

## **Australian Insolvency Regimes Rapidly Evolving**

Australia – February 2023

The new year has seen a rapid pace being set in terms of anticipated and actual legislative, regulatory and common law changes across Australia's restructuring and insolvency regimes. The federal government's inquiry into restructuring and bankruptcy laws is ongoing against a backdrop of sustained monetary policy interventions.

Those interventions are designed and intended to curb Australia's record levels of inflation, but they also have broader economic impacts. Although the Reserve Bank recognises the wider impacts are suboptimal, it contends that the midto long-term impacts of uncontrolled inflation would have far more detrimental impacts across the economy. Meanwhile, the federal government is being urged to alleviate some of the impacts of the Reserve Bank's interventions by focusing on cost of living (and business) pressures. The options being put in front of the treasurer range from the extreme, such as a national rental market freeze, to the judicially untested, such as the reversal of the Reserve Bank's cash rate decisions.

Despite some of the uncertainty, the broader economy remains defiantly resilient. In fact, with the re-engagement with key trading partners such as China, some sectors are already experiencing, or reasonably anticipating, greater transactional activity, including in Australia's rich resources sector, higher education and tourism. There is also anecdotal evidence that transactional activity at consumer level remains relatively unchanged, particularly in relation to discretionary spending. Even with those positives, the federal government remains (understandably) concerned – so much so that the attorney-general has flagged potential changes to not only the legislative regime that governs restructures and insolvencies, but also the regulatory framework that for many years has seen a unique split between personal and corporate insolvency.

## **The High Court**

This month the Australian High Court contributed to the ongoing debates by delivering judgment in two decisions that will impact how external administrators oversee the estates they are appointed to, and their dealings with third parties.

In the first decision, the High Court unanimously rejected the availability of a set-off defence against unfair preference claims brought by liquidators. Section 588FA of the Corporations Act (Act) defines an unfair preference as a transaction between a company and a creditor that results in the creditor receiving more from the company in respect of an unsecured debt it is owed than it would receive in a winding up. The creditor before the High Court claimed it could set-off the claim under Section 553C(1) of the Act, which provides an automatic set-off for mutual credits, mutual debts or other mutual dealings between an insolvent company and a creditor.

The High Court determined that the creditor's obligation to pay the liquidator only came into existence after the liquidation began. Further, it determined that the liquidator and the company had no claim against the creditor that could be set off immediately prior to liquidation. In overturning a series of long-standing decisions, including decisions of intermediate appellate courts, the High Court determined that the liquidator's claim against the creditor and the creditor's claim against the company were not mutual for the purposes of Section 553C(1).

In the second decision, the High Court examined the availability of, and reliance on, the peak indebtedness rule in insolvencies. The court determined that legislative context of Section 588FA(3) of the Act did not permit an inference to be drawn that Australia's legislature intended to incorporate the peak indebtedness rule into the Act. In rejecting the liquidator's arguments, the High Court relied on the ultimate effect doctrine, whereby it found that the insolvent estate's net indebtedness to the creditor had increased over the relevant period rather than decreased. As such, there could be no unfair preference claim available to the liquidator.



## The Outlook for Key Stakeholders

At the end of 2022, the markets were forecasting a cash rate that began with a 3. The latest economic developments and interventions have resulted in the general consensus shifting toward the Reserve Bank landing on a cash rate beginning with a 4. The ongoing uncertainty, despite various sectors experiencing good growth, likely means that Australia's at times two-speed economy will continue for some time. In that context, Australia's restructuring and insolvency regimes continue to undergo reviews and potentially imminent (significant) changes. The High Court's decisions this month are an integral part of the overall landscape. Depending on the viewpoint from which the decisions are assessed, the upside and downside risks vary. Abolition of any statutory right of set-off is welcome news for external administrators but problematic for creditors. In contrast, abolition of the peak indebtedness rule creates greater uncertainty and challenges for external administrators, whereas it is a welcome development from the perspective of commercial counterparties. In fact, organisations such as the Small Business Council would be relieved that its members, many of whom are often the target of claims in challenging trading contexts, now have one less (and particularly complex) issue to consider in their dealings with external administrators.

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