Federal Government Introduces Temporary Changes to Insolvency Laws in Wake of the Coronavirus

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On the 22nd of March, the Federal Government announced a suite of temporary changes to insolvency laws to help struggling businesses dealing with the economic fallout of the coronavirus.[1] These changes have been designed to act as a 'safety net', minimising the threat of actions that could unnecessarily push businesses into insolvency and, instead, allowing them to continue trading.

Changes to Demands from Creditors

One of the key changes announced is an increase to the current minimum threshold for creditors issuing a statutory demand on a company under the *Corporations Act 2001* (Cth) (the Act). The threshold will be increased from $2000 to $20,000 for a 6 month period from commencement of the changes. Similarly, the threshold for the minimum amount of debt required before a creditor may initiate bankruptcy proceedings will increase from $5000 to $20,000 for a 6 month period.

Not responding to a statutory demand within the specified time creates a presumption that the company is insolvent and allows creditors to file a winding up application. Similarly, not responding to a bankruptcy notice within the specified time allows a creditor to seek a bankruptcy order from the court. During this period, the statutory timeframe for responding to a statutory demand or bankruptcy notice will be extended from 21 days to 6 months.

As things stood, the law provided a short term "hair trigger" for creditors seeking to recover a debt due. By increasing the thresholds for service of statutory demands and initiating bankruptcy proceedings, and the periods for debtors to respond, the changes give debtors considerably more breathing room in respect of unpaid debts.

Changes to Liability of Directors for Insolvent Trading

The Government will temporarily relieve company directors of their duty to prevent insolvent trading with respect to any debts incurred in the ordinary course of the company's business. This means directors will not be personally liable for insolvent trading. The proposed relief will apply for 6 months.

Despite this relief, directors who engage in egregious dishonesty and fraud will still be liable to criminal penalties. Further, any debts incurred by a company will still be payable by the company.

This too represents a dramatic shift in directors' risk profile during the crisis, enabling them to have far more confidence in seeking in good faith to trade through the difficult times.

[1] Australian Government Fact Sheet – Temporary Relief for Financially Distressed Businesses

Relief for Individual Businesses

The Australian Tax Office (ATO) will also be able to tailor solutions for individual businesses struggling due to the coronavirus. Potential solutions could include temporary reductions of payments or deferrals and withholding enforcement actions such as Director Penalty Notices and wind-ups.

The Government has acknowledged the importance of regulatory certainty in providing relief to businesses at this time. As such, the Treasurer will be given a 6 month instrument-making power to temporarily amend provisions of the Act to provide relief from specific obligations or to modify obligations to enable compliance with legal requirements during the crisis. Any instruments made under this power will have effect for up to 6 months from the date they are made.

Implementation of Changes

The changes to demands from creditors and liability of directors are contained in Schedule 12 of the *Coronavirus Economic Response Package Omnibus Bill*, which was introduced and passed by both houses of Parliament on the 23rd of March.[2] The Bill is currently awaiting Royal Assent. Schedule 12 will come into effect the day after the Bill is assented to.

Where to from here?

Given the urgency of the situation, it is anticipated that the temporary changes will come into effect shortly. Businesses should familiarise themselves with the changes and be aware of the impact they may have on day-to-day operations. Some commentators, for example, have suggested that there will be a significant tightening in credit, as creditors will have less confidence that they are dealing with a solvent company.[3] Arguably, these changes merely shift the economic burden resulting from the economic slowdown from debtors to creditors: for every debtor that incurs a debt whilst insolvent, there is a creditor at greater risk of not getting paid. Whether this is an appropriate movement of the policy needle remains to be seen, but it certainly represents a dramatic shift in the landscape.

Addisons will continue to monitor the situation and provide updates as further information becomes available. If you require any assistance in understanding how these changes will apply to your business, we are here to help.

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[2] Coronavirus Economic Response Package Omnibus Bill
[3] 'Avalanche' of insolvencies will force law change

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