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Productivity Commission Inquiry into Business Set-Up, Transfer and Closure

In November 2014, the federal government asked the Productivity Commission to conduct an inquiry into the barriers to setting up, transferring and closing a business, and where appropriate, to identity options for reducing those barriers.

A draft report was released in May, following submissions made by a number of parties, including ARITA. The draft report takes an in depth look into personal and corporate insolvency (the impact of those regimes on business exits), and makes a number of recommendations for reform.

Insolvency and the Economy

The report examines the role of insolvency in the economy, and the importance of defined procedures to facilitate expedient closure of a business, and the redeployment of its employees and capital to more productive ventures where a restructure is not possible. It is suggested that those procedures should facilitate business exits in a *"structured, predictable and expedient manner to enable learning and adjustment following business exits without undue delay or cost."*

The Commission believe that insolvency should encourage economic activity through productive use of business assets, with distressed businesses utilising procedures to effect a restructure if possible, or where not possible, to provide a quick, cheap and efficient method for winding up.

It was recognised that insolvency practitioners had an enforcement role in detecting criminal activity in a business which had led to its winding up.

Current System

The Commission's inquiries found that the current insolvency regime was generally sound and robust, and that no wholesale change was required in order to achieve the goals outlined above. The Commission did not recommend a US Chapter 11 style system of insolvency: it believed that increased oversight by the Courts (associated with Chapter 11) was neither efficient nor cost effective.

Informal workouts were considered, and whilst some of the proposed recommendations are geared towards providing an

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environment more conducive to workouts or restructuring, the Commission noted that companies should not be saved at all costs. Rather, emphasis should be on the timing of a proposed restructure to ensure genuine attempts to do so are not unduly hindered. Where liquidation is required, the Commission's recommendations look to balance expediency and cost effectiveness against investigations.

The Commission made the following recommendations:

Personal Insolvency

Reduction of Period for Automatic Discharge

Reduce the period of automatic discharge from 3 years to 1 year, with trustees to have the ability to extend for up to 8 years if necessary.

Reduce Restrictions on Employment

The Commission noted that a number of professions placed significant restrictions on bankrupts continuing employment in that profession following their bankruptcy. The Commission recommended that government work with professional bodies to ensure that restrictions on employment of bankrupts beyond the period bankruptcy are justified.

Corporate Insolvency

Changes to Voluntary Administration

The Commission considered that options for an administrator can be severely limited in circumstances where a company has already exhausted its funds. Accordingly, the Commission recommended that the timing of voluntary administration should be earlier, and should not be available to companies who are already insolvent. The recommendation would see voluntary administration reshaped into a restructuring process (rather than an insolvent one), which would remove negative perceptions surrounding Part 5.3A.

It was also recommended that administrators be given greater flexibility to transfer administration to liquidation where appropriate, and vice versa.

Limited safe harbour period

A moratorium prior to voluntary administration would enable directors to obtain independent restructuring advice without being liable for insolvent trading. However, the Commission observed that the perceived threat of an insolvent trading action was perhaps larger than the actual threat, and in those circumstances, it was sceptical of the impact such a change would make. The Commission has sought further input regarding the extent and design of the rule.

Review of ipso facto clauses

As part of creating an environment to facilitate genuine restructuring attempts, ipso facto clauses have no effect until a liquidator has been appointed. This would then prevent suppliers and other creditors from terminating contracts only by reason of an insolvent event by the company.

Streamlined small liquidation process

A streamlined liquidation process for small and medium sized enterprises, which often have limited or no recoverable assets. Such a process would involve a review of the reporting and other formal requirements of a winding up, with a view to reducing the time and cost involved in the liquidation of such businesses.

The flavour of the recommendations illustrates the Commission's preference for "speed and effectiveness over absolute certainty of enforcement of all rights."

The Commission aims to finalise the report and provide it to government this month.

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