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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TREASURY LAWS AMENDMENT (2017 ENTERPRISE INCENTIVES NO. 2)
BILL 2017

EXPLANATORY MEMORANDUM

(Circulated by authority of the Acting Minister for Revenue and Financial Services,
Senator the Hon Mathias Cormann)

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
ASIC	Australian Securities and Investments Commission
CTCA	<i>Mobile Equipment (Cape Town Convention) Act 2013</i>
PSNA	<i>Payment Systems and Netting Act 1998</i>
The Act	<i>Corporations Act 2001</i>

General outline and financial impact

Amendments

The Government is reforming Australia's insolvency laws. Our current insolvent trading laws put too much focus on stigmatising and penalising failure. As part of the National Innovation and Science Agenda (NISA) these reforms aim to promote a culture of entrepreneurship and innovation which will help drive business growth, local jobs and global success.

The threat of Australia's insolvent trading laws, combined with uncertainty over the precise moment a company becomes insolvent have long been criticised as driving directors to seek voluntary administration even in circumstances where the company may be viable in the longer term. Concerns over inadvertent breaches of insolvent trading laws are frequently cited as a reason that early stage (angel) investors and professional directors are reluctant to become involved in a start-up.

The amendments in Schedule 1, Part 1 of this Bill will create a safe harbour for company directors from personal liability for insolvent trading if the company is undertaking a restructure outside formal insolvency. This will drive cultural change amongst company directors by encouraging them to keep control of their company, engage early with possible insolvency and take reasonable risks to facilitate the company's recovery instead of simply placing the company prematurely into voluntary administration or liquidation.

An 'ipso facto' clause is a provision that allows one party to terminate or modify the operation of a contract upon the occurrence of some specific event, regardless of otherwise continued performance of the counterparty. The operation of these clauses can reduce the scope for a successful restructure or prevent the sale of the business as a going concern.

The amendments in Schedule 1, Part 2 of this Bill will make certain types of these contractual rights unenforceable while a company is restructuring under administration, a compromise or arrangement aimed at avoiding being wound up in insolvency or when a managing controller has been appointed over all or substantially all of the property of the company.

This reform is aimed at enabling businesses to continue to trade in order to recover from an insolvency event instead of these clauses preventing their successful rehabilitation.

Together, these amendments will reduce instances of a company proceeding to a formal insolvency process prematurely and where companies do enter into particular formal insolvency procedures, they will have a better chance of being turned around or of preserving value for creditors and shareholders.

This in turn will promote the preservation of enterprise value for companies, their employees and creditors, reduce the stigma of failure associated with insolvency and encourage a culture of entrepreneurship and innovation.

Date of effect: The amendments in Schedule 1, Part 1 of this Bill will take effect from the day after Royal Assent. The amendments in Schedule 1, Part 2 of this Bill will take effect from the later of 1 July 2018 or the day six months after Royal Assent. Part 2 may commence at an earlier date as proclaimed by the Governor-General.

Proposal announced: The amendments were announced on 7 December 2015. Public consultation on the proposals occurred between 29 April 2016 to 27 May 2016 as part of the National Innovation & Science Agenda ‘Improving bankruptcy and insolvency laws’ proposals paper. Consultation on the draft legislation occurred between 28 March 2017 and 24 April 2017.

Financial impact: These amendments do not have a direct and measurable financial impact.

Human rights implications: This Bill raises human rights issue. See *Statement of Compatibility with Human Rights* — Chapter 3.

Compliance cost impact: Nil.

Chapter 1

Safe harbour for insolvent trading

Outline of chapter

1.1 This Chapter sets out a safe harbour for company directors from personal liability for insolvent trading in Schedule 1, Part 1 of the Bill.

1.2 Unless otherwise stated, all references are to the *Corporations Act 2001*.

Context of amendments

1.3 Australia's insolvent trading laws currently impose a duty on company directors to prevent a company from trading while insolvent.

1.4 Under section 588G of the Act, a director of a company may be personally liable for debts incurred by the company if at the time the debt is incurred there are reasonable grounds to suspect that the company is insolvent.

1.5 Breaching the insolvent trading provisions may result in civil and criminal penalties against an insolvent company's directors.

1.6 This duty to prevent insolvent trading is framed as a default contravention and the current provisions focus on the timing of when debts are incurred by a company rather than the conduct of the directors in incurring that debt.

1.7 The current focus on the solvency of the company and the time at which debts are incurred leads to potentially undesirable outcomes:

- as the relevant threshold is not actual insolvency, but “reasonable grounds for suspecting” insolvency, directors may cease trading prior to the commencement of insolvency proceedings, limiting the ability of a company to trade through financial difficulty;
- directors (particularly of larger companies) may have disproportionate concern as to their own personal exposure during times of financial stress and may potentially move to formal insolvency prematurely or focus on their own liability

rather than other potential ways to remedy the situation or the potential long term viability of the company;

- angel investors or skilled business people are deterred from taking up directorships in higher-risk start-ups where their skills and experience could help the company grow and succeed because of the inherent risk of personal liability.

1.8 The focus on personal liability may also lead to an absence of focus by directors on their general director's duties and the early appointment of an administrator with a potentially unnecessary destruction of enterprise value which may occur even where there are clear opportunities to adjust the company's business and continue operating for the overall benefit of the company, its shareholders, employees and creditors.

1.9 Even where a company may actually be solvent or could be turned around, the appointment of an administrator has the potential to result in the company being liquidated because of the loss of confidence amongst its suppliers, credit providers, employees and the general public.

1.10 The current insolvent trading provisions can also result in the unnecessary liquidation of companies that could otherwise be successfully restructured and continue to operate. This is not in the interests of the company's directors, employees, creditors and the economy as a whole.

Summary of new law

1.11 The new law gives directors a safe harbour from the civil insolvent trading provisions of section 588G(2).

1.12 The Government is seeking to strike a better balance between the protection of creditors and encouraging honest, diligent and competent directors to innovate and take reasonable risks. To this end, the safe harbour focuses on the behaviour of directors in trying to turn their company around, rather than just the solvency of the company and the precise timing of debts being incurred as has previously been the case.

1.13 This change is intended to encourage those company directors to remain in control of a business in financial difficulty and take reasonable steps to restructure and/or allow it to trade out of its difficulties.

1.14 The protection of safe harbour does not extend beyond the civil liability set out in section 588G(2). During safe harbour, directors must continue to comply with all their other legal obligations such as their director's duties, including under Part 2D.1 of the Act.

1.15 Safe harbour does not affect any obligation of a company (or any of its officers) to comply with any continuous disclosure obligations under the law, including section 674 of the Act, or any continuous disclosure rules imposed by a market operator which apply.

1.16 The aim of the safe harbour reform is to facilitate more successful company restructures outside of a formal insolvency process where doing so would achieve a better outcome for the company than immediately appointing an administrator or liquidator. This encourages directors to closely monitor the financial position of the business, engage early with financial distress and then actively take steps to either restructure the business or, if that is not possible, to move quickly to formal insolvency.

1.17 Under the safe harbour, directors will only be liable for debts incurred while the company was insolvent where it can be shown that they were not developing or taking a course of action that at the time was reasonably likely to lead to a better outcome for the company than proceeding to immediate administration or liquidation.

1.18 Whether a course of action is reasonably likely to lead to a better outcome for the company will vary on a case-by-case basis depending on the individual company and its circumstances at the time the decision is made. It is acknowledged that directors must operate in a rapidly changing and uncertain environment, often without the benefit of complete information, and that directors may consider a range of options and discard them in the process of settling on a course of action.

1.19 However, hope is not a strategy. Directors who merely take a passive approach to the business's position or allow a company to continue trading as usual during severe financial difficulty, or whose recovery plans are fanciful, will fall outside the bounds of the safe harbour. Directors who fail to implement a course of action, or to appoint an administrator or liquidator within a reasonable time of identifying severe financial difficulty will also lose the benefit of safe harbour.

1.20 As it is intended as a protection for competent directors who are acting honestly and diligently, the safe harbour is open only to directors who have been ensuring that the company complies with its obligation to pay its employees (including their superannuation) and meet its tax reporting obligations.

1.21 While the change is intended to allow companies to be restructured outside of a formal insolvency process, some companies may not be able to recover and will still proceed to voluntary administration or liquidation despite the directors' best efforts. Provided that the director was developing or pursuing a course of action reasonably more likely to lead to a better

outcome for the company then they will still have the benefit of safe harbour in these circumstances.

1.22 However, safe harbour is only open to a director who complies with certain formal obligations during a subsequent formal insolvency should the company be unable to be turned around.

1.23 When a person fails to provide an administrator or liquidator with certain required information, the safe harbour will be deemed not to have existed.

1.24 Where, following a safe harbour period, an administrator or liquidator is appointed, a director who does not provide them with access to the company's books or secondary evidence following an appropriate request will be prevented from using those materials as evidence of having taken a course of action for the purposes of the safe harbour. An equivalent provision applies in relation to a company director who does not provide a liquidator or administrator with other information about the company following an appropriate request.

1.25 These restrictions on the use of the safe harbour are in place to ensure that where a company eventually enters administration or is wound up, directors do not withhold books or information about the company in an attempt to prevent a liquidator or administrator from investigating the company's activities and taking appropriate action. Such action may include pursuing recovery against the directors personally for the company's debts.

1.26 These restrictions also ensure that books and information that were not available at the time a liquidator or administrator is appointed are not later prepared in a way to make it retrospectively appear that a director would have fallen within the safe harbour.

1.27 An exemption applies so that these restrictions will not apply in relation to directors who can demonstrate they did not have the books or information and there were no reasonable steps that could have been taken to obtain the materials.

1.28 Safe harbour will also operate to limit the compensation payable by a holding company where the directors of the subsidiary had the benefit of safe harbour and where the holding company was taking reasonable steps to ensure the directors of the subsidiary had the benefit of safe harbour.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Safe harbour provision will protect directors from liability for debts incurred by an insolvent company if they develop and take a course of action that is reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator and the debt was incurred directly or indirectly in connection with the course of action.	No equivalent
Directors will be prevented from using books and information about a company as evidence that they took a course of action as part of the safe harbor if they have previously not provided these materials to a liquidator or administrator following an appropriate request for the materials.	No equivalent
Directors will not be able to rely on the safe harbour in circumstances where the company is not meeting its obligations in relation to reporting to the controller of the company, employee entitlements (including superannuation) and its taxation reporting obligations.	No equivalent
Safe harbour provision will protect a holding company from liability resulting from debts incurred by a subsidiary where the directors of the subsidiary have the benefit of safe harbour and where the holding company took reasonable steps to ensure the directors of the subsidiary had the benefit of safe harbour.	No equivalent

Detailed explanation of new law

Safe harbour for company directors

1.29 New section 588GA establishes a safe harbour for directors of an insolvent company to protect them against personal liability for contraventions of the insolvent trading provisions under subsection 588G(2) of the Act and is a complementary protection to the defences in s588H. *[Schedule 1, Part 1, item 2, subsection 588GA(1)]*

1.30 The safe harbour protection from the insolvent trading provisions in section 588G(2) is aimed at facilitating more successful company restructures outside of formal insolvency processes. It is also aimed at driving a cultural change amongst company directors who encounter uncertainty over a company's solvency.

1.31 Directors will be able to remain in control of the company and take proactive steps to restructure a company in a way that is likely to deliver a better outcome than proceeding to the immediate appointment of an administrator or liquidator without unnecessary focus on their personal liability for debts incurred while the restructure takes place.

1.32 The safe harbour will protect a director in relation to debts that a company incurs directly or indirectly in connection with developing and taking a course of action that is reasonably likely to lead to a better outcome for the company than proceeding immediately to voluntary administration or winding up.

1.33 This will promote entrepreneurialism and encourage business people with the right skills, expertise and experience to serve as company directors without being deterred by personal liability for the company's debts.

Example 1.1

Jean and Brent develop a successful app which quickly gains popularity. Deciding to expand their business, they form a company and appoint themselves as directors.

As the business begins to expand, they quickly realise that their skill in IT does not translate to their ability to run a business. Concerned about cash flow, they cast around for options.

Arseni is an experienced company director who specialises in helping start-ups through the transition to operating as an established business.

Instead of immediately appointing an administrator and losing control of the company, Jean and Brent approach Arseni for advice. He agrees

to become a director of the company, knowing that he will have the benefit of safe harbour and not be personally liable for the company's debts.

Arseni puts in place proper corporate governance procedures and uses his contacts to negotiate a line of credit to fund the company's expansion.

1.34 The safe harbour will not protect a director from actions brought for any other breach of the law, including a breach of their director's duties.

1.35 Companies whose immediate solvency is in question should not continue trading lightly, and companies whose longer-term solvency is doubtful should not do so without a well-considered plan in place. It is incumbent upon directors to exercise ongoing diligence throughout their appointment in order to avoid circumstances where reliance on safe harbour may be necessary.

Limits of safe harbour

1.36 The protection of safe harbour does not extend beyond the civil liability set out in section 588G(2). During safe harbour, directors must continue to comply with all their other legal obligations such as their director's duties, including under Part 2D.1 of the Act.

1.37 Safe harbour does not affect any obligation of a company (or any of its officers) to comply with its continuous disclosure obligations under the law, including section 674 of the Act, or any continuous disclosure rules imposed by a market operator which apply.

1.38 Safe harbour will also not prevent the appointment of an administrator, liquidator or receiver by a third party.

Period of safe harbour

1.39 The safe harbour will start to apply from the time the person, after beginning to suspect that the company may become insolvent, starts developing one or more courses of action, and one of those courses of action is reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator. This includes the deliberative and decision making period which informs the course of action and any period required to garner initial advice. [*Schedule 1, Part 1, item 2, paragraph 588GA(1)(a)*]

1.40 Section 588GA(1)(a) provides directors who are genuinely intending to attempt to turn the company around with the opportunity to consider their options.

1.41 Directors must then proceed to take the determined course of action within a reasonable period in order to remain in safe harbour. [*Schedule 1, Part 1, item 2, paragraph 588GA(1)(b)(i)*]

Example 1.2

Daniel is a member of the board of Quick Fix Pty Ltd. Daniel begins to suspect that Quick Fix may become insolvent and so starts considering options and presents a well-documented plan to the board.

The board resolves to implement a new cost reduction strategy and to seek a buyer for part of its business to try and resolve its financial problems and negotiates a grace period with its main secured creditor in order to do so.

Daniel will be protected by the safe harbour protections from the time he starts developing the options available to the company as this is an essential part of taking a course of action that is reasonably likely to result in a better outcome for Quick Fix.

1.42 The safe harbour applies to a director until the person or company stops taking the course of action, the course of action stops being reasonably likely to lead to a better outcome or the company goes into administration or liquidation. The safe harbour will also end when, after starting to develop a course of action, the person fails to take a course of action within a reasonable period after that time. [*Schedule 1, Part 1, item 2, paragraph 588GA(1)(b)*]

1.43 The “reasonable period” gives directors the opportunity to carefully consider the company’s business, its financial position and its circumstances, and to investigate and deliberate on their options. It may also involve seeking advice on a course of action or negotiating with key creditors.

1.44 In many cases, directors will have a variety of options which they could pursue, only some of which might turn out to be a course of action which is reasonably likely to lead to a better outcome. A director genuinely intent on developing such a course of action will require time to consider the options.

1.45 However, during the reasonable period directors must have their duties to the company at front of mind. The reasonable period is not an excuse to tarry, and directors should move as promptly and decisively towards implementing a suitable course of action (or entering the company into formal insolvency) as is responsible in the circumstances. “Developing” requires more than merely thinking about the problem, but rather denotes actively taking steps to move towards a definite action.

1.46 The duration of the reasonable period will vary on a case-by-case basis. For a small company with a small scale business, a reasonable period

may only be days, while for a large complex entity this deliberative period may extend for weeks or even months.

1.47 During the reasonable period, it will be incumbent on directors to consider whether a course of action reasonably likely to lead to a better outcome for the company is likely to become available. In circumstances where the availability of such a course is unlikely, the better outcome for the company may be the immediate appointment of an administrator or liquidator.

Example 1.3

Sue is the sole director of a company that owns and runs a restaurant.

Sue's accountant warns her that the company may soon become insolvent. Sue decides that, rather than immediately appointing an administrator or liquidator, she will investigate options for turning the business around. She jots down some ideas on how she might proceed and decides to seek the advice of a professional adviser with experience in the restaurant business.

A month later, Sue has still not sought professional advice or taken any other actions as she has been occupied with other matters. After missing two payments on her loan, her bank appoints a managing controller. At this point, the company has been trading while insolvent for the last two weeks.

Sue will be unable to rely on the safe harbour in any subsequent proceeding. She started developing a course of action but then failed to take any action within a reasonable period of time.

Scope of safe harbour as to debts

1.48 The safe harbour protection applies to debts "incurred directly or indirectly in connection with" developing and taking the course of action. This would include ordinary trade debts incurred in the usual course of business. It would also include, for example, debts taken on for the specific purpose of affecting a restructure as part of that course (for example paying a professional turnaround adviser to provide advice on the course of action).

1.49 Even in circumstances where a company's solvency is doubtful, incurring debts may be part of a course of action reasonably likely to lead to a better outcome, and it may remain in the interests of the company that some loss-making trade should be accepted in trying to secure that better outcome – for example incurring debts associated with the sale of assets which would help the business's overall financial position.

1.50 The safe harbour may apply where the end result of taking on additional debts as part of a course of action turns out, in the fullness of time,

to result in a worse outcome for the company than the immediate appointment of an administrator or a liquidator, so long as the course of action was reasonably likely to lead to a better outcome at the time the decision was taken. This recognises that there are many variables that could impact on a company's rehabilitation, some of which may not be possible to predict.

1.51 Safe harbour does not, however, apply to debts which were not incurred directly or indirectly in connection with the course of action or its development, such as debts incurred where they are not for a proper purpose.

The course of action must be reasonably likely to lead to a better outcome for the company

1.52 The phrase "reasonably likely" does not require a better than 50 per cent chance of a better outcome than the immediate appointment of an administrator or liquidator. "Reasonably likely" here requires that there is a chance of achieving a better outcome that is not fanciful or remote, but is "fair", "sufficient" or "worth noting".

1.53 "Better outcome", for the company, means an outcome that is better for the company than the immediate appointment of an administrator, or liquidator, to the company. [*Schedule 1, Part 1, item 2, subsection 588GA(7)*]

Discussion on what would be a better outcome for the company

1.54 Determining if a course of action is reasonably likely to lead to a better outcome will depend on the circumstances in each case. The safe harbour gives directors sufficient latitude to take a course of action that is appropriate in the context of the relevant company (for example its size, financial position, nature and complexity), which will be unique. For example a course of action that is appropriate for a company with limited existing debt may not be appropriate for another similar company that already has a very high level of debt.

1.55 Whether the course of action is reasonably likely to lead to a better outcome is assessed as at the time the decision is made, recognising that not all restructure attempts will ultimately be successful and that administration or liquidation may occur despite the attempt.

1.56 A director is not required to undertake an exhaustive examination of the consequences which might flow from the appointment of an administrator or liquidator. Directors are required to determine, in the circumstances, whether it is reasonably likely that a chosen course of action will lead to a better outcome for the company, when compared with the consequences which would follow from the immediate appointment of an administrator or liquidator in the ordinary course of events. It is neither

necessary, nor desirable, for directors to contemplate all of the vicissitudes which could follow from the appointment of an administrator or liquidator. Directors are not expected to predict the future in order to invoke the safe harbour.

1.57 The benefit of hindsight should not impose unrealistic expectations on the decisions of a director or the board or the actions of the company at the time.

Taking a course of action that is reasonably likely to lead to a better outcome

1.58 In response to changing circumstances during a course of action, adjustments may be necessary to ensure it is still reasonably likely to lead to a better outcome. This may require that a new course of action is implemented or that the company be placed into administration or wound up.

1.59 Pursuing a course of action will necessarily require ongoing assessment of whether the course of action remains reasonably likely to lead to a better outcome for the company. Practically, this would not require an assessment to be undertaken for every debt incurred during the safe harbour, particularly for debts incurred in the usual course of trade. It would, however, require ongoing diligence, and may entail careful consideration of specific significant decisions, such as major asset purchases or changes in the activity of the company's business, which could affect the reasonable likelihood of achieving a better outcome.

1.60 Although consideration of every debt incurred is not required, directors must closely monitor, and should document, the course of action, as carrying on a course of action beyond the point at which it is reasonably likely to lead to a better outcome risks losing the safe harbour protection for any debts incurred from that point in time.

Indicia of a course of action reasonably likely to lead to a better outcome

1.61 New subsection 588GA(2) provides an indicative and non-exhaustive list of factors to be considered in determining whether a course of action was reasonably likely to lead to a better outcome for the company at the time it was being taken.

1.62 Factors to which regard may be had are whether the person has or had:

- kept themselves informed about the company's financial position;
- taken steps to prevent misconduct by officers and employees of the company;

- taken appropriate steps to ensure the company maintained appropriate financial records;
- obtained appropriate advice from an appropriately qualified adviser; and
- been taking appropriate steps to develop or implement a plan to restructure the company to improve its financial position.
[Schedule 1, Part 1, item 2, subsection 588GA(2)]

1.63 These indicia are not prescriptive and it is not necessary for all of these factors to apply for directors to have the protection of safe harbour.

1.64 These indicia provide a useful signpost as to how a director may continue to meet their general duties to the company to act with care and diligence, in good faith and in what they consider to be the company's best interests while in safe harbour.

1.65 The factors in subsection 588GA(2) therefore provide only a guide as to the steps a director may consider or take depending on the circumstances, and also to the factors a Court may consider in any subsequent proceedings where the safe harbour is at issue.

Discussion on getting advice from appropriately qualified advisors

1.66 Under s588GA(2)(d), regard may be had to whether the director is obtaining advice from an appropriately qualified entity who was given sufficient information to give the advice.

1.67 Seeking appropriate advice from an appropriately qualified entity, and ensuring that the adviser is provided with sufficient information to advise on possible courses of action, will often be a key part of developing and taking a course of action which is reasonably likely to lead to a better outcome.

1.68 In selecting an adviser, directors, in keeping with their duties to the company, should be wary of advisers who target company directors whose businesses may be in financial difficulty and suggest that they take actions which could be illegal, such as transferring assets to another person or company without that person or company paying for them. Such advice, if followed, may bring the existence of safe harbour into question and could potentially expose directors to other actions.

1.69 "Appropriately qualified" in this context is used in the sense of "fit for purpose" and is not limited merely to the possession of particular qualifications. It is for the person who appoints the adviser to determine

whether the adviser is appropriate in the context, having regard to issues such as:

- the nature, size, complexity and financial position of the business to be restructured;
- the adviser's independence, professional qualifications, good standing and membership of appropriate professional bodies (or in the case of an advising entity, those of its people);
- the adviser's experience; and
- whether the adviser has adequate levels of professional indemnity insurance to cover the advice being given.

1.70 The particular qualifications needed by the adviser will vary on a case-by-case basis.

1.71 For example, a small business with a simple structure may need only to seek the advice of an accountant, lawyer or other technical adviser, perhaps with experience in insolvency.

1.72 A larger or more complex business, such as a construction business, may require the advice of a properly qualified, specialised insolvency or turnaround practitioner who is a member of a professional insolvency or turnaround association, or a specialist lawyer.

1.73 A large complex business might most appropriately retain an entire team of turnaround specialists, insolvency practitioners, and law and accounting firms to advise on an appropriate course of action.

1.74 Beyond smaller businesses or those with relatively simple structures, it would be expected that the context of safe harbour will often see directors obtaining advice on the company's solvency (financial position) and its restructuring or turnaround options as part of determining a course of action reasonably likely to lead to a better outcome. If this sort of advice is needed or obtained then, given the size of the business and the potential impact on, and vulnerability of, affected stakeholders, one would expect an advisor with the customary attributes of a true 'professional', such as:

- possession of minimum educational qualifications as a condition of eligibility to practise or give that advice (and who is subject to Continuing Professional Development obligations whether by law or by membership of a professional association);

- possession of appropriate levels of professional indemnity insurance to cover their advice; and
- being bound by an enforced code of conduct or similar professional standards (whether under the law or by membership of a professional body).

Example 1.4

Nik runs a popular whiskey bar. Although business appears to be booming, he discovers that his recorded stock levels are far higher than his actual stock and that his cash reserves are low. Concerned that the business may be or become insolvent, Nik seeks the advice of an accountant to check his books and records and an experienced logistics manager to evaluate his stock control procedures. They provide advice that implementing new inventory management procedures to improve stock controls will probably address the problem and most likely lead to a prompt return to profitability. Nik determines that doing so would be reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator and implements the new procedures. Nik would have the benefit of safe harbour from the time he began developing the course of action.

Example 1.5

Narelle, Michael, Jason and Zoe are on the board of XYZ Limited, a listed iron ore miner with several thousand employees, a complex business structure and hundreds of millions of dollars in assets.

Because the company maintains good books and records, the board are aware of XYZ's rapidly deteriorating financial position brought about by ill-advised asset purchases by the previous board and exacerbated by a drop in the iron ore price. They continue to monitor the financial position of the company, but due to a further decline in the iron ore price they hold concerns for the solvency of the company.

Because XYZ is a large and complex business, the board resolves to seek professional advice from a well-regarded turnaround firm who retains lawyers, accountants and registered insolvency practitioners with substantial experience in dealing with large and complex restructures, both inside and outside formal insolvency, to conduct a business review and help develop a course of action. XYZ notifies the market operator of the appointment in accordance with the market listing rules.

The adviser firm provides advice that the company can, with the advising firm's assistance, negotiate with its creditors and avoid administration for the time being, and that this will be reasonably likely to lead to a better outcome for the company than immediate administration or liquidation because this will avoid a "fire sale".

The board resolves to do so, but negotiations take longer than expected due to the uncertainty in the market.

Expecting prices to stabilise, and on advice from their advisers that the course of action being pursued is still reasonably likely to lead to a better outcome than immediately appointing an administrator, the company resolves to continue to trade.

The iron ore price continues to fall, and negotiations with the company's bank break down. On advice from the adviser that renegotiated credit is likely to be prohibitively expensive, the board reconsiders whether the current course of action is still reasonably likely to lead to a better outcome for the company, and determines that it is not. The board immediately appoints a voluntary administrator.

In the resulting deed of company arrangement, shareholders receive only fractional values but creditors are mostly paid out.

Although the administrator's investigation reveals that the company was technically insolvent some weeks before her appointment, Zoe, Michael, Narelle and Jason are not personally liable for the company's debts because at all times they were complying with their director's duties and developing or taking a course of action which was reasonably likely to lead to a better outcome for the company.

Evidential burden and legal burden

1.75 Section 588GA(1) provides that section 588G(2) does not apply in relation to a person and a debt when certain circumstances are met, and that the debt was incurred directly or indirectly in connection with a course of action reasonably likely to lead to a better outcome than the immediate appointment of an administrator or liquidator. In circumstances where a proceeding is brought under section 588G(2) a person relying on the exclusion in section 588GA(1) bears an evidentiary burden in relation to that matter. For that person, the evidential burden in relation to a matter means the burden of adducing or pointing to evidence that suggests a reasonable possibility that the matter exists or does not exist. [*Schedule 1, Part 1, item 2, subsections 588GA(3) and (7)*]

1.76 This is appropriate because there will often be information which is peculiarly within the director's knowledge regarding the steps taken as part of the restructuring process which is not accessible to a liquidator (or other party) bringing later proceedings. A mere statement that a course of action was being developed or taken and that it would be reasonably likely to lead to a better outcome than immediately appointing a receiver or liquidator would not be sufficient. Directors should adequately document their turnaround plans, particularly during any determinative period to assist them in meeting the evidential burden.

1.77 However, it is the party bringing a proceeding for the purposes of section 588G(2) who will bear the legal burden to show to the balance of probabilities that the course of action being taken was one not reasonably likely to lead to a better outcome for the company.

Safeguards on the application of safe harbour

1.78 The safe harbour is intended to be available to directors acting competently and in accordance with their general director's duties to pursue a course of action reasonably more likely to lead to a better outcome. The new provisions contain appropriate safeguards to ensure that the safe harbour is only available to such directors.

1.79 To this end, there are certain factors which if present in a given case would make the safe harbour unavailable. The first is where a company has not attended or is not attending to its obligations to properly pay its employees (including superannuation). The second is where a company has not complied or is not complying with its taxation reporting obligations. In both these cases, a director will not be eligible for the safe harbour protection if the company is either serially failing to meet its obligations, or there has been a serious failure by the company to substantially meet its obligations to pay employee entitlements or meet tax reporting obligations. [*Schedule 1, Part 1, item 2, subsection 588GA(4)*]

Example 1.6

Rebecca is the sole director of a company that owns and runs a book store with three employees. Rebecca's accountant advises her that the company may soon become insolvent. The next day, Rebecca starts developing a plan to restructure the company to improve its financial position with the help of her accountant and a professional turnaround adviser.

The plan requires the company to incur debts while insolvent but it is reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator.

To help the company get through this difficult period, Rebecca decides to temporarily stop paying her employees the Superannuation Guarantee Contribution. She intends to pay them back when the company is on more sound financial footing.

Rebecca will be unable to rely on the safe harbour as the company failed to pay the entitlements of its employees as they fell due.

1.80 In cases where a company has met and continues to meet its employee entitlement obligations and its taxation reporting obligations, its directors fall within the safe harbour unless the company ceases to be compliant. If a company does cease to be compliant then the safe harbour

will not apply in relation to any debts incurred during the period the company is not compliant.

1.81 This requirement promotes early engagement with potential insolvency and reduces the risk of companies not meeting these obligations as they start to experience financial hardship and ensures that during any course of action to restructure or recover the company employee entitlements are properly paid and that the company meets its taxation reporting obligations.

1.82 Safe harbour will be taken not to have been available if the person fails to substantially comply with their obligations to assist an administrator, liquidator or controller in a formal insolvency under paragraph 429(2)(b) and subsections 475(1), 497(4) or 530A(1). [*Schedule 1, Part 1, item 2, subsection 588GA(5)*]

1.83 A person will be able to apply to a Court for relief from the effects of sections 588GA(4) and (5) in exceptional circumstances or in the interests of justice. [*Schedule 1, Part 1, item 2, subsection 588GA(6)*]

Subsequent formal insolvencies

1.84 It is acknowledged that restructuring attempts will not always be successful and that a company may still proceed into administration or liquidation. Where this happens, it is important to ensure that administrators are given sufficient information to assess the actions taken by the directors and the company leading up to the appointment.

1.85 New subsections 588GB(1) and (2) set out rules to prevent a director from relying on books or information as evidence of the safe harbour in a relevant proceeding where these materials have not been provided to a liquidator, administrator or controller as required.

1.86 The effect of the restrictions in the new section 588GB is that a director will not be able to deny a liquidator, administrator or controller access to a company's books or information about a company and later use these books or the information to evidence safe harbour.

1.87 These restrictions will limit potential dishonest activity where books and information are fabricated to make use of the safe harbour.

1.88 These new restrictions will not, however, apply to directors who prove that they did not possess the relevant books or information and there were no reasonable steps that could have been taken to obtain the materials. This will protect directors who genuinely do not have access to the material at the time it is sought. [*Schedule 1, Part 1, item 2, paragraph 588GB(3)(a)*]

1.89 The restrictions will not apply to directors who were not notified that a failure to provide the books or information will prevent them from being later used by the directors as evidence in relation to the safe harbour. *[Schedule 1, Part 1, item 2, paragraph 588GB(3)(b) and subsection 588GB(5)]*

1.90 A failure to notify a director about the consequences of not providing books or information about a company will not otherwise impact the validity of any notice, order or warrant that is issued. *[Schedule 1, Part 1, item 2, subsection 588GB(6)]*

1.91 Courts will have a power to determine that the safe harbour will be available to a director even where books or information were not provided as required under new section 588GB. This is to ensure that a director would not be taken out of safe harbour where appropriate in the interests of justice. *[Schedule 1, Part 1, item 2, paragraph 588GB(3)(c) and subsection 588GB(4)]*

Safe harbour for holding companies

1.92 New section 588WA provides for a safe harbour for holding companies. The safe harbour for holding companies provides that a holding company will not be liable under section 588V to compensate creditors of its subsidiary for losses that arise as a result of debts incurred by the subsidiary when the directors of the subsidiary have the benefit of safe harbour and the holding company has taken reasonable steps to ensure that the directors of the subsidiary have the benefit of safe harbour. *[Schedule 1, Part 1, item 4, subsection 588WA(1)]*

1.93 The evidential burden on the holding company to access the safe harbour operates in the same way as the evidential burden for directors accessing the safe harbour under section 588GA. The holding company therefore bears the burden of adducing or pointing to evidence that suggests a reasonable possibility that the matter exists or does not exist. *[Schedule 1, Part 1, item 4, subsections 588WA(2) and (3)]*

Consequential amendments

1.94 A new provision is included in section 588E to provide that where evidence has been adduced that suggests that the director or holding company falls within the safe harbour provisions under section 588GA(1) or 588WA(1), it is presumed that the evidence has been adduced in relation to other proceedings relating to the same matter. *[Schedule 1, Part 1, item 1]*

1.95 The headings of section 588H and 588X are updated to differentiate those existing provisions from the new safe harbour provisions. *[Schedule 1, Part 1, items 3 and 5]*

Application and transitional provisions

1.96 These amendments apply to actions taken before, at or after the commencement of this Part of the Bill, and debts incurred at or after commencement of this Part of the Bill. *[Schedule 1, Part 1, item 6]*

Chapter 2

Stay on enforcing rights merely because of arrangements or restructures

Outline of chapter

2.1 This Chapter sets out new provisions to stay the enforcement of ipso facto clauses that are triggered when a company enters administration, where a managing controller has been appointed over all or substantially all of the company's property, or where the company is undertaking a compromise or arrangement for the purpose of avoiding being wound up in insolvency (each a *formal restructure*) in Schedule 1, Part 2 of the Bill.

2.2 Unless otherwise stated, all references are to the *Corporations Act 2001*.

Context of amendments

2.3 An ipso facto clause creates a contractual right that allows one party to terminate or modify the operation of a contract upon the occurrence of some specific event. In the current insolvency context, such rights may allow one party to terminate or modify the contract solely due to the financial position of the company (including insolvency) or due to the commencement of formal insolvency proceedings, such as on the appointment of an administrator. This type of termination can occur regardless of the counterparty's continued performance of its obligations under the contract.

2.4 The operation of ipso facto provisions can thus reduce the scope for a successful restructure, destroy the enterprise value of a business entering formal administration or prevent the sale of the business as a going concern.

2.5 These outcomes can also reduce or eliminate returns in liquidation because they disrupt the businesses' contractual arrangements and destroy goodwill, potentially prejudicing other creditors and defeating the purpose of a voluntary administration.

2.6 Entrepreneurs and private equity firms often invest in struggling companies with a view to making them profitable. The ability of a business' suppliers, customers or other creditors to terminate a contract solely due to the financial position of the company or the commencement of a formal restructure increases uncertainty for the potential investor and makes the

business a less attractive investment opportunity. As a result, the operation of ipso facto clauses may deter such investment, or reduce the price a potential investor is willing to pay for a business.

2.7 For example, if a company with a strong asset base has a short term lack of liquidity which leads the directors to appoint a voluntary administrator, an ipso facto clause might still allow a major supplier to cancel their contract. This may in turn deprive the business of the chance to continue to trade while they restructure even though there has not otherwise been a breach of the contract, with a negative impact on the business, its employees and other creditors.

2.8 The lack of protection from the operation of ipso facto clauses has been a key criticism of Australia's insolvency regime in general, particularly in the context of the voluntary administration regime contained in Part 5.3A of the Act and compromises and arrangements under Part 5.1 of the Act. Making ipso facto clauses unenforceable during a company restructure promotes the objectives of the existing voluntary administration regime in the Act by assisting viable but financially distressed companies to continue to operate while they restructure their business.

2.9 Subject to exceptions, under this amendment contractual rights will be unable to be enforced against a company which is undertaking a formal restructure when the rights are triggered by the company's financial position or its entry into a formal restructure. That stay will continue indefinitely in circumstances where the event on which the right depended occurred before or during the formal restructure.

2.10 The aim is to allow breathing space for a company to continue to trade during a formal restructure. This may also improve the position for directors of companies facing severe financial hardship when entering into early negotiation with their creditors about pursuing a restructure (including under the safe harbour provisions) as they will know that future entry into formal insolvency will not necessarily trigger an ipso facto clause. This will assist in protecting asset values for the benefit of the company, its employees and its creditors which in turn will assist to promote a culture of entrepreneurship and reduce the stigma of failure.

2.11 Notwithstanding the operation of the stay, a counterparty maintains the right to terminate or amend an agreement with the debtor company for any other reason, such as a breach involving non-payment or non-performance.

2.12 To afford protection to creditors, where the operation of an ipso facto clause is stayed, the ability of the company to enforce a right under a contract for a new advance of money or credit is also stayed.

Summary of new law

2.13 Part 2 of Schedule 1 of the Bill enshrines the primacy of the *Payment Systems and Netting Act 1998* (PSNA) and the International Interests in *Mobile Equipment (Cape Town Convention) Act 2013* (CTCA).

2.14 Parliament has expressed the intention that the PSNA and CTCA prevail over other Acts. Accordingly, where there is an inconsistency between the operation of these provisions and the PSNA or the CTCA, those Acts prevail to the extent of the inconsistency.

2.15 The definition of specified provisions set out in section 5 of the PSNA has been expanded to include the provisions in this Bill where applicable. This ensures that the provisions in the PSNA have effect despite the stay provisions in this Bill.

2.16 The amendments in Part 2 of Schedule 1 of the Bill provide that certain rights that amend or terminate an agreement are not enforceable when a company is undertaking a formal restructure except in certain limited circumstances.

2.17 The stay applies regardless of whether the right is self-executing or triggered by one of the parties to an agreement.

2.18 This stay on the enforcement of rights does not apply in relation to rights:

- in a type of contract specified in regulations or declared by the Minister;
- of a kind or declared by the Minister; or
- in agreements made after the commencement of the formal restructure.

2.19 The Court will have discretion to allow a right to be enforced if doing so would be appropriate in the interests of justice, and to restrict the enforcement of other rights in an agreement if it appears likely that those rights will be exercised merely because of an insolvency event.

2.20 Rights may continue to be enforced with the consent of the relevant administrator, scheme administrator or managing controller.

2.21 Rights may be unenforceable indefinitely after the formal insolvency where they relate only to the body's entry into formal insolvency or its financial position before or during formal insolvency. This avoids the perverse outcome where a counterparty can enforce a pre-existing right after a

formal insolvency when they did not do so beforehand. The regulations may also prescribe rights to which this indefinite stay may apply.

2.22 Under section 436C of the Act, a person who is entitled to enforce a security interest in the whole, or substantially the whole, of a company's property may by writing appoint an administrator of the company if the security interest has become, and still is, enforceable. This recognises that the ability to appoint an administrator to the company may be a less drastic remedy than the secured creditor enforcing its rights.

2.23 Extending the stay on rights which have the function of an ipso facto clause to circumstances where a managing controller is appointed over all or substantially all of the company's property avoids the circumstance where a secured creditor would appoint both a managing controller (who would not otherwise have the benefit of the stay) and also appoint an administrator in parallel. This would lead to an increased burden on the assets of the company to cover two parallel insolvencies, further eroding any funds remaining to pay out creditors, employees or shareholders.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Stay on the enforcement of express rights that amend or terminate a contract because of the appointment of an administrator, presence of a managing controller over all or the substantial portion of a corporation's property or because an entity is subject to a compromise or arrangement	No equivalent
Courts will have a discretion to allow or prevent the enforcement of rights that are triggered because of the appointment of an administrator, presence of a managing controller over all or the substantial portion of a corporation's property or because an entity is subject to a compromise or arrangement	No equivalent

Detailed explanation of new law

2.24 The amendments in Part 2 of Schedule 1 of the Bill provide for a stay against the enforcement of rights that amend or terminate an agreement because of a formal restructure or the company's financial position before or during a formal restructure once a formal restructure is taking place. The amendments apply in relation to entities entering into a Part 5.1 compromise or arrangement (where that scheme is for the purpose of avoiding insolvent liquidation), companies that are placed into administration under Part 5.3A of the Act, or where a managing controller is appointed over all or substantially all of the property of the company.

Rights not the subject of the stay

2.25 The stay does not apply in circumstances where it would be contrary to the PSNA and CTCA. This ensures that Parliament's stated intention to provide primacy to the provisions in those Acts is maintained. To the extent that the stay is contrary to the provisions in those Acts, the provisions in those Acts will prevail. [*Schedule 1, Part 2, item 7, section 415G; item 8 section 434M and item 14 section 451H*]

2.26 The stay on the enforcement of rights does not apply in relation to rights:

- in a type of contract specified in regulations or declared by the Minister;
- of a kind declared by the Minister;
- in agreements made after the commencement of the formal restructure; or
- with and to the extent consented to by the relevant administrator, managing controller or the person appointed to manage the scheme.

2.27 Subject to certain anti-avoidance mechanisms, the provisions do not prohibit the exercise of a right for any other reason. For example, a counterparty may still terminate or exercise another right under the contract, agreement or arrangement, because the entity has failed to perform an obligation, including a payment obligation.

Stay on the enforcement of rights because a company is under administration

2.28 Subsection 451E(1) provides that an express right in a contract, agreement or arrangement is not enforceable against a company only because of:

- the company entering into administration;
- while a company is under administration, a reason prescribed in the regulations; or
- the company's financial position while under administration.

[Schedule 1, Part 2, item 14, subsection 451E(1)]

2.29 The effect of the stay is that companies that are in external administration are not prevented from trading because of the operation of a relevant ipso facto clause if the company continues to meet its other contractual obligations.

2.30 The stay against the enforcement of these rights is intended to assist viable but financially distressed companies to continue to operate while they restructure their business. The stay will assist in protecting asset values for the benefit of the company, its employees and its creditors.

2.31 The stay applies in relation to express rights that are triggered either because of a company being in external administration or owing to a company's financial position while it is in administration. It will not, however, prevent a right from being enforced where the company has failed to meet its payment or other obligations under the agreement.

2.32 The broad regulation making power to prescribe reasons to which the stay will apply has been included as an anti-avoidance mechanism to ensure the Government can respond to possible contracts or agreements that are drafted or prepared in a way to circumvent the provisions in section 451E(1). It is appropriate and necessary for this power to be in regulations so that the Government has the flexibility to respond quickly to ensure that the stay effectively applies to such contracts and agreements before they become widespread and negate these reforms. The regulations will be subject to normal disallowance provisions and would therefore still be subject to effective Parliamentary scrutiny.

2.33 Regulations may also set out exceptions where the ipso facto stay is not intended to operate. For example, in certain derivatives contracts, staying the operation of the right would render the contract a nonsense.

2.34 The stay does not apply with and to the extent consented to in writing by the administrator. *[Schedule 1, Part 2, item 14, subsection 451E(7)]*

Period of the stay

2.35 The express rights covered by the stay will not be enforceable against a company from the time the company enters into external administration until the administration ends unless:

- the administration ends because the company is being wound up, in which case the rights will not be enforceable until the time when the affairs of the company are fully wound up; or
- where the company makes an application to the Court to extend the period for which the rights will not be enforceable:
 - either the application is withdrawn or the Court rejects the application; or
 - the order of the Court extending the period ceases to apply.

[Schedule 1, Part 2, item 14, subsection 451E(2) and (3)]

2.36 The Court may extend the period for which an applicable express right is not enforceable against a company if the Court is satisfied that doing so is in the interests of justice. An interim order may be made while the application is being considered but cannot require an undertaking relating to damages as a condition. *[Schedule 1, Part 2, item 14, subsection 451E(3)]*

2.37 A right that is not enforceable because of subsection 451E(1), will not be enforceable after the end of the stay period to the extent that the reason for seeking to enforce the right relates to:

- the company having come under or been under external administration;
- its financial position as at a time before the end of the stay period; or
- a reason prescribed in the regulations relating to circumstances in existence before the end of the stay period;

[Schedule 1, Part 2, item 14, subsection 451E(4)]

2.38 This is included to prevent the perverse outcome of a clause in an agreement that is stayed during an external administration being used against

a company once its administration has ended on the basis that it was under administration.

2.39 This regulation making power is included to support the anti-avoidance regulation making power under section 451E(1). The anti-avoidance regulation making power in section 451E(1) ensures that the stay can be extended to apply to clauses in agreements drafted in a way to circumvent the intended application of the stay.

2.40 The stay on the enforcement of rights under subsection 451E(1) does not apply:

- if the rights relate to a contract, agreement or arrangement entered into after the day the company goes into administration;
- to rights that are of part of a type of contract, agreement or arrangement that are specified in the regulations or a kind declared by the Minister;
- to a right of a kind declared by the Minister; or
- if and to the extent that the administrator has consented in writing to the enforcement of the right

[Schedule 1, Part 2, item 14, subsections 451E(5), (6) and (7)]

2.41 There are some cases where it would not be appropriate for a stay against the enforcement of rights to be enforceable because of the nature of the agreement or the parties to the agreement. For example, some kinds of derivative arrangements would not be possible if the stay was extended to apply to them. It is therefore necessary for these types of agreements or rights to be excluded from the application of the stay.

2.42 It is appropriate to do this in the regulations so that the list can be updated regularly in response to the development of new and innovative financial products. As more new and complex financial products become available adjustments and changes will have to be made in a timely way. The regulations may also prescribe the types of contracts in which rights may still be enforced even if they are contrary to the stay in section 451E(1).

2.43 In addition, the Minister's power to allow certain rights to still be enforceable through a ministerial determination is required to ensure that if there are circumstances in which the application of the stay would result in unintended consequences, the problem could be remedied very quickly.

2.44 While rights against a company are not enforceable because of subsection 451E(1), any rights the company has against the other party for the provision of new advances of money or credit are also not enforceable. *[Schedule 1, Part 2, item 14, subsection 451E(8)]*

2.45 On application by the holder of a right that is unenforceable because of the stay, the Court has a general discretion to order that the right can in fact be enforced in the interests of justice. *[Schedule 1, Part 2, item 14, section 451F]*

2.46 New subsection 451G(1) provides the Court with the discretion to make an order that a right in a contract is not enforceable against a company without the leave of the Court and subject to the terms imposed by the Court. *[Schedule 1, Part 2, item 14, subsection 451G(1)]*

2.47 A Court is able to do this on application by a company's administrator where the court is satisfied that the rights are exercised, are likely to be exercised, or there is a threat that they will be exercised merely because the company is in administration. *[Schedule 1, Part 2, item 14, subsection 451G(2)]*

2.48 However, a Court cannot make such an order in relation to rights under subsection 451E(5) and 451E(7). *[Schedule 1, Part 2, item 14, subsection 451G(4)]*

2.49 Where a Court does make an order, the order must specify the period for which the rights will not be enforceable. *[Schedule 1, Part 2, item 14, subsection 451G(3)]*

2.50 A Court is able to make an interim order before deciding to make an order that a right is not enforceable against a company but must not make the order subject to an undertaking as to damages. *[Schedule 1, Part 2, item 14, subsections 451G(5) and (6)]*

Preserving the rights of secured creditors

2.51 Section 441A is amended to ensure that stays on enforcement of rights under section 451E and 451G(1) do not affect the rights of a secured creditor to enforce their interests. *[Schedule 1, Part 2, items 9 and 10, subsection 441A(3)]*

2.52 Similarly, section 441B is amended to ensure that a stay under section 451E or an order under section 451G(1) does not affect the rights of a secured creditor, receiver or other party from enforcing a security interest. *[Schedule 1, Part 2, item 11, subsection 441B(2)]*

2.53 Section 441C is also amended to ensure that a stay under section 451E or in an order under subsection 451G(1) does not affect the rights of a secured party or receiver or controller appointed for the purposes of Part 5.2 from enforcing a security interest in perishable property. [*Schedule 1, Part 2, item 12, subsection 441C(2)*]

2.54 Lastly, section 441E is amended to ensure that a stay under section 451E or in an order under subsection 451G(1) does not prevent a person from giving a notice under an agreement under which a security interest is created or arises. [*Schedule 1, Part 2, item 13, subsection 441E*]

Stay on enforcement of rights triggered as a result of the appointment of a managing controller

2.55 Subsection 434J(1) provides that an express right in a contract, agreement or arrangement is not enforceable against a corporation only because:

- there is a managing controller over the whole or substantially the whole of corporation's property;
- the corporation's financial position if there is a managing controller over the whole or substantially the whole of the corporation's property; or
- a reason prescribed in the regulations in cases where there is a managing controller appointed over the whole or substantially the whole of the corporation's property.

[*Schedule 1, Part 2, item 8, subsection 434J(1)*]

2.56 The stay against the enforcement of these rights is intended to allow affected corporations to effectively restructure. The stay applies in relation to express rights that are triggered either because the corporation has a managing controller appointed over all or substantially all of its property, or owing to its financial position. The stay does not, however, prevent a right from being enforced where the corporation has failed to meet its payment or other obligations under the agreement.

2.57 The broad regulation making power to prescribe reasons to which the stay will apply has been included as an anti-avoidance mechanism to ensure the Government can respond to possible contracts or agreements that are drafted or prepared in a way to circumvent the provisions in section 434J(1). It is appropriate and necessary for this power to be in regulations so that the Government has the flexibility to respond quickly to ensure that the stay effectively applies to such contracts and agreements before they become widespread and negate these reforms. The regulations will be subject to

normal disallowance provisions and would therefore still be subject to effective Parliamentary scrutiny.

Period of the stay

2.58 Rights that are subject to the stay in section 434J(1) will not be enforceable against a company from the time a managing controller is appointed until the managing controller's control of the corporation ends unless a Court order is made to extend the period of the stay. *[Schedule 1, Part 2, item 8, subsections 434J(2)].*

2.59 A Court may extend the period for which a right is not enforceable against a company if the court is satisfied that doing is in the interests of justice. An interim order may be made while the application is being considered but cannot require an undertaking relating to damages as a condition. *[Schedule 1, Part 2, item 8, subsection 434J(3)]*

2.60 A right that is not enforceable because of subsection 434J(1), will not be enforceable indefinitely after the end of the stay period to the extent that the reason for seeking to enforce the right relates to:

- the corporation's financial position before or during the stay period;
- the appointment of a managing controller of the whole or substantial portion of the corporation's property; or
- a reason prescribed in the regulations relating to circumstances in existence before the end of the stay period.

[Schedule 1, Part 2, item 8, subsection 434J(4)]

2.61 This is included to prevent the perverse outcome of a clause in an agreement that is stayed while a managing controller is appointed over all or substantially all of a corporation's property being used against a company once the managing controller's control over the company has ended.

2.62 The regulation making power is included to support the anti-avoidance regulation making power under section 434J(1). The anti-avoidance regulation making power in section 434J(1) ensures that the stay can be extended to apply to clauses in agreements drafted in a way to circumvent the intended application of the stay.

2.63 The stay on the enforcement of rights under subsection 434J(1) does not apply:

- if the rights relate to a contract, agreement or arrangement entered into after the day managing controller is appointed;

- to rights that are part of a type of contract, agreement or arrangement that are specified in the regulations or as declared by the Minister;
- to a right of a kind declared by the Minister; or
- if and to the extent that the managing controller has consented in writing to the enforcement of the right.

[Schedule 1, Part 2, item 8, subsections 434J(5), (6) and (7)]

2.64 There are some cases where it would not be appropriate for a stay against the enforcement of rights to apply because of the nature of the agreement or the parties to the agreement. For example, some kinds of derivative arrangements would not be possible if the stay was extended to apply to them. It is therefore necessary for these types of agreements or rights to be excluded from the application of the stay.

2.65 The regulations may prescribe the types of contracts in which rights may still be enforced even if they are contrary to the stay in section 434J(1). It is appropriate to do this in the regulations so that the list can be updated regularly in response to the development of new and innovative financial products. As more new and complex financial products become available, the types of rights that may still be enforceable will need to be adjusted and the changes will have to be made in a timely way.

2.66 In addition, the Minister's power to allow certain rights to remain enforceable is required to ensure that unintended consequences could be remedied very quickly.

2.67 While rights against a corporation are not enforceable because of subsection 434J(1), any rights the company has against the other party for the provision of new advances of money or credit are also not enforceable.
[Schedule 1, Part 2, item 8, subsection 434J(8)]

2.68 In cases where a new managing controller is appointed over the whole or substantially the whole of a corporation's property, the operation of the stay will be considered to have started to apply from the time the previous managing controller was appointed and will only end once the new managing controller's control ends. *[Schedule 1, Part 2, item 8, subsection 434J(9)]*

2.69 On application by the holder of a right that is unenforceable, the Court has a general discretion to order that the right can in fact be enforced in the interests of justice. *[Schedule 1, Part 2, item 8, section 434K]*

2.70 New subsection 434L(1) provides the Court with the discretion to make an order that a right in a contract is not enforceable against a company without the leave of the court and subject to the terms imposed by the Court. *[Schedule 1, Part 2, item 8, subsection 434L(1)]*

2.71 A Court is able to do this on application by the managing controller of the corporation where the court is satisfied that the applicable rights are exercised, are likely to be exercised, or there is a threat that they will be exercised only because of a reason listed in paragraphs 434J(1)(a) or (b). *[Schedule 1, Part 2, item 8, subsection 434L(2)]*

2.72 However, a Court cannot make such an order in relation to rights under subsection 434J(5) and 434J(7). *[Schedule 1, Part 2, item 8, subsection 434L(4)]*

2.73 However, if a Court does make an order, the order must specify the period for which the rights will not be enforceable. *[Schedule 1, Part 2, item 8, subsection 434L(3)]*

2.74 A Court is able to make an interim order before deciding to make an order that a right is not enforceable against a company but must not make the order subject to an undertaking as to damages. *[Schedule 1, Part 2, item 8, subsections 434L(5) and (6)]*

Stay on enforcement of rights triggered as a result of a compromise or arrangement under Part 5.1 of the Act

2.75 New section 415D in Part 5.1 of the Act provides a stay against the enforcement of express rights against a body which would allow a contract to be terminated or amended only because of:

- the body's financial position prior to or during a compromise or arrangement for the purpose of avoiding being wound up in insolvency, while the body is undergoing the scheme;
- an application by the body under section 411 for a compromise or arrangement for the purpose of avoiding being wound up in insolvency;
- the body being the subject of a compromise or arrangement approved as a result of an application under section 411;
- a reason prescribed in the regulations while the body is undergoing a compromise or arrangement.

[Schedule 1, Part 2, item 7, subsection 415D(1)]

2.76 The stay against the enforcement of these rights is intended to allow affected bodies to effectively restructure. The stay applies in relation to express rights that are triggered either because a body applies for or is subject to a compromise or arrangement under section 411, or owing to its financial position. The stay does not however prevent a right from being enforced where the corporation has failed to meet its payment or other obligations under the agreement.

2.77 The broad regulation making power to prescribe reasons to which the stay will apply has been included as an anti-avoidance mechanism to ensure the Government can respond to possible contracts or agreements that are drafted or prepared in a way to circumvent the provisions in section 415D(1). It is appropriate and necessary for this power to be in regulations so that the Government has the flexibility to respond quickly to ensure that the stay effectively applies to such contracts and agreements before they become widespread and negate these reforms. The regulations will be subject to normal disallowance provisions and would therefore still be subject to effective Parliamentary scrutiny.

2.78 The stay only applies if the application under section 411 states that the application is made for the purpose of the body avoiding being wound up in insolvency.

Period of the stay

2.79 Rights that are subject to the stay will not be enforceable against a body from the time the body makes an application for a compromise or arrangement under section 411 until either the:

- application is withdrawn or the Court dismisses the application;
- at the end of any compromise or arrangement approved as a result of the application under section 411; or
- when the affairs of the body have been fully wound up following a resolution or order for the body to be wound up.

[Schedule 1, Part 2, item 7, subsections 415D(2)].

2.80 In relation to a body that is a disclosing entity, the stay will apply from the time that the body publically announces that it will be making an application under section 411 for a period of 3 months unless the body makes the section 411 application within the 3 month period or the Court orders an extended application period. Where an application is made within the 3 month period (or extended application period granted by the Court), the stay will apply as outlined above. *[Schedule 1, Part 2, item 7, subsection 415D(1), 415D(2) and 415D(3)]*

2.81 A right that is not enforceable because of subsection 415D(1), will not be enforceable indefinitely after the end of the stay period to the extent that the reason for seeking to enforce the right relates to:

- the body's financial position before or during the stay period;
- the body being subject to an announcement of, application for or approval of a compromise or arrangement; or
- a reason prescribed in the regulations;

[Schedule 1, Part 2, item 7, subsection 415D(4)]

2.82 This regulation making power is included to prevent the perverse outcome of a clause in an agreement that is stayed while a body is subject to a compromise or arrangement being used against a company once the scheme has ended.

2.83 This regulation making power supports the anti-avoidance regulation making power under section 415D(1). The anti-avoidance regulation making power in section 415D(1) ensures that the stay can be extended to apply to clauses in agreements drafted in a way to circumvent the intended application of the stay. The regulations will be subject to normal disallowance provisions and would therefore still be subject to effective Parliamentary scrutiny.

2.84 The rights will, however, only be stayed where the application under section 411 states that it is being made for the purpose of the body avoiding being wound up in insolvency. *[Schedule 1, Part 2, item 7, subsection 415D(5)]*

2.85 Subsection 415D(6) provides an exemption to allow certain types of rights that would otherwise be unenforceable under subsection 415D(1) to continue to operate. These include rights relating to:

- a contract, agreement or arrangement entered into after the arrangement is entered into takes effect;
- a type of contract, agreement or arrangement that is specified in the regulations or declared by the Minister;
- a right of a kind declared by the Minister; or
- agreements where the person appointed to administer the arrangement has consented to the enforcement of the rights in writing.

[Schedule 1, Part 2, item 7, subsections 415D(6), 415D(7) and 415D(8)]

2.86 There are some cases where it would not be appropriate for a stay against the enforcement of rights to apply because of the nature of the agreement or the parties to the agreement. For example, some kinds of derivative arrangements would not be possible if the stay was extended to apply to them. It is therefore necessary for these types of agreements or rights to be excluded from the application of the stay.

2.87 The regulations may prescribe the types of contracts in which rights may still be enforced even if they are contrary to the stay in section 415D(1). It is appropriate to do this in the regulations so that the list can be updated regularly in response to the development of new and innovative financial products. As more new and complex financial products become available, the types of rights that may still be enforceable will need to be adjusted and the changes will have to be made in a timely way.

2.88 In addition, the Minister's power to allow certain rights to still be enforceable through a ministerial declaration is required to ensure that if there are circumstances in which the application of the stay would result in unintended consequences, the problem could be remedied very quickly.

2.89 Where rights against a company are not enforceable because of subsection 415D(1), any rights the company has against the other party for the provision of new advances of money or credit are also not enforceable. *[Schedule 1, Part 2, item 7, subsection 415D(9)]*

2.90 On application by the holder of a right that is unenforceable, the Court has a general discretion to order that the right can in fact be enforced in the interests of justice. The Court may make such an order on application by the holder of a relevant right to allow that right to be enforceable from the time the body made the application for the compromise or arrangement under section 411 or , in the case of a listed entity, for the date of announcement. *[Schedule 1, Part 2, item 7, section 415E]*

2.91 The flexibility provided to the Court means that it can intervene to allow a right to be enforceable if that would be appropriate in the circumstances.

2.92 New subsection 415F(1) provides the Court with the discretion to make an order that a right in a contract is not enforceable against a body without the leave of the Court and subject to the terms imposed by the Court. *[Schedule 1, Part 2, item 7, subsection 415F(1)]*

2.93 A Court is able to do this on application by the body seeking the compromise or arrangement. An application may also be sought by a person appointed to administer a compromise or arrangement. However, the section 411 application will have to state it is for the purpose of the body avoiding being wound up in insolvency. *[Schedule 1, Part 2, item 7, paragraphs 415F(2(a) and (c) – (d)]*

2.94 The Court can grant the application if it is satisfied that the rights are likely to be exercised, or there is a threat that they will be exercised because for the reasons outlined in paragraphs 415D(1)(a) – (d). *[Schedule 1, Part 2, item 7, paragraph 415F(2)(b)]*

2.95 However, a Court cannot make such an order in relation to rights under subsection 415D(6) and 415D(8). *[Schedule 1, Part 2, item 7, subsection 415F(4)]*

2.96 Where Court does make an order, the order must specify the period for which the rights will not be enforceable. *[Schedule 1, Part 2, item 7, subsection 415F(3)]*

2.97 A Court is able to make an interim order before deciding to make an order that a right is not enforceable against a company but must not make the order subject to an undertaking as to damages. *[Schedule 1, Part 2, item 7, subsections 415F(5) and (6)]*

Consequential amendments

2.98 Section 5 of the PSNA is amended to include sections 415D to 415F, 434J to 434L and 451E to 451G in the list of provisions that do not apply to that Act. This amendment provides guidance when reading the PSNA that that Act prevails over these sections. *[Schedule 1, Part 2, item 15 to 16 Section 5 of the PSNA]*

Application and transitional provisions

2.99 The amendments in this part of the Bill only apply to rights arising under contracts, agreements or arrangements which are entered into after the commencement of this Part. This Part will commence on the later of 1 July 2018 or the day after 6 months after Royal Assent. However, the Governor-General may make a proclamation that it is to commence earlier. *[Schedule 1, Part 2, item 17]*

Chapter 3

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017

3.1 This Bill is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

3.2 The Bill amends the *Corporations Act 2001* to:

- provide for a safe harbour from insolvent trading provisions for company directors and holding companies; and
- stay the enforcement of ipso facto clauses that are triggered when a company enters administration, where a managing controller has been appointed over all or substantially all of the company's property, or where the company is undertaking a compromise or arrangement for the purpose of avoiding insolvent liquidation.

Human rights implications

3.3 The safe harbour for company directors and holding companies imposes an evidential burden on company directors and holding companies respectively to adduce or point to evidence that suggests a reasonable possibility that they have been acting under the safe harbour.

Safe harbour for company directors

3.4 Under section 588GA(1), company directors relying on safe harbour will be required to point to evidence that suggests that they started to develop a course of action reasonably likely to lead to a better outcome for the company after starting to suspect the company was insolvent. It is

appropriate for this evidential burden to apply to a company director wishing to rely on safe harbour because:

- details about the courses of action developed are peculiarly within the director's knowledge; and
- it would be significantly more difficult and costly for the opposing party to disprove the possibility that the director developed a course of action reasonably likely to lead to the better outcome for the company.

3.5 It is only the evidential burden that is imposed on the company director seeking to rely on the safe harbour. Therefore, all a company director would have to do is to point to or adduce some evidence that there was a reasonable possibility that a course of action was developed. The other party would have to prove on the balance of probabilities that the director did not develop a course of action reasonably likely to result in a better outcome for the company.

Safe harbour for holding companies

3.6 Similarly, under section 588WA, a holding company relying on the safe harbour would be required to point to evidence that it took reasonable steps to ensure that its subsidiary company's directors were developing a course of action reasonably likely to lead to a better outcome for the subsidiary company and that each of those directors did in fact take such a course of action. It is appropriate for the evidential burden in this case to fall on the holding company seeking to rely on the safe harbour as:

- the details of the steps taken by the holding company to determine if the subsidiary company's directors took a course of action reasonably likely to lead to a better outcome for the subsidiary is peculiarly within the knowledge of the holding company; and
- it would be significantly more difficult and costly for the opposing party to disprove the possibility that the holding company took any steps to ensure each of the directors of its subsidiary company took steps to develop a course of action reasonably likely to lead to a better outcome for the subsidiary company.

3.7 It is only the evidential burden that is imposed on the holding company seeking to rely on safe harbour. Therefore, all the holding company would have to do is to point to or adduce some evidence that there was a reasonable possibility that it took all appropriate steps to ensure that the directors of its subsidiary company developed a course of action that was

reasonably likely to lead to a better outcome for the subsidiary. The other party would have to prove on the balance of probabilities that the holding company did take reasonable steps to achieve this.

Conclusion

3.8 The application of an evidential burden on company directors and holding companies wishing to rely on safe harbour is appropriate and consistent with human rights because in both cases the approach is consistent with the Commonwealth Guide to Framing Offences, Infringement Notices and Enforcement Powers as:

- the information about the course of action taken and the thought process underpinning it are peculiarly within the knowledge of each respective director or holding company; and
- it is significantly more difficult and costly for the opposing party to disprove the fact that:
 - for a company director, the director developed a course of action reasonably likely to lead to a better outcome for the company; or
 - for a holding company, the directors of the subsidiary had the benefit of safe harbour and the holding company took reasonable steps to ensure the directors of the subsidiary had the benefit of safe harbour.

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