Insolvency Law Reform Act 2016: Practical effects

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Summary

The *Insolvency Law Reform Act* 2016 ('the Act') is due to take effect on 1 March 2017. The focus of the legislation is on those who become insolvent or cause insolvency and those who run the resultant administrations. That's all well and good but what does this mean for credit providers? The principal practical effects on the credit sector will be:

- A greater effort will need to be made during personal bankruptcies to recover because the minimum bankruptcy period will be markedly reduced.
- Insolvent trading claims against directors will be harder to pursue.
- Supply contracts will not automatically terminate if a corporate customer goes into voluntary administration.

How will the Act work?

The Act will consolidate the rules which govern corporate and personal insolvencies, which are currently split between the *Bankruptcy Act* 1966, the *Corporations Act* 2001 and the *Australian Securities and Investments Commission Act* 2001 (Cth). The new rules will be put into a consolidated set of rules called the 'Insolvency Practice Schedule' and the 'Insolvency Practice Rules.' The Rules are yet to be released (which has led to speculation that the commencement date of the Act will be pushed back to 1 July 2017).

Changes you can expect

The major amendments to the current legislation will affect credit providers as follows:

- The default bankruptcy period will be reduced from three years to one (but the power to extend the bankruptcy period up to eight years will be maintained). It is unclear whether this amendment will apply retrospectively to existing bankrupts.
- Safe harbour provisions will be added to protect directors from insolvent trading claims if the company appoints a restructuring adviser to develop a turnaround plan for the company which is being implemented at the time any alleged insolvent trading takes place. The purpose of this change is to allow directors to make decisions relating to the restructure of their company free from fear of liability.
- If a company goes into voluntary administration, it will not automatically have to cancel its contracts or cease trading.
- Similarly, a standard clause of a contract which enables one party to terminate the agreement upon the insolvency of the other party will not automatically apply if the company has appointed a restructuring adviser.
- The body that supervises bankruptcy trustees, Australian Financial Security Authority, will have increased power to review and audit the conduct of insolvency practitioners.
- A statutory default remuneration figure of $5,000 will be introduced to corporate insolvencies without the need to hold creditors' meetings. There will also be a 'maximum default amount' which applies when there is an absence of remuneration determination. The remuneration provisions have been included in the new legislation to address the fact that 80% of insolvency related complaints to ASIC between 2006 - 2010 related to excessive fees and poor disclosure of remuneration.

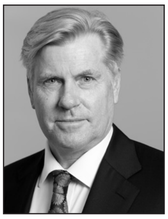
- The ability of insolvency practitioners to seek prospective approval of their remuneration will also be limited to a capped fee.
- There will be flexibility surrounding creditors' meetings depending on the type of administration.
- Creditors will have the power to propose a resolution to replace a liquidator or appoint an independent specialist to review the performance of the liquidator without needing to apply to the Court.
- Liquidators will be able to assign their right to bring statutory claims such as unfair preference claims and other voidable transaction claims to a third party (subject to certain limitations).

Implications

- It will make lending riskier as people may find it easier to skip out on their liabilities having become bankrupt. Similarly it will become easier for people with failed businesses to start new ones.
- Insolvent trading claims, which are often difficult and expensive to pursue, may become even less frequent.
- Credit providers may have a great opportunity to unseat underperforming insolvency administrators.

Watch this space for further announcements on the changes that will be implemented and the practical effects on credit providers. Until the legislation is implemented, it will be hard to know for sure whether the balance between encouraging risk-taking, innovation and economic growth, and protecting creditors from irresponsible or negligent directors, has been struck.

For more information, please contact:



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