Supplier beware: Part 5.3B "small business" restructuring, winding up applications and dispositions of company property during "debtor-in-possession" trading

Mark Wellard, Senior Lecturer, UTS Law

The new Part 5.3B small business restructuring procedure is in large part modelled on Part 5.3A voluntary administration. However, there are significant differences between the two procedures (some intended, some perhaps less so). One obvious and well-known difference is that, unlike the traditional notion of an external administration, Part 5.3B of the *Corporations Act 2001* (Cth) ("the Act") provides for a restructuring period during which a company's directors will continue to cause the company to enter into transactions in the ordinary course of the company's business with no involvement or authority required of the "restructuring practitioner" ("RP").[1]

Unfortunately, the validity of many transactions that would be expected to occur in a "debtor-in-possession" trade-on under a small business restructuring will be brought into question if a winding up order is made subsequent to the appointment of a RP.

Part 5.3B appointments subsequent to a winding up application

Two issues raised in my own submission to Commonwealth Treasury on the exposure draft legislation were not addressed by any amendment to the bill as introduced into Parliament.[2] These two issues, now a feature of Part 5.3B of the Act that commenced on 1 January 2021, relate to the interaction of the small business restructuring procedure with:

- A pre-existing winding up application (which needs to be dealt with in the event of the appointment of a RP); and
- A winding up order that might be made subsequent to the appointment of a RP.

The first issue largely amounts to an unfortunate impost of time and cost that could have been averted by better legislative design of the Part 5.3B procedure. The second issue appears to be a more fundamental flaw in the legislation that undermines the validity of "ordinary-course" dispositions of property made by a company after a RP is appointed (during the restructuring period).

This second issue amounts to a simple but serious proposition in practical terms: if a person is dealing with a company that has appointed a RP, any property that person receives from the company under an "ordinary-course" transaction is exposed as a "void disposition" that could be claimed back by a subsequent court-appointed liquidator. "Supplier beware", one might say. Indeed, *any* person who receives property or a payment from a company during a restructuring – eg, a purchaser of the company's product or an employee receiving wages – stands exposed unless either a subsequent liquidator chooses not to press the matter or a court grants relief.

As discussed further below, court relief – a 'validation order' – may be an available solution but this comes with associated cost and uncertainty: precisely the opposite of what Part 5.3B was intended to deliver, as stated by the Explanatory Memorandum to the reform bill (emphasis added):[3]

> This new framework is designed to meet the needs of small business and to support increased productivity and innovation by **reducing the complexity and costs in insolvency processes**.

Appointment of a RP and adjourning a pre-existing winding up application

Unfortunately for a "small business" insolvency procedure, s 453Q(1) in Part 5.3B of the Act mirrors s 440A in Part 5.3A voluntary administration:

> 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.

Parliament's decision to have s 453Q in Part 5.3B replicate the position in voluntary administration means that undesirable time and cost will need to be spent by a RP convincing a court why it is in creditors' interests to adjourn any winding up application that precedes the RP's appointment. In a "small business" insolvency procedure where time and costs are critical factors, it would have been far preferable to provide for an *automatic* stay of any pre-existing winding up application upon the appointment of a RP.

Putting a small business restructuring procedure to the immediate time and cost of a court hearing, simply to address a pre-existing winding up process, is nothing short of a legislative "own goal". How does a s 453Q hearing, with its attendant affidavits and lawyers' appearances, "reduce complexity and costs in insolvency processes"? As discussed below, it is disappointing to observe that the very first two appointments under Part 5.3B in early 2021 have immediately ended up in court to determine a necessary application for the adjournment of a pre-existing winding up application.

Readers are probably familiar with s 440A(2) case law and the competing factors relevant to a court's decision whether to adjourn a winding up application (allowing the voluntary administration to ensue and a DOCA be proposed) or proceed directly to make a winding up order. As Alice Carter stated in her 2018 article in the *Insolvency Law Bulletin*:[4]

> Rather than accepting the submissions of the administrator (an officer of the court) that an adjournment is, in their opinion, in creditors' best interests, the court appears to be going one step further to form its own opinion as to what it considers to be in creditors' best interests.

Courts have made it clear that to sustain an adjournment under s 440A(2) of the Act there must be more than a "mere speculative possibility" that it is in the interests of creditors for the administration to continue rather than the defendant be wound up.[5]

An interesting and open question is whether courts will take the view that s 440A(2) case law applies *mutatis mutandis* to s 453Q adjournment hearings. Do the specific and different objects and features of small business restructuring have any bearing on a court's decision to adjourn a winding up application or proceed directly to wind up the company?

The object of Part 5.3A has been referred to by courts when determining s 440A(2) adjournment applications. In *Deputy Commissioner of Taxation v Fyna Constructions (Hire & Sales) Pty Ltd (administrators appointed)*, Griffiths J stated:[6]

> [T]here are numerous cases relating to the operation of s 440A(2) and its predecessor provisions. They provide helpful guidance as well as some useful statements of general principle. Ultimately, however, each case necessarily turns on its own facts and evidence, with particular attention having to be paid to the express terms of the statutory provision when construed with appropriate regard to context and purpose (which includes the object set out in s 435A and related provisions which define the processes and duties of an administrator, such as ss 438A, 439A and 439C).

Section 435A of the Act provides:

> **435A Object of Part** [5.3A]
>
> The object of this Part, and Schedule 2 to the extent that it relates to this Part, is to provide for the business, property and affairs of an insolvent company to be administered in a way that:
>
> (a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or
> (b) if it is not possible for the company or its business to continue in existence—results in a better return for the company's creditors and members than would result from an immediate winding up of the company.

On the other hand, s 452A of the Act sets out the object of Part 5.3B in different terms which may be instructive in the context of a s 453Q adjournment application:

> **452A Object of this Part** [5.3B]
>
> The object of this Part, and Schedule 2 to the extent that it relates to this Part, is to provide for a restructuring process for eligible companies that allows the companies:
>
> (a) to retain control of the business, property and affairs while developing a plan to restructure with the assistance of a small business restructuring practitioner; and
> (b) to enter into a restructuring plan with creditors.

The language of Part 5.3B's objects clause appears to reflect a legislative intention that Part 5.3B afford eligible companies *the opportunity* to utilise the debtor-in-possession procedure in order to develop and propose a restructuring plan with creditors. This apparent emphasis on "process over outcome" (in comparison with the object of Part 5.3A) *may* put a different complexion on courts' deliberations under s 453Q whether to allow a small business restructuring to proceed in the face of an extant winding up application. Courts *may* be more prepared to let a small business restructuring process run its course.

Early judicial consideration of the "test" for a s 453Q adjournment

The very first two appointments of a RP under Part 5.3A necessitated successful applications to the Victorian Supreme Court for the adjournment of a pre-existing winding up application. In both cases, the Court granted an adjournment because it was satisfied that there was a "sufficient possibility" of a higher return to creditors if the restructuring process were to continue. Accordingly, in neither case was it necessary for the Court to explore the question of whether the assessment of creditors' best interests under s 453Q of Part 5.3B of the Act could yield a different result than the assessment required by s 440A(2) in Part 5.3A.

In *Re Dessco Pty Ltd*[7] the consideration of the "best interests of creditors" was a straightforward affair with the Court finding that:

- "[T]he 'best interests of the creditors' test under s 453Q is analogous to the test under s 440A(2) of the Act";
- "[T]he [s 440A] authorities establish that the best interests of the creditors relates to whether creditors could hope to get more by way of payment of their debts from administration than from liquidation … based on a sufficient possibility as distinct from mere optimistic speculation"; and
- The company had indicated that it intended to offer a dividend of 5 cents in the dollar to creditors while a winding up would not deliver any return, meaning that the Court was

> "satisfied that it is in the interests of the company's creditors for the company to continue under restructuring rather than being wound up."

In *Re DST Project Management and Construction Pty Ltd (ACN 623 076 031)*[8] the Court was more explicit in stating that any possible difference between the assessments required by ss 453Q and 440A did not need to be determined in the circumstances of the case:[9]

> The Company agrees that the s 440A(2) authorities provide guidance, save that it submits that having regard to the purpose and objectives of Part 5.3B as compared to Part 5.3A of the Act, the threshold test by which the Court is satisfied is a lesser standard of satisfaction under Part 5.3A. In particular … the Company drew attention that level of investigation required of the restructuring practitioner in respect of the Company's affairs is less than that required under Part 5.3A. There is some force to this argument, however, in the context of this application, where the proposed return to creditors under the restructuring far exceeds that available on a best-case scenario liquidation, the test pursuant to the authorities on s 440A(2) is met, and it is not necessary for me to determine whether any lesser standard ought to be applied.

We await with interest the further, inevitable judicial consideration of s 453Q of the Act.

Appointment of a RP: Are "ordinary-course" dealings retrospectively voided by a subsequent winding up order?

A more serious legislative oversight appears to threaten the very validity and certainty of "ordinary course" dispositions of company property made after the appointment of a RP.

In keeping with the "debtor-in-possession" nature of small business restructuring, the company (acting through its directors) can validly enter into transactions or dealings "in the ordinary course of the company's business": s 453L(2)(a) of the Act. If a transaction or dealing is *not* in the ordinary course of the company's business, then it can only be validly entered into with the consent of the RP or under a court order: s 453L(2)(b) and (c).

What is the status of such transactions and dealings if and when a winding up order is made subsequent to the appointment of a RP? As discussed above, a winding up order might occur at a s 453Q hearing because an adjournment of a winding up application is refused. Alternatively, a winding up order might occur shortly after the creditors reject a restructuring plan (noting however, that there is no automatic or "seamless" transition to a creditors' winding up if a restructuring ends because creditors reject the plan).[10]

If a winding up order is made at any time during a small business restructuring, the restructuring will terminate under Regulation 5.3B.02(g). The winding up will be taken to have commenced on the (earlier) date of the appointment of the RP: ss 453A, 513A(da) and 513CA of the Act.

Section 468(1) of the Act voids "*any disposition of property of the company … made after the commencement of the winding up by the Court*" except for a number of "*exempt dispositions*" provided in s 468(2). A transfer of an asset or payment of money will be a "disposition" of company property for the purposes of s 468 regardless of whether the company receives something in return (however, a *quid pro quo* transaction may well meet the criteria for a validation order by a court, discussed further below).

Section 468(2)(ac) of the Act now exempts dispositions "*made in good faith by or with the consent of"* the RP. However, s 468(2) makes no mention of "ordinary-course" dispositions contemplated by s 453L that never required the consent of the RP in the first place. These "ordinary-course" dispositions, the hallmark of the heralded "debtor-in-possession" model, appear to be

retrospectively voided under s 468(1) by the commencement of a court-ordered winding up. Unlike dispositions that are made by or under the general authority and power of a Part 5.3A administrator, "ordinary-course" dispositions during a Part 5.3B small business restructuring are not "saved" by s 468(2).

Are there any other provisions of Part 5.3B which might "save" ordinary-course dispositions from a subsequent winding up order? Section 453N provides that:

> A payment made, transaction entered into, or any other act or thing done, in good faith by:
>
> (a) the restructuring practitioner for a company under restructuring; or
> (b) a company under restructuring with the consent of the restructuring practitioner for the company; or
> (c) a company under restructuring in compliance with an order of the Court;
>
> is valid and effectual … and is not liable to be set aside in a winding up of the company.

Again however, this provision does not address "ordinary-course" transactions entered into by the company *without* the consent or involvement of the RP. Therefore, s 453N does not appear to address the potential effect of s 468 on such dispositions of company property. In any event, s 468 does not provide for *voidable* dispositions that may be "set aside" in a winding up; rather, the provision *voids* dispositions of company property that are not "exempt dispositions".

If the validity of ordinary-course dealings cannot be protected from the potential operation of s 468(1), a real risk is posed for parties dealing with a company that is in a Part 5.3B restructuring. Even suppliers providing the company (in restructuring) with goods and services on "cash on delivery" terms could be exposed: a payment of money by the company is a "disposition" of company property for the purposes of s 468.

One might also ask whether the potential retrospective effect of s 468 on "ordinary-course" dispositions of company property during a Part 5.3B restructuring is a relevant factor a court should consider under s 453Q when deciding whether to adjourn a winding up application or order that the company be wound up. This issue was not considered by the Court in the two Victorian cases discussed above.

Can a workaround or court relief solve the s 468 problem?

Could the s 468 problem be addressed by the RP effectively providing a "blanket" consent to all ordinary-course dealings? This would be the antithesis of a "debtor-in-possession" model and may raise liability and cost issues for the RP.

A court has the power under ss 468(1) and (3) to validate ordinary-course dispositions made during a Part 5.3B restructuring. Relief under s 468(3) probably needs to be sought before the winding up order is made, but there is authority for the proposition that a court has jurisdiction under s 468(1) of the Act to make a validation order *after* a winding up order is made.[11]

In *Re Tellsa Furniture Pty Ltd*,[12] a case dealing with the statutory predecessor of s 468, Justice Young of the NSW Supreme Court validated a payment of around $90,000 made by a company to its main supplier:

> [T]he applicant was a supplier of material which the company converted into furniture. The company converted all the material supplied into furniture and sold it to department stores, who then sold it to members of the public. The department stores paid the company, and the company used that money

> for its purposes, including paying creditors, amongst which was the applicant, and for keeping itself going.

In comparison, a bald payment of money to discharge a "pre-liquidation" debt is unlikely to be validated by a court under s 468 of the Act.[13]

Conclusion: s 468 redux?

The old case law on s 468 validation orders appears to have been revived by a legislative oversight contained in the amended definition of "exempt disposition" in s 468(2) of the Act.

It seems clear that "ordinary-course" dispositions of company property during a Part 5.3B restructuring have reasonable prospects of being "saved" by a validation order of a court. However, the interests of time, cost and certainty for stakeholders would have been better served if s 468(2) had been properly drafted to accommodate (rather than void) the inherent nature of "debtor-in-possession" trading that Part 5.3B introduces into Australian insolvency law.

Mark Wellard
Senior Lecturer
UTS Law

[1] Section 9 of the Act defines "restructuring practitioner": "(a) in relation to a company but not in relation to a restructuring plan: means a small business restructuring practitioner for the company appointed under Part 5.3B".
[2] All submissions made to Commonwealth Treasury on the exposure draft bill and subordinate legislation ("*Insolvency reforms to support small business*") are available at https://treasury.gov.au/consultation.
[3] Corporations Amendment (Corporate Insolvency Reforms) Bill 2020, *Explanatory Memorandum*, "Context for the reforms", p 9.
[4] A Carter "Section 440A of the Corporations Act: the changing landscape of 'creditors' best interests'" (2018) 19(8) *INSLB* 153.
[5] For example, *In the matter of Polar Agencies Pty Ltd* [2019] VSC 43 at [26] to [31]. See also *Creevey v DCT* (1996) 19 ACSR 456, *Waste Recycling and Processing Services of NSW v Local Government Recycling Co-operative* [1999] NSWSC 507 and *Weriton Finance Pty Ltd v PNR Pty Ltd (in admin)* (2012) 92 ACSR 88.
[6] *Deputy Commissioner of Taxation v Fyna Constructions (Hire & Sales) Pty Ltd (administrators appointed)* [2019] FCA 578 at [24]. See also *Waste Recycling and Processing Services of NSW v Local Government Recycling Co-operative* [1999] NSWSC 507 at [5] per Santow J.
[7] *Re Dessco Pty Ltd* [2021] VSC 94.
[8] *Re DST Project Management and Construction Pty Ltd (ACN 623 076 031)* [2021] VSC 108.
[9] *Re DST Project Management and Construction Pty Ltd (ACN 623 076 031)* [2021] VSC 108 at [30].
[10] *Corporations Regulations 2001* (Cth), reg 5.3B.02(b) provides that the restructuring of a company ends if the company's proposal to make a restructuring plan lapses. In turn, reg 5.3B.20 provides that a company's proposal to make a restructuring plan lapses if the restructuring plan is not accepted in accordance with subreg 5.3B.25(1). If a winding up order was made, say, one week after a restructuring ends in this manner, would that mean that the company was under restructuring "immediately before the order was made" for the

purposes of s 513A(da)? If not, then the commencement of the winding up will *not* revert to the s 513CA day (the day on which the restructuring of the company began by appointment of the RP under s 453B).

[11] *Adelaide Truss & Frame Pty Ltd (In Liq) v Bianco Hiring Services Pty Ltd* (1992) 60 SASR 160; *Guthrie (as Liquidator of Transconsult Australia Pty Ltd) v Chandler* (1991) 5 ACSR 387. Note the language of s 468(1) which voids dispositions (other than exempt dispositions) "unless the Court otherwise orders".

[12] *Re Tellsa Furniture Pty Ltd* (1985) 81 FLR 185.

[13] *Re Grays Inn Construction Co Ltd* [1980] 1 All ER 814 at 821 per Buckley LJ (cited by Young J in *Re Tellsa Furniture Pty Ltd* (1985) 81 FLR 185): "The court can in appropriate circumstances validate payment in full of an unsecured pre-liquidation debt which constitutes a necessary part of a transaction which as a whole is beneficial to the general body of unsecured creditors. But we have been referred to no case in which the court has validated payment in full of an unsecured pre-liquidation debt where there was no such special circumstance, and in my opinion it would not normally be right to do so, because such a payment would prefer the creditor whose debt is paid over the other creditors of equal degree."