

27 March 2020

Coronavirus (COVID-19): Important Temporary Relief in Insolvency Law

Summary

The Australian Government has introduced temporary measures to curtail the impact of COVID-19 on Australian businesses by lessening the threat of otherwise viable businesses being placed into external administration.

In part, these measures seek to prevent the winding up of companies which are experiencing short term financial distress and protect company directors from potential personal liability in order to incentivise continued trade through the COVID-19 health crisis. Similar temporary relief measures extend to individuals in financial difficulty.

Temporary Relief Measures

On 22 March 2020, the Australian Government announced the introduction of a number of new measures to provide flexibility in the *Corporations Act 2001* (Cth) (**Corporations Act**) and temporary relief for financially distressed individuals and businesses.

These temporary reforms are contained in Schedules 8 and 12 of the *Coronavirus Economic Response Package Omnibus Act 2020* (**CERP Legislation**) respectively. Late on 23 March 2020, the Federal Parliament passed the CERP Legislation and Royal Assent was received on 24 March 2020. The reforms in the relevant Schedules of the CERP Legislation commenced on 25 March 2020 and will be in place until 25 September 2020 or any later date that is subsequently prescribed.

Creditor issued Statutory Demands

In the normal course, under section 459E of the Corporations Act, a creditor can issue a statutory demand against a company demanding payment of a debt of at least \$2,000 (**the statutory minimum**) that is currently due and payable. The company then has 21 days after being served with the statutory demand to pay the demanded amount, reach an agreement with the creditor about the debt to the creditor's satisfaction, or to apply to a relevant court to have the statutory demand set aside.

If a company fails to respond to the statutory demand within 21 days, it will be presumed to be insolvent and the

creditor can make an application to a court for the company to be wound up in insolvency and a liquidator to be appointed to the company.

In order to reduce the instances of companies being liquidated, the CERP Legislation makes the following changes to the statutory demand process:

1. **increase the statutory minimum from \$2,000 to \$20,000** – meaning that a creditor must have a much larger debt owing to it by the company before it can issue a statutory demand; and
2. **extend the time for a company to respond to a statutory demand from 21 days to six months** – meaning that the company will have a longer period of time to deal with the statutory demand, reducing the pressure on the company for a quick response.

These changes will apply for **six months** from 25 March 2020 and will apply to statutory demands that are served on or after that date. The statutory demands can relate to debts already incurred and due and payable.

The changes to the statutory demand regime **do not** affect the ability of the creditor to pursue a company through the courts to obtain a court order or judgment for the amount owing to it.

Liability for trading while insolvent

Ordinarily, under section 588G of the Corporations Act, a director of a company is under an obligation to prevent the

company trading while it is insolvent. A director may be personally liable for debts incurred by the company if it trades while insolvent.

This can result in directors placing the company into external administration as soon as they suspect insolvency, in order to reduce their potential personal liability.

The measures introduced by the CERP Legislation provide a special safe harbour provision to **relieve company directors from their duty to prevent insolvent trading for debts incurred in the ordinary course of the company's business.**

It is hoped that the proposed temporary relief measures will give businesses the confidence to continue to trade, with the aim of returning to viability once the COVID-19 crisis has passed.

This relief will apply for **six months** from 25 March 2020 (or any longer period that is subsequently prescribed).

Importantly, the temporary relief measures **do not** affect the liability of a company to repay debts that it incurs.

Flexibility in the Corporations Act

In order to provide increased regulatory certainty and flexibility to respond to the developing COVID-19 situation, the CERP Legislation also grants the Treasurer temporary power to amend provisions of the Corporations Act, to provide relief from or to amend statutory obligations.

The Treasurer will have this instrument-making power for **six months** and any instrument made by the Treasurer under this power will apply for **up to six months** from the date it is made.

This power is in addition to the existing power that the Australian Securities and Investment Commission already has to offer relief from certain provisions in the Corporations Act or to refrain from taking action in relation to failures to comply with the Corporations Act.

Action against individuals (rather than companies)

Mirroring the amendments in relation to the winding up of companies, relief has been introduced for individuals facing bankruptcy action.

Ordinarily, where a debt is owed by an individual, under section 41 of the *Bankruptcy Act 1966* (Cth) (**Bankruptcy Act**), a creditor can request that the Official Receiver issue a bankruptcy notice to an individual (**the debtor**), if the creditor has obtained a final judgment or final order against the debtor for an amount of at least \$5,000.

The debtor then has 21 days after being served with the bankruptcy notice to respond to it, in the same way as a company served with a statutory demand.

Pursuant to the CERP Legislation:

1. a creditor must now have a final judgment or order against the debtor for a **minimum amount of \$20,000** (increased from \$5,000) before it can request the Official Receiver issue a bankruptcy notice; and
2. the time for a debtor to respond to a bankruptcy notice is extended to **six months** (from 21 days).

These changes will also apply for **six months** from 25 March 2020 and will apply to bankruptcy notices issued on or after that date.

A creditor is still able to enforce a debt owing to it by an individual through the courts.

Debtor's petition protection

As an alternative to an order for a person's bankruptcy made by a court, an individual can voluntarily become bankrupt by presenting a debtor's petition to the Official Receiver under section 55 of the Bankruptcy Act.

Before presenting a debtor's petition, the individual can present a declaration to the Official Receiver of their intention to present a debtor's petition under section 54 of the Bankruptcy Act. If the Official Receiver accepts this declaration, the debtor is afforded "stay period" of up to 21 days, during which period unsecured creditors are not able to apply for the issue of enforcement process in respect of certain debts or to enforce a remedy against the debtor's person or property in respect of certain debts (**debtor protection period**).

Under the temporary relief measures, **the debtor protection period is temporarily extended from 21 days to six months.**

This temporary measure will apply for **six months** and will apply to petitions and declarations presented on or after 25 March 2020.

The ATO

In addition to the measures discussed in this Alert, the Government has indicated that the Australian Taxation Office will tailor solutions for company directors or business owners that are struggling due to COVID-19, including temporary reduction of payments or deferrals, and withholding enforcement actions such as Director Penalty Notices and applications to wind up companies.

How will this affect businesses?

These reforms certainly provide much needed relief in easing the burden of cash flow restrictions on companies and reducing the immediate risk associated with incurring a debt or deferring payment in this time of crisis.

However, it exposes creditors who continue to extend credit to a higher risk that it will not be paid or payment will be delayed for an extended period. It may, in effect, result

in an informal moratorium on payment of debts for six months.

This will put further stress on those creditors and may result in creditors terminating supply agreements, tightening of business-to-business credit terms or the enforcement of security.

We expect that the reforms will also lead to creditors requiring security for future indebtedness, whether by way of director guarantees or other security instruments.

Please note: this information is current as of **27 March 2020**. The speed with which COVID-19 is spreading and the varied responses both internally within Australia and externally change on a daily basis. It is important that you regularly keep up to date with all relevant information and be prepared to respond as the landscape in which the virus is moving changes.

For updated COVID-19 legal issues and considerations please access our website [here](#).

Contact details

If you have any queries regarding this alert, please contact:

Lisa Calabrese *Partner*

lisa.calabrese@finlaysons.com.au

+61 8 8235 7479

James Jarvis *Partner*

james.jarvis@finlaysons.com.au

+61 8 8235 7550

Stephanie Campbell *Associate*

stephanie.campbell@finlaysons.com.au

+61 8 8235 7423

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