Planning for the cliff

By Roger Mendelson*

There is much talk about 'the cliff'. What will happen when COVID subsidies cease and insolvency laws revert to pre-COVID rules.

The aim of this article is to review principles and tactics which credit managers can plan for and apply, to get to the other side. I.e. when some degree of normality returns.

This is a challenging time to be involved in credit, due to the fact that there is no rule book and the economy is still ultimately being held hostage to the pandemic and its course is impossible to predict.

An additional factor to deal with is the issue of reputation. Achieving great credit results and not causing damage to the creditor's reputation has always been a difficult balancing act. In the current climate, it has been much more difficult because it may take only one isolated incident to create a media storm.

Thus, it is essential to be ultra-cautious.

Major insolvency changes

Let's review the major insolvency changes, all of which have been extended to December 31. I feel that there is a significant chance that they may be extended beyond that date to March 31.

- The minimum Statutory Demand sum has been lifted from $2,000 to $20,000.
- The bankruptcy thresh-hold has increased from $5,000 to $20,000.
- The time for compliance with a Bankruptcy Notice or Statutory Demand has increased from 21 days to 6 months.
- Insolvency trading exposure of directors has been lifted.


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Companies

The result of the liquidation changes is that Creditors' Petitions have dropped dramatically and ATO and other government applications have completely stopped being issued.

This will in part cause the insolvency cliff, because companies which would normally be wound up aren't being wound up. In addition, there must be a large number of companies which are trading, are insolvent but are surviving on subsidies and rent relief.

This must cause alarm bells to ring. Granting credit to company customers is now much riskier. Even relying on references and accounts will be of much less use because they will be historic and not fully reflect the post -March situation.

A practical change in process is that personal guarantees should be required as part of standard requirement rather than as an added condition in weak credit cases. The reality is that there will be many older and once stable companies which are now potential basket cases.

A question is-should Statutory Demands be put on hold until January, in the expectation that the 6 month response period will replaced by 21 days?

The answer is that Demands should still be served. This puts the debtor company under pressure and increases the chance that useful negotiations will commence. Doing nothing is not an option.

If the 21 day period does come back in on January 2 and you issued a Statutory Demand in November, simply withdraw the Demand and issue a fresh one on January and get the benefit of the 21 days.

Should you sue?

The short answer is that there is no reason to wait. The courts in all jurisdictions are operating. In our experience, well over 90 % of legal actions for genuine debts result in default judgments. This solidifies the claim, an order for costs is obtained and interest starts to run on the judgment.

If a Defence is received, the COVID rules will slow down the steps toward hearing but at least the claim is progressing.

In many cases, service rules during the COVID period are easier than before.

Negotiation

A risk is that older debts become riskier in terms of collectability and statutory periods are also running by.

Putting debt recovery on hold during COVID will increase risk, increase bad debts and will lead to a backlog later.

However, if your debtor is open to genuine negotiation, never pass that opportunity up. Setting up instalment arrangements is always a better option than suing for a lump sum, providing that the arrangement represents a genuine attempt to pay the debt off.

It also provides the benefit that, with properly worded settlement deeds, there is no opportunity for a later Defence, interest and default costs can be built in, guarantees may be required where they did not apply before and the life of the debt is extended.

Enforcements

There is no reason why garnishee action should be put on hold, especially if the debtor has a secure job. For NSW in particular, where the process is cheap and quick, the risk of losing money by the debtor leaving or losing his job is outweighed by the high success rate on most garnishee claims.

In my view, warrants of seizure were ineffective before COVID and will be less effective now because so many businesses do not hold sufficient seizable assets.

Bankruptcy

As the standard path to bankruptcy is to obtain a judgment first, there is no rational reason to not at least do this. That is, get the judgment now. Don't wait. The question then becomes – do you wait until after December 30 to issue the Bankruptcy Notice or do it now?

If the debtor's assets are sufficient for him to want to avoid bankruptcy and the judgment exceeds $20,000, my advice is to issue the notice now.

This will raise the pressure on the debtor to negotiate.

The only risk in this is that if the COVID rules revert back on December 30, you may be stuck with the balance of a 6 month response period. You could reissue the notice but the likely cost in legal fees and disbursements will approximately be $2,200 and this won't be recoverable.

A challenge

At a time when credit risk has increased massively, there will be a need for businesses to provide credit in order to gain new business. Gutsy suppliers can use this as an advantage in winning customers over.

There is a strong case to aggressively provide credit, to gain new orders, as many competitors will do the opposite. However, it must be matched with credit decisions based on intuition and experience, rather than being a box-ticking exercise.

This will also be a time to tighten your business trading terms. For example, if your business provides building materials or services, include a clause in your trading terms providing for a right to lodge a caveat or mortgage over any property owned by the customer.

Use this quieter period to refine your credit tools and processes. Review your new customer form. Ensure that you collect meaningful and useful information from new customers before you advance credit or for existing customers, if they wish to lift credit limits.

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