GREENWAY CHAMBERS

COMMERCE AND COVID-19: LOOKING UNDER THE FACEMASK OF SOME INSOLVENCY AND COMMERCIAL ISSUES

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INTRODUCTION

1. There were many things to learn in 2020:

   (a) an improperly fitted face mask can be a nightmare, even a traffic hazard, if you wear glasses;

   (b) tic-tok is not just a sign you make to get your kids to hurry up and get ready, even when after 10 minutes they've only got one shoe on;

   (c) to get out of your great-aunt's birthday there's no need to pretend to have gastro – just say you've got a sniffle, have had a COVID test, and have to self-isolate. It then becomes your civic duty to watch Netflix (and, apparently for Victorians, to get on the beers).

2. There were, additionally, a few laws passed (some of which have come and gone, and others which are just beginning), and judgments delivered. This paper takes a quick look at some of those.

3. This paper consists of 4 parts:

   (a) Part 1 examines amendments to statutory demands and bankruptcy notices.

   (b) Part 2 outlines a new "safe harbour" provision for insolvent trading.

   (c) Part 3 sets out new regimes for small business restructuring, and streamlined liquidations.

   (d) Part 4 examines a few cases.

PART 1: IT WAS GOOD WHILE IT LASTED: REFORMS TO STATUTORY DEMANDS AND BANKRUPTCY NOTICES

4. On 25 March 2020, the *Coronavirus Economic Response Package Omnibus Act 2020* (Cth) was enacted. Initially in force for six months, the changes were subsequently extended to 31 December 2020.

5. For statutory demands, there were two reasonably significant changes.

6. First, one could not issue a statutory demand unless the debt was $20,000 – instead of the previous $2,000.

7. Secondly, recipients of statutory demands had 6 months to respond – instead of 21 days.

8. So, the upshot was probably that a lot of statutory demands were put at the bottom of the in-tray. Of course, another upshot was that a lot of companies that might otherwise have had some serious difficulties would have been able to keep on trading, even if they might be what (hopefully affectionately) are known as "zombies". The forthcoming year might present difficulties for them as those statutory demands are now agitated, and perhaps some that were not served will be on their way in the mail.

9. Bankruptcy notices on individuals were also modified in similar ways.

10. The amount required was changed from $5,000 to $20,000. And the period was similarly extended from 21 days to 6 months for responding to a bankruptcy notice (and likewise, the period for protection on the presentation of a declaration of intention to present a debtor's petition was 6 months, not 21 days).

11. Since 1 January 2021, the $5,000 has permanently been doubled to $10,000 (by the *Bankruptcy Amendment (Bankruptcy Threshold) Regulation 2000* (Cth)).

12. As mentioned, the new laws went out with a bang at the same time as the fireworks on the Harbour Bridge. 2021 (and perhaps the next couple of years) might see some increased action in this space.

PART 2: SMOOTH SAILING IN THE SAFE HARBOUR

13. In addition to the changes to amounts and periods of statutory demands and bankruptcy notices, a new "temporary safe harbour" defence to insolvent trading was enacted, adjacent to the safe harbour defence of s 588GA (which concerns taking a course of action reasonably likely to lead to a better outcome for the company, inserted in September 2017).

14. Section 588GAAA(1) provides that s 588G(2) – concerning a director's duty to prevent insolvent trading – does not apply in relation to a debt incurred by a company if the debt is incurred on the satisfaction of three conditions:

    (a) First, the debt must be incurred in the ordinary course of the company's business;

    (b) Secondly, the debt must be incurred from 25 March 2020 to 31 December 2020; and

    (c) Thirdly, the debt must be incurred before any appointment during that period of an administrator or liquidator of the company.

15. Under s 588GAAA(2), the defendant has an evidential burden. One would think in most cases the main area of dispute would be whether the debt was incurred in the ordinary course of business, which the defendant would have to prove. That is, the date of the debt, and whether there was an appointment of a liquidator or administrator at the time it was occurred, would appear likely to be less contentious in most cases.

16. As at the date of writing, there appear to be no cases dealing with the section.

17. The concept of "ordinary course of business" is used in other parts of law, such as unfair preferences and partnerships, and it seems reasonable to assume that at least some of these concepts would ultimately be used in considering any defences under s 588GAAA:

    (a) The expression "in the ordinary course of business" refers to 'business" as a general concept and is not restricted to the conduct of any particular business, but is referring to the transaction of business as a known and recognised activity pursued by anybody engaged in an attempt to win or earn or 'make' money or a living in a systematic or regular way. The phrase 'in the ordinary course of business' is meant to refer to transactions regularly taking place in a sustained course of activity or some usual process naturally passing without examination (*Taylor v White* (1964) 110 CLR 129 per Dixon CJ at 136).

    (b) The ordinary course of business raises the question would an objective observer, knowing the actual business facts of how the particular payment came to be made, regard it as one in the ordinary course of business (*Harkness v Partnership Pacific Ltd* (1997) 41 NSWLR 204 at 274-275 per Priestley JA).

    (c) The normal procedures and practices of the parties' businesses and the trade in which they operate, as well as the dealings between them, are not irrelevant. Evidence of such matters is necessary so that the court may consider the payment in question in its factual context (*Harkness* at 218).

PART 3: NEW YEAR, NEW RESTRUCTURING AND INSOLVENCY LAWS FOR SMALL BUSINESSES

18. There have been two changes for distressed companies – restructuring for small businesses, and a streamlined liquidation process.

19. The new restructuring process is located in Part 5.3B.

20. It is directed at companies with liabilities of less than $1 million, and is only available if the directors and former directors have not been subject of restructuring or simplified liquidation within the past 7 years, and if the company itself has not been subject to restructuring or simplified liquidation within 7 years (s 453C and r 5.3B of the *Corporations Regulations*).

21. The regime contemplates the business developing a "restructuring plan" with the assistance of an insolvency practitioner (s 452A) (although he or she will not have control over the company – this being a point of distinction from forms of external administration).

22. Section 453E provides that the functions of the restructuring practitioner are:

    (a) to provide advice to the company on matters relating to restructuring;

    (b) to assist the company to prepare a restructuring plan;

    (c) to make a declaration to creditors in accordance with the regulations in relation to a restructuring plan proposed to the creditors.

23. The proposal of a restructuring plan is, itself, an act of insolvency (s 455A(2)).

24. During the restructuring, statutory moratoria are made available, such as an automatic stay of proceedings (s 453S), and suspension of enforcement processes (s 453T).

25. Under s 458A, the court has a discretionary power to "*make such order as it thinks appropriate as to how this Part is to operate in relation to a particular company*".

26. Voting on the restructuring plan takes place on the papers (r 5.3B.21), and the threshold for acceptance is a majority in value to the last day of the acceptance period (r 5.3B.25). Once made, the restructuring plan has the effect of a deed (r 5.3B.26-28).

27. On fulfilment of the plan, the company is released from admissible debts and claims (r 5.3B.31).

28. There is also a temporary safe harbour provision in s 588GAAC, which provides protection to directors in respect of companies who are "*eligible for temporary restructuring relief*" (see s 458E), which are seeking to take advantage of the new restructuring regime, and who have taken all reasonable steps to appoint a restructuring practitioner. If a debt is incurred in the ordinary course of the company's business, s 588G(2) does not apply. Again, the defendant bears the evidential burden.

29. To turn to the streamlined insolvency process, this is set out in ss 500A to 500AE and r 5.5.01 and following of the Regulations.

30. It is available for companies with certain characteristics, including liabilities not exceeding $1 million (r 5.5.03).

31. The main features are (s 500AE(2), (3) and r 5.5.05):

    (a) meetings of creditors are not held;

    (b) there is no committee of inspection;

    (c) there are reduced obligations on liquidators to investigate the company's affairs and make reports to creditors; and

    (d) there are some limitations on operation of voidable transaction provisions.

32. One can see how this might create more efficiencies in the winding up of smaller operations, with the aim of increasing any return to creditors – and, similarly, reducing the workload (and cost) of liquidators in such cases.

PART 4: COVID IN THE COURTS (NOT INFECTIONS, JUST CASES)

Overview

33. COVID is everywhere. Fortunately, so far as the courts have been concerned, it has been the subject of consideration, not causing consternation. One reason is the rapid adoption of video-conferencing and the willingness of courts and litigants to use emerging technology, perhaps resulting in 10 years of incremental change taking place in 10 months.

34. There have been a number of cases already delivered which have COVID as a centrepiece – although what has occurred to date is no doubt is an "amuse-bouche" of what will become a 12-course degustation menu (hopefully with matching wines) of COVID related cases that will emerge in the next few years. Here are a few that are worth a look.

Case 1: HDI Global Specialty SE v Wonkana (No 3) Pty Ltd [2020] NSWCA 296

35. This was a test case for a business interruption policy (involving two policy holders).

36. The Insurers contended that the claim under the policy was excluded from coverage.

37. The relevant exclusion clauses referred to the *Australian Quarantine Act 1908* and subsequent amendments.

38. However, that Act had been repealed prior to either policy, by the *Biosecurity Act 2015*.

39. The proceedings were removed by Hammerschlag J to the Court of Appeal. It was heard by a 5 judge bench, constituted by Bathurst CJ, Bell P, Meagher JA, Hammerschlag J, and Ball J.

40. The main issue in the case was whether the reference to the 1908 Act and subsequent amendments should be construed as extending or referring to the 2015 Biosecurity Act, or whether the references to the 1908 Act were an obvious mistake.

41. The Court of Appeal found against the Insurers. The essential reason was that the 1908 Act had been repealed, and the words "and subsequent amendments" meant "subsequent amendments", not a new act, replacing the 1908 Act (see Hammerschlag J at [119]-[121], with whom, on this issue, Bathurst CJ and Bell P agreed at [2], and Meager JA and Ball J saying that they "substantially agreed" at [7], but offering their own analysis).

42. As to the importance of any mistake in respect of using the repealed 1908 Act in the exclusion clause, Meagher JA and Ball J concluded that there was no mistake in the language of the clause as to the expression of the parties' intention, even if it were right that the parties made an incorrect assumption (as to the 1908 Act being in force) (at [61]-[65]). Hammerschlag J, in considering this issue, held that the wording was not a clear mistake, and if it was a clear mistake then it did not rise to the level of absurdity, saying that the Court "*does not substitute, by way of construction, its own commercial judgment for that of the parties*" (at [126]-[127]). Bathurst CJ and Bell P agreed with the other judges that orthodox principles of contractual construction were not so flexible as to admit of the insurers' second argument (at [5]).

43. The proceedings were dismissed. It appears from publicly available information that the Insurers have sought special leave to appeal to the High Court.

Case 2: *Rockment Pty Ltd t/a Vanilla Lounge v AAI Limited t/a Vero Insurance* [2020] FCAFC 228

44. The Full Court of the Federal Court (constituted by Besanko, Derrington and Colvin JJ) also considered an exclusion clause in respect of a business interruption policy.

45. The Full Court was called on to answer a separate question, as to whether an exclusion clause was engaged if (broadly) the loss arose from a human disease (ie, COVID), specified in a declaration of a human biosecurity emergency made under the *Biosecurity Act 2015*.

46. The Full Court said “no”.

47. However, the way in which the case was determined means it might have limited precedential value. The Full Court emphasised that the case was argued in a particular way on a particular basis (at [65]).

48. Ultimately, the Full Court decided that the separate question could not be answered in the terms sought by the Insurers (at [69]), saying “It is not sufficient to exclude cover under the Exclusion if the claim is somehow causally connected to a human disease specified in a declaration of a human biosecurity emergency.”

49. As is often the case, the Full Court went on to say: “That question of causation is a matter of fact to be answered in the circumstances of each particular case.”

50. Therefore, this case stands for the proposition that (for the particular exclusion clause in that policy), the mere presence of some causal connection to COVID, after having been specified in the relevant declaration, was insufficient – and that proving whether the claimed loss was within the exclusion would be done on a case by case basis.

Case 3: *In the matter of Ryals Hotel Pty Ltd* [2020] NSWSC 1906

51. The plaintiff applied to wind up the defendant in insolvency or on the basis it was just and equitable to do so. The plaintiff was a lessor of the Ryals Hotel. The defendant was the lessee. Part of the hotel was used for student accommodation. There was a shortfall in rent. As Black J succinctly said, the hotel “unsurprisingly has little student or other occupancy in the midst of a pandemic”.

52. Undeterred by the legislative changes referred to above, the lessor proceeded to seek to wind up the lessee. The Court found that the lessor failed to establish that the lessee was insolvent, and also rejected a winding up on the just and equitable ground.

53. Moreover, Black J concluded that the winding-up application was an abuse of process, given the lessor had not sought to renegotiate the lease as required by Regulations made under the *Conveyancing Act* 1919; and the presence of a substantial dispute concerning the underlying debt was inappropriate to determine in a proceeding of this nature.

54. Justice Black went on to say that, irrespective of those findings, he would have dismissed the application or adjourned it for 12 months under s 467, on the basis the legislature was seeking to narrow the basis on which companies could be wound-up, and the application was an attempt to side-step that outcome. In a subsequent judgment, an order for indemnity costs in a gross sum was made against the plaintiff.

CONCLUSION

55. It is unlikely that 2020 will be remembered for its temporary changes to insolvency regimes. It is also inevitable that we are just seeing the tip of the iceberg when it comes to the impact of COVID-19 in the Courts. No doubt 2021 and the following years will bring unanticipated fact scenarios, and throw up interesting and challenging issues concerning statutory and contractual interpretation and its impact on parties' rights and liabilities.

56. By then, hopefully, all the home improvement projects that went hand-in-hand with the pandemic will be finished.