analysis may be required if the application is made at a later stage of the restructuring process, when such investigations have been undertaken.

Whether it is in the interests of the company's creditors for the company to continue under restructuring, rather than be wound up, will always play a key role in the court's assessment of applications under s 453Q(1). This will usually require the applicant company to establish that the restructuring process is likely to yield a better return to creditors than a liquidation scenario. The evidence of the SBRP, and the SBRP's assessment of the likely returns under these different scenarios, is likely to be critical in the court's assessment of this issue.