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

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Law and Bills Digest Section

## Contents



**Date introduced**: 1 June 2017

**House**: House of Represntatives

**Portfolio**: Treasury

**Commencement**: Schedule 1, Part 1 commences on the day after Royal Assent. Schedule 1, Part 2 will commence on the later of 1 July 2018 or six months after Royal Assent. However, Schedule 1, Part 2 may commence at an earlier date as proclaimed by the Governor-General.

**Links**: The links to the Bill, its Explanatory Memorandum and second reading speech can be found on the Bill's home page, or through the Australian Parliament website.

When Bills have been passed and have received Royal Assent, they become Acts, which can be found at the Federal Register of Legislation website.

**All hyperlinks in this Bills Digest are correct as at September 2017.**

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## Purpose of the Bill

The purpose of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017 (the Bill) is to amend the *Corporations Act 2001* to:

- create a 'safe harbour' for directors from personal liability for insolvent trading if the company is undertaking a restructure outside formal insolvency and
- make '*ipso facto*' clauses in contracts unenforceable while a company is restructuring under:
  - voluntary administration
  - a compromise or arrangement aimed at avoiding being wound up in insolvency (a 'scheme of arrangement') or
  - when a managing controller has been appointed over all or substantially all of the property of the company.[1]

## Structure of the Bill

The Bill has one Schedule, divided into two Parts:

- Part 1 contains the amendments related to the proposed 'safe harbour' for directors and
- Part 2 contains the amendments that will make '*ipso facto*' clauses in contracts unenforceable, in certain situations.

## Background

The terms 'solvency' and 'insolvency' are defined in section 95A of the *Corporations Act* as follows:

1. a person is **solvent** if, and only if, the person is able to pay all the person's debts, as and when they become due and payable and
2. a person who is not solvent is **insolvent**.

As such, a company will be insolvent when it cannot pay all its debts as and when they become due and payable.

### *Types of external administration for insolvent companies*

The *Corporations Act* provides for five main types of external administration for insolvent companies:

1. receivership
2. voluntary administration
3. deeds of company arrangements
4. liquidation (sometimes referred to as 'winding up') and
5. schemes of arrangement.

As the amendments deal with all five types of external administration, they are briefly outlined below.

#### Receivership

Instruments executed by companies that create a security interest over their assets in favour of a secured party (for example, a creditor), usually contain provisions authorising the secured party, in the event of default by the company, to appoint a receiver to enforce the security interest by taking control of the secured property.

The function of the receiver depends on the range of property over which the security interest is granted, and the terms of the relevant contract. In a typical case the company creates a security interest over all of its assets and undertakings.[2] In that case, any receiver appointed will take control of both the company's business **and** property from the directors (this is called a receiver and manager). In other cases the receiver may only have to sell assets without controlling the company's business.[3] Importantly, receivers and receivers and managers are

1. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, p. 3.
2. R Austin and IM Ramsay, *Ford, Austin and Ramsay's principles of corporations law*, 16th edn, LexisNexis Butterworths, Australia, 2015, p. 1700.
3. *Corporations Act*, section 420.

typically appointed by a creditor, and therefore their objective is to act in the interests of the creditor, not the company.[4]

**Receivership and controllership**

Receivers and controllers fulfil much the same roles under Part 5.2 of the *Corporations Act*. The Explanatory Memorandum to the Bill refers generally to controllers rather than receivers. To ensure consistency in the terminology in the Bill and the Explanatory Memorandum, this Bills Digest also refers to controllers and controllership.

In practice controllership involves the appointment of an independent, registered insolvency practitioner by a secured creditor to take control of the company and/or possession of the secured property and make various business decisions (including whether to sell secured property and, out of the proceeds, repay the secured debt owed by the company).[5]

### Voluntary administration

Voluntary administration involves the appointment of an independent, registered insolvency practitioner (an 'administrator') to take control of the company for a relatively short period of time.[6] The aim of voluntary administration is to maximise the chances of the company and its business remaining in existence and, failing that, to achieve a better return to creditors than the immediate winding up of the company would achieve.[7]

However, as noted by the Productivity Commission, 'almost 60 per cent of Australian companies that enter voluntary administration are deregistered within three years of the commencement of the administration'.[8] This suggests that the current regime does not maximise the chances of the company and its business remaining in existence, at least over the long-term. The Productivity Commission also noted a strong stigma associated with voluntary administration (leading to loss of value of the business), and that in effect, voluntary administration processes, 'are seen to favour the interests of creditors over the continuation of the company'.[9] This led the Productivity Commission to conclude:

> The current culture, incentives and legal framework around voluntary administration inhibit its effectiveness as a genuine restructuring mechanism.[10]

### Deeds of company arrangement

A deed of company arrangement (DOCA) is one of the possible outcomes for a company put into voluntary administration.[11]

A DOCA is an agreement between the company and its creditors that follows from a voluntary administration and is one potential mechanism of restructuring a company and returning it to solvency.[12] An administrator for the DOCA must be appointed (typically, but not always, the former voluntary administrator), hence why a DOCA can also be considered a form of external administration. During the operation of a DOCA, the company continues to trade and, importantly for the directors, the company is not insolvent while under a DOCA.[13]

The DOCA can include an agreement to waive or delay payment of debts, allow payments of debts in instalments, or compromises under which creditors agree to accept payment of a lesser amount in final settlement of their debts.[14]

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4. Productivity Commission (PC), *Business set-up, transfer and closure*, Inquiry report, 75, PC, Canberra, 30 September 2015, pp. 353, 360–361.
5. *Corporations Act*, section 420. P Lipton, A Herzberg and M Welsh, *Understanding company law*, 15th edn, Thomson Reuters, Pyrmont, 2010, p. 620; PC, *Business set-up, transfer and closure*, op. cit., pp. 360–361.
6. *Corporations Act*, Part 5.3A.
7. Australian Securities and Investments Commission (ASIC), 'Creditors: voluntary administration', ASIC website, 23 March 2016.
8. PC, *Business set-up, transfer and closure*, op. cit., p. 24.
9. Ibid., pp. 352, 354, 345, 24, 23.
10. Ibid., p. 367.
11. P Lipton, A Herzberg and M Welsh, *Understanding company law*, 15th edn, Thomson Reuters, Sydney, 2010, p. 620; *Corporations Act 2001*, section 444B.
12. ASIC, 'Creditors: deed of company arrangement', ASIC website, 23 March 2016.
13. PC, *Business set-up, transfer and closure*, op. cit., p. 358.
14. *Corporations Act*, subsection 444A(4).

### Schemes of arrangement

Schemes of arrangement are a form of external administration that provide an alternative to companies seeking to restructure and avoid liquidation, by enabling the rights and liabilities of shareholders and creditors of a company to be reorganised and allowing the company to continue to trade.[15]

The goal of a scheme of arrangement is to obtain a binding agreement that modifies, reorganises or alters the legal rights of shareholders and creditors.[16]

The *Corporations Act* does not restrict the nature of a scheme but typical features of schemes include a partial curtailment of the creditors' rights such as accepting less than the full amount owed, allowing for interest free periods, payment by instalment over an extended period of time, or debt for equity swaps.[17]

While the content of schemes is flexible, the process to establish them is not, requiring six formal steps. The proponent of the scheme must formulate—**in concert with an insolvency practitioner**—a proposal, which ultimately must be approved by the court and filed with the Australian Securities and Investments Commission (ASIC).[18]

The Productivity Commission noted that whilst schemes of arrangement 'can, in theory be entered into separately from other insolvency processes (specifically voluntary administration)' in practice:

> … **a lack of a moratorium on creditor actions during a scheme** creates a risk that individual creditors can undermine the attempts of the scheme to restructure the company, or use the threat of action to extract favourable concession. **As such moratoriums are available in voluntary administration, companies have some incentive to seek that protection**.[19] (emphasis added)

It has been noted that setting up a scheme or arrangement is a time-consuming, complex and expensive process.[20] According to the Productivity Commission whilst they appear to be an 'unattractive option' compared to other forms of external administration (as evidenced by the very few scheme administrators appointed in recent years), are 'rare, and cumbersome', nonetheless schemes of arrangement 'have one advantage, that they are not seen as an insolvency process' and hence 'are seen as valuable tools, where Court oversight is appropriate in a 'big business' corporate restructure given the size and complexity of the transactions involved'.[21]

### Liquidation

Liquidation is a form of external administration under which the company's affairs are wound up, its property sold, debts owed to creditors repaid (in full or in part) and the surplus (if any) distributed amongst its shareholders. As such, liquidation ultimately results in the company ceasing to exist as a legal entity.[22] The Productivity Commission noted:

> … liquidations were by far the most common type of the nearly 14 000 appointments of an external administrator in 2013-14 — liquidators accounted for 71 per cent of appointments, receivers for over 16 per cent, voluntary administrators 9 per cent and deed administrators (for DOCAs) nearly 3 per cent … The prominence of liquidation compared to other forms of appointment is in accordance with experience in other countries.[23]

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15. *Corporations Act*, Part 5.1.
16. Lipton, Herzberg and Welsh, *Understanding company law*, op. cit., p. 645; PC, *Business set-up, transfer and closure*, op. cit., pp. 356–357.
17. PC, *Business set-up, transfer and closure*, op. cit., p. 356.
18. Ibid., pp. 356–357.
19. Ibid., p. 357.
20. Lipton, Herzberg and Welsh, *Understanding company law*, op. cit., pp. 635–636.
21. PC, *Business set-up, transfer and closure*, op. cit., p. 357.
22. Lipton, Herzberg and Welsh, *Understanding company law*, op. cit., p. 620.
23. PC, *Business set-up, transfer and closure*, op. cit., p. 359.

### *Why would directors initiate external administration?*

With the exception of receivership, directors of financially troubled or insolvent companies are able to initiate the other forms of external administration referred to above.[24] There are a number of reasons why they may do so, such as:

- to achieve a better outcome for shareholders and creditors than maintaining the status quo or
- because they are 'encouraged' to take such action by 'a number of legislative incentives'.[25]

The decision about whether a corporation is insolvent is one which is made by its directors. Importantly, the duty to prevent insolvent trading includes a duty not to incur debts when a company is insolvent. Compensation proceedings for amounts lost by creditors as a result of the company trading while insolvent can be initiated against a director personally by ASIC, a liquidator or, in certain circumstances, a creditor.

This is one of the 'legislative incentives' for directors of financially troubled companies to initiate external administration.[26] The others are:

- directors can avoid personal liability if they put the company into voluntary administration and ensure that it executes a DOCA that is acceptable to the company's creditors
- directors may also avoid personal liability for insolvent trading where they can establish that they took all reasonable steps to prevent the company from incurring debts when there were reasonable grounds to suspect it was insolvent[27] and
- placing a company that is insolvent (or company that is suspected to be, or soon to be, insolvent) into external administration is especially attractive to directors who have personally guaranteed the debts of the company, as section 440J of the *Corporations Act* operates to prevent creditors from enforcing those guarantees whilst the company is under voluntary administration.

The Productivity Commission notes these incentives have created:

> … a perception that Australia's insolvency regime provides insufficient focus on, or incentives to, restructure … and instead, puts too much focus on penalising and stigmatising corporate failure.[28]

### *Ipso facto clauses*

An '*ipso facto*' clause is a default or termination clause that is commonly found in modern commercial contracts.[29] Such a clause entitles a party to terminate a contract when certain circumstances arise, such as when a counterparty is placed into external administration, **regardless** of the continued payment or performance by the counterpart of the contract as a whole.

#### Impact on company turnarounds

> In the case of small and medium sized enterprises the termination of contracts will generally lead to the deterioration of company value. For example, a manufacturer of shoes may have a number of contracts with suppliers for raw materials. If these contracts are terminated the result for the shoe manufacturer can be quite drastic. Firstly, the company loses key contracts with suppliers which will result in the company no longer having raw materials to service future product sales. Secondly, the company will have to re-negotiate new terms with the supplier, provided, of course, that the supplier is still willing to transact with the company. If terms are re-negotiated, the supplier will be in a significantly higher bargaining position as it will be conscious of the company's strained financial position. As a result, more stringent terms may be placed in the new contract which will intentionally favour the position of the supplier.

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24. Lipton, Herzberg and Welsh, *Understanding company law*, op. cit., pp. 620–626.
25. Ibid., p. 626.
26. *Corporations Act*, section 588M; P Lipton, A Herzberg and M Welsh, *Understanding company law*, op. cit., pp. 626–627.
27. *Corporations Act*, subsections 588H(5) and (6). In determining whether that was the case, a court must have regard to any actions the director took with a view to appointing an administrator, when that action was taken and the results of the action, thus further incentivising directors to engage external administration at the early stages of a company's financial issues.
28. PC, *Business set-up, transfer and closure*, op. cit., p. 23.
29. '*ipso facto*' is Latin for 'by the fact itself'.

> It is also evident that *ipso facto* clauses have the potential to cause significant value destruction in larger corporations, particularly where the corporation has limited physical assets. The damaging consequence of *ipso facto* clauses was evident in the collapse of the telecommunications retailer, One Tel Limited. When the company was placed into voluntary administration in 2001, the presence of *ipso facto* clauses enabled their major suppliers, Optus and Telstra, to terminate their supply contracts. This effectively put the "nail in the coffin" for the company, as without these supply contracts, the company could no longer function as a going concern.[30]

The Productivity Commission noted that *ipso facto* clauses 'can severely constrain the ability of a business to continue trading during restructure' and operate to 'reduce the scope for a successful restructure or prevent the sale of the business as a 'going concern'.[31] It also noted that 'many countries have restricted the use of such clauses'.[32]

The Bill aims to stay (that is, temporarily prevent) 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.[33]

For the purposes of this Bills Digest, the above are referred to as 'external administration'. The Explanatory Memorandum notes:

> 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.[34]

### *Previous reports and consultations*

There have been a number of previous inquiries and reports that have dealt with corporate insolvency. These are set out in the **Appendix** at the end of this Bills Digest. Briefly, however, over time views about the impact of *ipso facto* clauses and Australia's corporate insolvency laws on the efficacy of the operation of existing forms of external administration as genuine turnaround or restructuring mechanisms has changed.

The current prevailing view is that laws directed at preventing businesses from trading while insolvent and the operation of *ipso facto* clauses may negatively impact on genuine work-out attempts and inhibit the use of various forms of external administration as genuine restructuring mechanisms.[35]

To give context to the amendments proposed by the Bill, the most recent reports and consultations are outlined below.

#### 2015—Productivity Commission inquiry

In 2015 the Productivity Commission released its report entitled *Business Set-up, Transfer and Closure*.[36] As part of that report, issues regarding business restructuring and corporate insolvency were examined. The Productivity Commission found:

- the current culture, incentives and legal framework around voluntary administration inhibit its effectiveness as a genuine restructuring mechanism and
- while some specific reforms are warranted 'wholesale change to the Australian insolvency system is not justified'.[37]

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30. R Purslowe, 'Decisions in the twilight zone of insolvency: should directors be afforded a new safe harbour?', *University of Notre Dame Australia Law Journal*, 13 (113), 2011, pp. 113–152 at pp. 129–130.
31. PC, *Business set-up, transfer and closure*, op. cit., pp. 25 and 373.
32. Ibid., p. 25.
33. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, p. 25.
34. Ibid., p. 26.
35. PC, *Business set-up, transfer and closure*, op. cit., pp. 36–38.
36. Ibid.

The Productivity Commission made a number of recommendations, which in relation to the Bill included:

- the *Corporations Act* should be amended to allow for a safe harbour defence to insolvent trading in certain circumstances[38]
- the *Corporations Act* should be amended such that:
  - *ipso facto* clauses that have the purpose of allowing termination of contracts **solely** due to an insolvency event are unenforceable in certain circumstances whilst
  - ensuring that the party experiencing the insolvency is in no way absolved of any other contractual obligations[39] and
- the *Corporations Act* should be amended to create a moratorium on creditor enforcement actions during the formation of schemes of arrangement.[40]

The Bill largely reflects these recommendations.

#### 2016—Treasury proposals paper and consultation

In April 2016, the Government released a proposals paper on measures to improve Australia's insolvency laws by introducing a safe harbour for directors, and changing the operation of *ipso facto* clauses.[41] Seventy-two submissions were received as part of that consultation process.[42]

#### 2017—Treasury exposure draft consultation

Based on feedback from the 2016 proposals paper consultation process, an exposure draft was released for feedback and consultation by Treasury in March 2017.[43] Forty-five submissions were received as part of that consultation process.[44]

### *Aims of the reforms*

Announcing the release of the draft legislation for consultation, Minister for Revenue and Financial Services, Kelly O'Dwyer stated:

> The creation of a safe harbour creates necessary breathing room for directors to turn a company around rather than allowing it to fail for fear of personal liability. This will not only promote a culture of entrepreneurship and help reduce the stigma associated with business failure, but offers businesses a better chance of restructuring outside of a formal insolvency, which often produces significantly better outcomes for the company, its employees and its creditors.[45]

The Minister for Small Business, Michael McCormack, stated that the aim of the Bill is to improve Australia's corporate insolvency regime by:

- driving cultural change among 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
- enabling companies to continue to trade in order to recover from an insolvency event by preventing *ipso facto* clauses interfering with their successful rehabilitation

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37. Ibid., p. 36.
38. Ibid., recommendation 14.2, p. 37.
39. Ibid., recommendation 14.5, p. 38.
40. Ibid., recommendation 14.6, p. 38.
41. National Innovation and Science Agenda (NISA), *Improving bankruptcy and insolvency laws: proposals paper*, Treasury, Canberra, April 2016.
42. Ibid.
43. The Treasury, 'National Innovation and Science Agenda: improving corporate insolvency law: exposure draft', Treasury website, 28 March 2017.
44. Ibid.
45. K O'Dwyer (Minister for Revenue and Financial Services), *Government releases insolvency law reforms for consultation*, media release, 28 March 2017.

- reducing the instances of companies proceeding to formal insolvency processes prematurely, and, where companies do enter into formal insolvency procedures, ensuring they 'have a better chance of being turned around or of preserving value for creditors and shareholders'
- promoting the preservation of enterprise value for companies, their employees and creditors and
- reducing the stigma of failure associated with corporate insolvency and thereby encouraging a culture of entrepreneurship and innovation.[46]

## Committee consideration

### *Senate Economics Legislation Committee*

The Bill was referred to the Senate Economics Legislation Committee (the Committee) for inquiry and report by 8 August 2017. The Committee recommended that the Bill be passed, and made no recommendations regarding possible amendments in response to the issues raised by submissions to the Committee's inquiry because:

> … the stringency of Australia's insolvent trading laws has been publically debated for many years and … the reforms proposed in the Bill have been the subject of extensive stakeholder consultation … The committee acknowledges submitters' views with regard to the operation of the Bill and how it may be improved to best achieve its intended policy objectives. However, the committee also notes the broad support received for the Bill and considers that a number of the matters raised in submissions would best be clarified in regulations accompanying the legislation.[47]

### *Senate Standing Committee for the Scrutiny of Bills*

The Senate Standing Committee for the Scrutiny of Bills made no comments on the Bill.[48]

## Policy position of non-government parties/independents

At the time of writing no public comments by non-government parties and independents were identified regarding the measures proposed by the Bill or the Bill itself.

## Position of major interest groups

Major interest groups are supportive of the policy intent of the measures contained in the Bill.[49]

### *Proposed safe harbour*

Some stakeholders raised specific concerns about the operation of the proposed reforms in specific circumstances. These are discussed below under the heading 'Key issues and provisions: proposed safe harbour for insolvent trading' below. However, most stakeholders supported the broad policy intent underpinning the Bill's proposed 'safe harbour' from insolvent trading.[50] For example, accounting firm Ernst and Young supported

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46. M McCormack (Minister for Small Business), 'Second reading speech: Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017', House of Representatives, *Debates*, 1 June 2017, p. 6011.

47. Senate Economics Legislation Committee, *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017 [Provisions]*, The Senate, Canberra, August 2017, p. 21.

48. Senate Standing Committee for the Scrutiny of Bills, *Scrutiny digest*, 6, 2017, The Senate, 14 June 2017, p. 63.

49. Senate Economics Legislation Committee, *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017 [Provisions]*, op. cit., p. 9.

50. See, for example: TMA Australia, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 6 July 2017; Ashurst, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 11 July 2017; Australian Small Business and Family Enterprise Ombudsman (ASBFEO), Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 12 July 2017; Chartered Accountants Australian and New Zealand (CAANZ), Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 12 July 2017; Ernst & Young (EY), Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 12 July 2017; Law Council of Australia (LCA), Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 12 July 2017; Housing Industry Association (HIA), Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 12 July 2017; KordaMentha, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 12 July 2017; Australian Bankers Association (ABA), Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 12 July 2017; Henry Davis York (HDY), Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 12 July 2017; Clayton Utz, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 12 July 2017; Australian Institute of Company Directors (AICD), Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment*

the proposed reforms noting they would be 'a positive step in facilitating and fostering a rescue culture, which ultimately produces a better return to stakeholders'.[51] Likewise, the Law Council of Australia (LCA) supported the Bill because Australia's 'current insolvent trading laws put too much focus on stigmatising and penalising failure' and hence a 'cultural shift' in how corporate failure and restructuring is approached is needed.[52]

Chartered Accountants Australia and New Zealand (CAANZ) supported the measures in the Bill on the basis that 'the package of proposals' contained in the Bill:

> … provide [an] appropriate balance between supporting businesses to work through temporary difficulties and protection of rights for those transacting with them.[53]

The Australian Restructuring Insolvency and Turnaround Association (ARITA) also supported the proposed safe harbour provisions.[54]

### *Ipso facto clauses*

A majority of stakeholders are supportive of the broad policy intent underpinning the Bill's reforms to the operation of *ipso facto* clauses.[55] However, some stakeholders raised concerns about the operation of the reforms on specific types of contracts or in specific circumstances. For example, the Housing Industry Association (HIA) stated:

> Although the broad intent of the Bill is supported, HIA has concerns with aspects of the legislation, most particularly the potential impact the proposed restriction on enforcing ipso facto clauses will have on contracting and warranty insurance arrangements that already operate in the residential building industry.[56]

## Financial implications

The Explanatory Memorandum states that the reforms proposed by the Bill 'do not have a direct and measurable financial impact'.[57]

## Statement of Compatibility with Human Rights

As required under Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (Cth), the Government has assessed the Bill's compatibility with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of that Act. It acknowledged that placing the evidential burden onto a director or holding company seeking to rely on the proposed safe harbour might be an issue. However, the Government considered that the Bill is compatible stating:

> 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*.[58]

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*(2017 Enterprise Incentives No. 2) Bill 2017*, 12 July 2017; Herbert Smith Freehills (HSF), Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 12 July 2017; Australian Restructuring Insolvency and Turnaround Association (ARITA), Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 12 July 2017; Australian Institute of Credit Management (AICM), Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 12 July 2017.

51. EY, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 3.
52. LCA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2.
53. CAANZ, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 1.
54. ARITA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., pp. 1–2.
55. Senate Economics Legislation Committee, *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017 [Provisions]*, op. cit., p. 17.
56. HIA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 4.
57. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, p. 4.
58. The Statement of Compatibility with Human Rights can be found at pages 43–45 of the Explanatory Memorandum to the Bill.

### *Parliamentary Joint Committee on Human Rights*

The Parliamentary Joint Committee on Human Rights considered that the Bill did not raise any human rights concerns.[59]

## Key issues and provisions: proposed safe harbour for insolvent trading

### *Current offences*

Subsection 588G(1) of the *Corporations Act* applies if:

- a person is a director of a company at the time when the company incurs a debt
- the company is insolvent at that time, or becomes insolvent by incurring that debt **and**
- at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be.

By failing to prevent the company from incurring the debt, the person contravenes section 588G if:

- the person is aware at that time that there are such grounds for so suspecting or
- a reasonable person in a like position in a company in the company's circumstances would be so aware.[60]

Contravention of this provision gives rise to a pecuniary penalty.[61] A court may order a person to pay a pecuniary penalty of up to $200,000.[62] Insolvent trading also gives rise to both civil and criminal offences.[63] However, in contrast to the civil penalty provisions, the criminal offence provision only applies where dishonesty is found to be a factor in insolvent trading. The criminal offence attracts a maximum penalty of 2,000 penalty units or imprisonment for five years, or both.[64]

The Government argues that the current law focuses on the timing of when debts are incurred, rather than the conduct of the directors in incurring that debt[65] and often results in:

> … 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 … 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 … 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.[66]

### *Current defences liability for insolvent trading*

Currently, section 588H of the *Corporations Act* provides the following defences to civil liability for insolvent trading:

- reasonable grounds to expect that the company was solvent when the debt was incurred and would remain solvent even if it incurred that debt and any other contemporaneous debts
- reasonable reliance on a competent and reliable person who is responsible for providing adequate information about the company's solvency
- non-participation in the management of the company because of illness (or for some other good reason)

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59. Parliamentary Joint Committee on Human Rights, *Report*, 5, 2017, Canberra, 14 June 2017, p. 49.
60. *Corporations Act*, subsection 588G(2).
61. Ibid., subsection 1317E(1), table item 6.
62. Ibid., subsection 1317G(1).
63. Ibid., subsection 588G(3) and subsection 1311(1). ASIC, 'Directors: consequences of insolvent trading', ASIC website, 15 October 2014.
64. *Corporations Act*, Schedule 3, table item 138. Under section 4AA of the *Crimes Act 1914*, a penalty unit is equivalent to $210. This means the maximum penalty is $420,000.
65. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, p. 5.
66. Ibid., p. 6.

- taking all reasonable steps to prevent the company from incurring the debt, including by the appointment of an administrator under Part 5.3A of the *Corporations Act 2001* (the 'reasonable steps' defence).

A director can also seek relief from the court from civil liability for insolvent trading if the director has acted honestly and, having regard to all the circumstances, ought fairly to be excused.[67]

If none of the above defences are available, a director can be personally liable for an amount equal to the amount of the loss or damage suffered in relation to the debt because of the company's insolvency.[68] This amount can be recovered by the liquidator or a creditor (with the liquidator's consent or the leave of the court).[69]

#### Limitations

Whilst the above defences provide some measure of protection for directors, there is no guarantee that they will apply in the circumstances and they do not allow directors to:

- remain in control of the company and
- protect them from personal liability **while** they seek to develop, and then implement, a restructuring for the company.

### *Safe harbour rather than defence*

**Item 2** of Part 1 of the Bill inserts **proposed section 588GA** into the *Corporations Act* to create a 'safe harbour' from the civil penalty offence provision outlined above—in order to 'facilitate more successful company restructures outside of a formal insolvency process'.[70] It does not apply to the criminal offence provision.

Currently, where all the requisite elements of the civil contravention are present directors are *prima facie* liable for insolvent trading. In order to access the current defences a director must provide evidence that the legal elements of the defence are satisfied.

Under the proposed safe harbour, directors will not have contravened the prohibition on insolvent trading provided that they satisfy the following elements:

- it will be available after a director 'starts to suspect' that the company may become or is insolvent
- the director starts developing one or more courses of action that are reasonably likely to lead to a 'better outcome' for the company[71]
- the debt(s) must be incurred directly or indirectly in connection with the course of action[72] and
- it ends at the earliest of the following times:
  - the end of a reasonable period after a person starts to suspect the company's insolvency if the person fails to take the required course of action within that period[73]
  - when the person ceases to take the course of action[74]
  - when the course of action ceases to be reasonably likely to lead to a better outcome for the company[75]
  - the appointment of an administrator or a liquidator of the company.[76]

These are discussed below.

#### Element: suspects the company may become or be insolvent

The safe harbour is available after a director 'starts to suspect' that the company may become or is insolvent. ASIC notes that signs that may indicate a company is at risk of insolvency include:

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67. *Corporations Act*, sections 1317S, 1318.
68. Ibid., section 588M.
69. Ibid., subsections 588M(2) and (3) and sections 588R, 588S and 588T.
70. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, p. 7.
71. *Corporations Act*, **proposed paragraph 588GA(1)(a)**.
72. Ibid., **proposed paragraph 588GA(1)(b)**.
73. Ibid., **proposed subparagraph 588GA(1)(b)(i)**.
74. Ibid., **proposed subparagraph 588GA(1)(b)(ii)**.
75. Ibid., **proposed subparagraph 588GA(1)(b)(iii)**.
76. Ibid., **proposed subparagraph 588GA(1)(b)(iv)**.

- ongoing losses, poor cash flow, increasing debt (liabilities greater than assets), creditors unpaid outside usual terms, solicitors' letters, demands, summonses, judgements or warrants issued against your company, suppliers placing the company on cash-on-delivery (COD) terms
- incomplete financial records or disorganised internal accounting procedures
- problems selling stock or collecting debts, unrecoverable loans to associated parties, overdraft limit reached or defaults on loan or interest payments, problems obtaining finance and
- overdue taxes and superannuation liabilities.[77]

Case law in relation to insolvent trading suggests that determining whether the director could have (or should have) suspected the company may become (or is) insolvent is considered in light of all the circumstances of the company, including that it is operating in a practical business environment.[78] Further, it would appear that the director must be able to prove that they:

- took an active interest in the affairs of the company
- put checks in place to ensure that the information about the company's financial status was reliable and
- regularly reviewed that information themselves.[79]

Therefore the safe harbour will only be available to directors who closely monitor the financial position of the company and take an active interest in its affairs.[80]

### Element: developing one or more courses of action

The safe harbour is only available when, after the director starts to suspect the company may become (or is) insolvent, they start developing one or more courses of action that are reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator, or liquidator, of the company.[81]

The Explanatory Memorandum notes that whilst 'developing a course of action' includes garnering initial advice and subsequent deliberative and decision periods, 'developing' a course of action:

> … requires more than merely thinking about the problem, but rather denotes actively taking steps to move towards a definite action.[82]

> **Example**
>
> 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 relevant experience.
>
> 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.[83] (emphasis added)

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77. ASIC, *Insolvency: a guide for directors*, Information sheet, 42, ASIC, August 2015, p. 3.
78. *New World Alliance Pty Ltd, Re; Sycotex Pty Ltd v Baseler [No 2]* (1994) 51 FCR 425, [1994] FCA 1117 as per Gummow J as [29]: '… the statute appears to focus attention upon what it is reasonable to expect in a given set of circumstances, such a consideration necessarily being made by someone operating in a practical business environment. Attention is focussed at whether a person would expect that at some point the company would be unable to meet a liability. Such a question is necessarily a factual one to be decided in light of all the circumstances of the case'.
79. *Metropolitan Fire Systems Pty Ltd v Miller* [1997] FCA 399, (1997) 23 ACSR 699.
80. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, p. 7.
81. *Corporations Act*, **proposed paragraph 588GA(1)(a)**.
82. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, p. 12.
83. Ibid., p. 13.

In its submission to the Committee inquiry into the Bill, ASIC suggested that consideration could be given to amending the Bill to specifically require directors to document proposed restructuring plans, for a number of reasons including because it would:

- support and assist the director to adduce evidence that the course of action developed and taken is reasonably likely to lead to a better outcome for the company
- promote market confidence and militate against inappropriate access to a 'safe harbour' (that is, when achieving a genuine restructure or better outcome for the company is unlikely) and
- assist liquidators and creditors determine when the 'safe harbour' period commences and to decide the merits of prosecuting a claim of insolvent trading.[84]

However, given that **proposed subsection 588GA(3)** of the *Corporations Act* provides that directors seeking to rely on the safe harbour will have the evidential onus of demonstrating it was available, such an amendment may not be strictly necessary. This is because directors should adequately document their turnaround plans, particularly during any determinative period to assist them in meeting the evidential burden—should it be necessary.[85]

**Example**

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.[86] (emphasis added)

From a practical perspective, it would not be sufficient for a director to provide a statutory declaration that simply stated they had considered a course of action and formed a view it was reasonably likely to lead to a better outcome. Rather, a director would be required to lead other evidence, such as proof of the qualified entity they engaged to provide advice, when they were engaged, when the advice was considered, how the advice was used in relation to the course of action and so forth.

### Element: reasonably likely

For the safe harbour to apply, a course of action developed by the director must be reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator, or liquidator, of the company.[87]

**Proposed subsection 588GA(2)** of the *Corporations Act* sets out an indicative, but not exhaustive, list of factors that **may** be considered in determining whether a course of action is reasonably likely to lead to a better outcome for a company, namely whether the directors:

- properly informed themselves about the company's financial position
- took steps to prevent misconduct by the company's officers and employees that could adversely affect the company's ability to pay its debts
- took appropriate steps to ensure that the company is keeping appropriate financial records
- obtained advice from an 'appropriately qualified' entity who was given sufficient information to give appropriate advice or
- developed or implemented a plan for restructuring the company to improve its financial position.

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84. ASIC, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2.
85. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, p. 7.
86. Ibid., p. 12.
87. *Corporations Act*, **proposed subsections 588GA(1)**.

### Issue: is 'reasonably likely' an appropriate threshold?

Whilst most submissions supported the use of the 'reasonably likely' threshold, the Australian Institute of Company Directors (AICD) argued that the threshold was 'inherently uncertain as it involves predictions about possible future events' and hence recommended that the addition of the concept of a 'rational belief' into the proposed safe harbour provisions (a term already employed in the Act) along the following lines:

> … the person starts developing one or more courses of action that **the person rationally believes** are likely to lead to a better outcome …[88]

It is difficult to foresee how a course of action can be 'reasonably likely' to lead to a better outcome than the immediate appointment of an administrator, or liquidator, of the company without having a rational basis from which to draw such a conclusion (and hence provide a rational basis for belief in likelihood that the course of action will lead to a better outcome). In turn, it is difficult to see how a belief in a course of action can be rational if there is no reasonable prospect it will lead to a better outcome for the company.

As such, this amendment does not appear strictly necessary.

Ernst and Young (EY) also argued that the threshold was 'too low' and 'requires a more robust framework'. It recommended that the safe harbour only be available where:

- it is **probable** that the restructure plan is capable of being executed upon ***and***
- it is **probable** that a better outcome would be achieved for the company.[89]

EY argued that this would introduce an appropriate threshold, namely that the pursuit of a restructure will be 'more likely than less likely (probable) to be successful' and 'more likely than less likely to result in a better outcome for the company and its creditors', that is, the course of action would have more than a 50 per cent chance of being successful and more than a 50 per cent chance of resulting in a better outcome for the company and creditors than the immediate appointment of an administrator, or liquidator, of the company.[90]

However, if such a threshold were adopted it would appear likely to require predictions about possible future events to a degree of detail that may significantly restrict access to the safe harbour, or at least dissuade directors from considering its availability in the first place.

### Issue: better outcome for the company, creditors, or both?

As currently drafted, the safe harbour is available where the course of action is reasonably likely to lead to a better outcome for the ***company*** than the immediate appointment of an administrator, or liquidator, of the company.

A number of submissions to the Committee suggested or inferred that the safe harbour should be amended to apply only when the course of action is reasonably likely to lead to a better outcome for the ***company and creditors*** than the immediate appointment of an administrator, or liquidator, of the company.[91]

However, a larger number of submissions supported confining the safe harbour to courses of action that are reasonably likely to lead to a better outcome for the ***company***.[92] For example, law firm Clayton Utz stated:

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88. AICD, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., pp. 4–5.
89. EY, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 1.
90. Ibid.
91. ASIC, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2.; EY, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 1; HSF, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 4.; SV Partners, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., pp. 2, 5; AICM, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 12 July 2017, pp. 2, 8.
92. Jones Day, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 1; TMA Australia, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 1; ARITA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*,

> We welcome the move away from a focus on the interests of both the company and its creditors. These interests may be quite different at any particular time during a restructure and may otherwise cause some confusion for directors who might be in the process of developing and implementing a "course of action" reasonably likely to lead to an outcome better than the immediate appointment of an administrator, or liquidator, of the company.
>
> As currently drafted, it is clear that directors must continue to act in accordance with all their legal obligations including, their general director's duties under Part 2D.1 of the Act despite seeking the protection of safe harbour and therefore, must continue to have regard to both the interests of shareholders and creditors with the focus on creditors' interests where a company is in financial distress.[93]

The Law Council of Australia expressed a similar view, stating:

> While it could be argued that these creditors will be at a disadvantage because they will not be able to take action against the directors for insolvent trading, it must be borne in mind that the purpose of the safe harbour is to encourage and support directors while they try to successfully restructure the company. If this succeeds then the company may return to profitability and the company's stakeholders will be better off because the company will continue to trade.[94]

Whilst some interest groups have expressed concern that the current drafting does not adequately consider the interests of creditors, those concerns may be misplaced given that the interests of creditors are a subset of the interests of the company as a whole. Further, given the degree of value destruction associated with administration and liquidation it would appear that where a restructure is successful, creditors should end up in a better position than if the company had entered into administration or liquidation. However, where the restructure is not successful creditors are likely to face a similar outcome (for example, partial or non-repayment of debts owing) to what would have occurred if the restructure had not been attempted – the key difference being the delay in the outcome being known, due to the restructuring attempt being undertaken.

### Issue: the application of the five factors

**Proposed subsection 588GA(2)** sets out the factors which may be considered in determining if a course of action is reasonably likely to lead to a better outcome for the company.

A number of submissions to the Committee recommended amending the Bill to provide that where all five factors apply, that fact constitutes 'prima facie evidence that a course of action was reasonably likely to lead to a better outcome for the company than the immediate liquidation or voluntary administration'.[95] However, such an amendment would deprive the relevant decision maker of the discretion which is inherent in the subsection as drafted.

### Issue: advice from appropriately qualified entity

One of the matters listed for consideration is whether advice was obtained from 'an appropriately qualified entity'.[96] The phrase 'appropriately qualified entity' is not defined in the Bill.

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op. cit., p. 1; CAANZ, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 1; LCA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., pp. 2–3; Clayton Utz, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2; ABA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2; ASBFEO, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 1.

93. Clayton Utz, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2.
94. LCA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., pp. 2–3.
95. AICD, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 6; Jones Day, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2.
96. *Corporations Act*, **proposed subsections 588GA(2)**.

### Productivity Commission recommendation

The Productivity Commission took the view that access to the proposed safe harbour should be restricted to circumstances where:

- an adviser has been appointed with the explicit purpose of providing restructuring advice, aimed at ensuring the business's continued solvency and ongoing viability[97]
- the safe harbour adviser is 'registered as such with ASIC', and is a 'substantially experienced' practitioner.[98]

The Productivity Commission acknowledged that a broad range of persons could potentially act as safe harbour advisers, including:

- turnaround executives
- accountants and lawyers and
- investment bankers and shadow banking participants.[99]

Ultimately the Productivity Commission stopped short of recommending—as some submitters to its inquiry had suggested—that registration as a safe harbour adviser with ASIC be restricted to entities with ARITA Professional Membership or persons who are registered liquidators.[100]

Instead, the Productivity Commission left open the precise qualifications and expertise required for registration as a safe harbour adviser with ASIC and simply noted 'advisers should be of significant standing within the profession' and that elements of registration with ASIC as a safe harbour adviser would involve 'checks of qualifications, continuing professional development and appropriate levels of practitioner insurance' (that is, professional indemnity insurance).[101]

### Alternative proposals from interest groups

A number of submissions to the Committee inquiry into the Bill recommended the Bill should specify that members of the following groups meet the description of 'appropriately qualified entity':

- registered liquidators (or a qualified sub-class of registered liquidator)
- tertiary qualified individuals or
- prescribed members of certain approved professional organisations, such as ARITA.[102]

Alternatively, in the absence of such a definition, the Bill should instead be amended so that only entities with professional indemnity insurance could be an 'appropriately qualified entity'. This would ensure that the entity is:

- a member of a recognised professional body and/or is required by law to hold insurance (for example, a lawyer, registered liquidator or member of an accounting professional body) or
- has independently applied for and obtained insurance against the risk of liability for acts or omissions in providing advisory services.[103]

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97. PC, *Business set-up, transfer and closure*, op. cit., p. 381.
98. Ibid., p. 383.
99. Ibid., p. 383.
100. Schedule 2 to the *Corporations Act*, requires amongst other things that liquidators are registered, provides for the educational standards of liquidators and outlines the procedures for disciplining of liquidators.
101. PC, *Business set-up, transfer and closure*, op. cit., p. 384.
102. HDY, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2; AICM, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2; KordaMentha, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 1; ARITA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 6.
103. ARITA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 6; KordaMentha, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 1; HDY, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2.

Despite these suggestions, a majority of submissions to the Committee inquiry did not support inserting a definition of 'appropriately qualified entity' into the Bill.[104] Others recommended providing more clarity around the meaning of an 'appropriately qualified entity' without being unduly restrictive.[105] For example, the Law Council of Australia recommended:

> … the concept of an 'appropriately qualified entity' in s588GA(2)(c) should be clarified in legislation and by regulatory guidance … Imposing tougher standards on who is an 'appropriately qualified entity' will send a strong message to the business community that turnaround and restructuring advice requires minimum standards of knowledge and skills and give creditors greater confidence in the bona fides of those undertaking the restructuring effort.[106]

In contrast, TMA Australia noted:

> … we confirm that we support the present "appropriately qualified entity" test. The existing wording of the test reflects the fact that the variety of appropriate advisors to a company are as diverse as Australian businesses themselves … In our view, the test should remain broad to allow a company to seek the advice that is right for their business. No exhaustive list of accreditations can possibly cover the range of skill sets and practical experience which can be effectively brought to bear on a turnaround … For this reason, the TMA does not support limiting the definition to require the advisor be a member of/accredited by a special interest group – for example registered liquidators … Under the present test, advisors must be "appropriately qualified" in the sense that they are "fit for purpose". Advisors will be exposed to adverse legal action if their advice and/or "better outcome opinion" is incorrect. In our view, under the present test, firms and individuals are appropriately incentivised to carefully consider their qualifications, practical experience and resources before accepting an engagement. Over time, we expect that industry standards and best practice will evolve regarding the experience and qualifications necessary to engage in the various Safe Harbour work streams.[107]

According to the Explanatory Memorandum to the Bill:

> "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.
>
> The particular qualifications needed by the adviser will vary on a case-by-case basis.[108]

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104. TMA Australia, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., pp. 2, 4; Clayton Utz, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 3; AICD, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 7.
105. LCA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 3. See also: ASIC, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2; CAANZ, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2.
106. LCA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 3. See also: ASIC, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2; CAANZ, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2.
107. TMA Australia, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., pp. 2, 4.
108. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, p. 17.

**Issue: unregulated pre-insolvency advisors**

Whilst the absence of a formal definition of 'appropriately qualified entity' in the Bill provides flexibility, it also presents risks. In particular, it may allow 'largely unregulated pre-insolvency advisors' to 'give inappropriate advice and facilitate improper phoenix activities'.[109]

> **About phoenixing**
>
> In its most basic form fraudulent phoenix activity involves one corporate entity carrying on a business, accumulating debts without any intention of repaying those debts (for the purpose of wealth creation or to boost the cash flow of the business) and liquidating to avoid repayment of the debt. The business then continues in another corporate entity, controlled by the same person or group of individuals.
>
> Fraudulent phoenix arrangements are, however, often more sophisticated. In the ATO's experience, a typical fraudulent phoenix arrangement would be structured as follows:
>
> - a closely held private group is set up, consisting of several entities one of which has the role of hiring the labour force for the business
> - the labour hire entity will usually have a single director who is not the ultimate 'controller' of the group
> - the labour hire entity has few, if any, assets and little share capital
> - the labour hire entity fails to meet its liabilities and is placed into administration or liquidation by the ATO
> - a new labour hire entity is set up and the labour moved across to work under this new entity and
> - the process is repeated, with little disruption to the day-to-day operation of the overall business and the financial benefits from the unpaid liabilities are shared amongst the wider group.

Source: Australian Government, *Action against fraudulent phoenix activity: proposals paper*, Treasury, Canberra, November 2009, p. 2

Whilst such advisers may be 'exposed to adverse legal action' if their advice and 'better outcome' course of action is incorrect or negligently produced,[110] recouping losses from the use of inappropriate pre-insolvency advisors would require litigation and may leave the directors exposed to personal liability.[111]

As such, there may be some merit in amending the Bill to allow either of the following to occur:

- ASIC to set minimum registration guidelines that allow registration of the diverse range of potential turn-around advisors noted by the Productivity Commission and TMA Australia, subject to having appropriate professional indemnity insurance or
- Regulations to prescribe specific classes of recognised professional bodies that are required (either by law or the rules of the body) to hold professional indemnity insurance, such as lawyers and accountants, whilst still allowing companies to appoint other types of turn-around advisors who hold appropriate professional indemnity insurance.

Either of the above would allow companies to use a diverse range of turn-around advisors, whilst decreasing (but not eliminating) the risks of directors engaging unregulated and inappropriate pre-insolvency advisors who may then give inappropriate advice and/or facilitate improper phoenix activities.

**Element: debt must be incurred directly or indirectly in connection with the course of action**

The safe harbour applies to directors of an insolvent company.[112] Whilst it will protect those directors from the civil penalties that would otherwise arise for engaging in insolvent trading, it will protect them only in relation to debts that the company incurs:

- in connection with developing and then taking
- a course of action

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109. LCA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 3.
110. TMA Australia, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 4.
111. *ASIC v Somerville* (2009) 259 ALR 574, [2009] NSWSC 934.
112. *Corporations Act*, **proposed paragraph 588GA(1)**.

- that is reasonably likely to lead to a better outcome for the company than proceeding immediately to voluntary administration or winding up.[113]

As such, the safe harbour will not apply to:

- debts incurred that make the company insolvent or
- debts incurred whilst the company is insolvent

where those debts **do not** relate to 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.

It has been suggested that most debts would be considered to be incurred in the ordinary course of the company's business—rather than specifically 'in connection with' the course of action. In that case, the scope of the safe harbour may be substantially curtailed.[114]

Whilst the Explanatory Memorandum states that the phrase 'incurred directly or indirectly in connection with' should be interpreted in such a way as to 'include ordinary trade debts incurred in the usual course of business',[115] when interpreting the actual words of the Bill, a Court will reach its own conclusion based on the facts before it.[116]

### Element: length of time of safe harbour

**Proposed paragraph 588GA(1)(b)** of the *Corporations Act* sets the time limits during which the safe harbour will be available.

The Bill, as drafted, is consistent with the Productivity Commission's view that the safe harbour 'should apply for the period from the adviser's engagement until the implementation of the advice is complete', indicating an inherent degree of flexibility as to the length of time the safe harbour would be available, based on the circumstances of each restructure.[117] However, one submission to the Committee inquiry argued that the Bill should provide specific 'reasonable time frames' during which the safe harbour could operate, stating:

> … whilst no two companies are the same and are likely to require different timeframes to return to a viable trading position, the absence of a reasonable timeframe leaves the proposed new laws open to abuse. An accountability mechanism should be included to ensure that both objective and subjective aspects of what 'a reasonable person, in the company's circumstances would have done' occurs in a reasonable timeframe. Our concerns arise due to the increased obligations of a liquidator to prove the safe harbour protection is not available should restructuring attempts fail.[118]

Although the Productivity Commission did 'not propose any fixed time frames' it considered that 'there should be some limits to the period and availability of advice', should 'operate to ensure that safe harbour provides an opportunity for restructure while minimising opportunities for abuse'.[119] Therefore the safe harbour should be 'subject to general anti-avoidance provisions to prevent repeated use of safe harbour within a short period'.[120]

The Productivity Commission provided a diagram of how the timeline of seeking and receiving safe harbour advice, and when it would apply during the process of restructuring, would operate, set out below. The Bill is consistent with that model.

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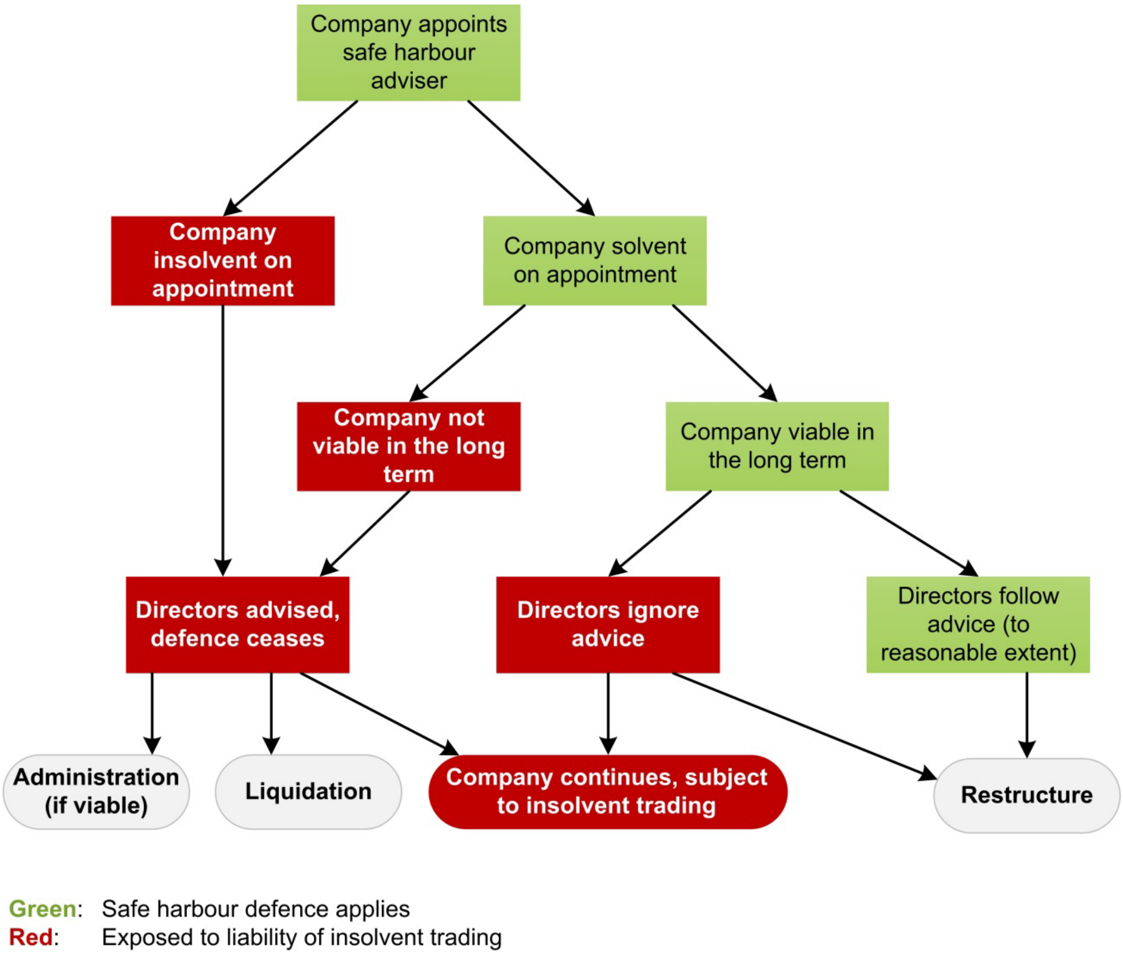
113. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, p. 5.
114. Ashurst, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., pp. 5–6.
115. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, paragraph 1.48.
116. Ashurst, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., pp. 5–6.
117. PC, *Business set-up, transfer and closure*, op. cit., p. 384.
118. SV Partners, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 4.
119. PC, *Business set-up, transfer and closure*, op. cit., p. 385.
120. Ibid., recommendation 14.2, p. 387.

**Figure 1: timelines and operation of safe harbour as recommended by the Productivity Commission**




Source: Productivity Commission (PC), *Business set-up, transfer and closure*, Inquiry report, 75, PC, Canberra, 30 September 2015, p. 385

### *Other requirements*

The proposed safe harbour will not be available where certain legal requirements are not complied with. These relate to the payment of employee entitlements, compliance with tax obligations, the provision of information and documents to administrators, controllers of company property or liquidators. These are discussed below.

#### Paying employee entitlements and complying with tax obligations

**Proposed subsection 588GA(4)** of the *Corporations Act* provides that the safe harbour will not be available to directors or in respect of a debt where:

- employee entitlements have not been paid by the time they fall due[121]
- tax returns or other documents required by taxation laws have not been given[122] and
- either of the above relevant failures:
  - amounts to 'less than substantial compliance' with the relevant laws[123] or
  - is one of two or more failures during the previous 12 months.

121. *Corporations Act*, **proposed subparagraph 588GA(4)(a)(i)**.
122. Ibid., **proposed subparagraph 588GA(4)(a)(ii)**.
123. Ibid., **proposed subparagraph 588GA(4)(b)(i)**.

The note to **proposed subsection 588GA(4)** states 'Employee entitlements are defined in subsection 596AA(2)'. However, the definition of 'employee entitlements' only applies to entitlements of an employee protected under Part 5.8A of the *Corporations Act* and arguably would not **automatically** apply to **proposed section 588GA**.

To prevent any uncertainty as to the definition of 'employee entitlements' and hence the requirement that employee entitlements have been paid on time before the safe harbour is available, one submission to the Committee inquiry recommended that 'there should be a substantive provision incorporating the *Corporations Acts* 596AA(2) definition of 'entitlements of an employee' included in the Bill.[124]

In relation to the use of the phrase 'less than substantial compliance', it would appear that the provisions are intended to ensure that full compliance is not required, and will operate to ensure that directors are able to access the safe harbour despite a compliance failure which is 'technical or trivial in nature'.[125] This point was made by the Australian Institute of Company Directors (AICD):

> … a technology failure may cause a payment to be delayed by 24 hours. In this circumstance, it would be unjust to deny the director the protection of s 588GA(1). The qualification is therefore a necessary common sense addition to render the Bill effective in practice, and not susceptible to failure on the basis of legal technicalities.[126]

The Explanatory Memorandum confirms:

> 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.[127]

### Failure to provide information and books

**Proposed subsection 588GA(5)** of the *Corporations Act* provides that the safe harbour is not available to directors in respect of a debt where, after the debt is incurred, there is a failure to provide information or documents to controllers of company property or liquidators, where the failure amounts to less than substantial compliance with the relevant requirements.

### Consequences of failure to provide information and books

**Proposed section 588GB** of the *Corporations Act* provides that directors are not entitled to rely on books and records in supporting their entitlement to use the safe harbour in a proceeding for a failure to prevent incurring a debt by insolvent trading if they:

- concealed, destroyed or removed books of the company or
- failed to provide administrators, controllers of company property or liquidators with access to books or other material following an appropriate request, **unless**:
  - they did not have the materials and there were no reasonable steps that they could have taken to obtain them or
  - they were not notified of the consequences of failure to provide them.[128]

**Proposed subsection 588GB(4)** of the *Corporations Act* creates a further exception to the general rule by allowing a director to apply for a court order overriding this restriction where there are exceptional circumstances or it is otherwise in the interests of justice to allow them to rely on books and records in supporting their entitlement to the safe harbour.

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124. Ashurst, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 6.
125. AICD, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., 12 July 2017, p. 8.
126. Ibid.
127. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, p. 20.
128. *Corporations Act*, **proposed paragraph 588GB(3)(b)**.

**Court discretion regarding other requirements**

**Proposed subsection 588GA(6)** of the *Corporations Act* provides the court with the discretion to order that a failure to satisfy the above legal prerequisites does not preclude safe harbour being available to a director, provided:

- the failure was due to exceptional circumstances or
- it is otherwise in the interests of justice to make the order.

### *Safe harbour for holding companies*

Currently section 588V of the *Corporations Act* provides that a holding company may be liable for debts of its subsidiary incurred when:

- the company was a holding company of the subsidiary at the time the debts were incurred by the subsidiary
- the subsidiary was insolvent when it incurred the debts
- at the time there were reasonable grounds for suspecting insolvency and
- the holding company (or at least one of its directors):
  - was aware of the grounds for suspecting insolvency or
  - 'having regard to the nature and extent of the corporation's control over the [subsidiary's] affairs and to any other relevant circumstances', it was reasonable to expect the holding company or one of its directors to be aware of the grounds for suspecting insolvency.

In these cases a liquidator may recover from the holding company an amount equal to the loss or damage.[129]

**Proposed section 588WA** provides a 'safe harbour' for holding companies. In short, a holding company will not be liable under existing section 588W 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 under **proposed section 588GA** and
- the holding company has taken reasonable steps to ensure that the directors of the subsidiary have the benefit of safe harbour.

As with the safe harbour for directors contained in **proposed section 588GA**, a holding company seeking to rely on the safe harbour will have the evidential onus of demonstrating it was available.[130]

## Key issues and provisions: *ipso facto* clauses

As noted earlier in this digest, an '*ipso facto*' clause is a provision in a contract that allows the contract to be terminated on the occurrence of a specific event (for example, the appointment of an administrator or receiver) regardless of continued performance of the contract by the party subject to the specific event. From a practical perspective, *ipso facto* clauses can operate to reduce the scope for a successful restructure, a point noted by the Housing Industry Association (HIA):

> … it can be very difficult, and somewhat impractical, for a company to be salvaged if all of its key suppliers, contractors and customers are free to terminate their contracts with the company solely on the basis of the appointment of an administrator.[131]

The amendments in the Bill operate to prevent the enforcement of *ipso facto* clauses in certain contracts where a company is seeking to restructure with the intention of avoiding an insolvent liquidation. The purpose of the stay is to assist viable but financially distressed companies to continue to operate while they restructure their business.[132]

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129. *Corporations Act*, section 588V and 588W.
130. Ibid., **proposed subsection 588WA(2)**.
131. HIA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 7.
132. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, p. 26.

## *Types of external administration affected by the proposed stay on ipso facto clauses*

The amendments in the Bill operate to stay the enforcement of *ipso facto* clauses only where:

- schemes of arrangement (schemes) are proposed to avoid the company being wound up in insolvency under Part 5.1 of the *Corporations Act*[133]
- managing controllers over the whole or substantially the whole of a company's property are appointed under Part 5.2 of the *Corporations Act* [134] and
- when voluntary administration is entered into under Part 5.3A of the *Corporations Act* with a view to executing a DOCA.[135]

However, the stay will only apply when the relevant triggering events are present.

## *Types of agreements captured*

The stay on enforcement will not apply to *ipso facto* clauses in agreements:

- entered into before the commencement of the *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act* (when enacted) or
- entered into before the commencement, but varied or amended after the commencement of the *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act*.[136]

The stay on enforcement will not apply to *ipso facto* clauses in contracts, agreements or arrangements made after the commencement of the formal restructure[137] or contained in a type of contract specified in the Regulations or declared by the Minister.[138] The stay on enforcement will not apply to kinds of contracts, agreements or arrangements or to kinds of rights which have been declared by the Minister by legislative instrument.[139]

### Issue: distortion of market due to non-retrospective application

A number of submissions to the Committee inquiry into the Bill expressed concern that application of the stay on *ipso facto* clauses did not apply retrospectively. Those submissions noted that the new protections do not apply to existing contracts which can be amended and added to in the future 'without ever coming under the protection against *ipso facto* clauses'.[140]

This has two consequences. First, it potentially limits the effectiveness of the measure. Second, the relevant amendments in the Bill would effectively create two classes of contracts:

- those entered into before the commencement of the Bill in 2018 (even where there have been multiple changes over time) to which the protections would not apply and
- those entered into from 2018, to which the protections would apply.

The Law Council of Australia argued:

> This will create a competitive imbalance in the economy and will make it harder, not easier, to restructure as different contracting parties (who might even have virtually identical contracts) will have radically different rights in restructuring simply because one contract is pre-2018 and the other is post-2018.[141]

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133. *Corporations Act*, **proposed section 415D** inserted by **item 7** in Part 2 of the Bill.
134. Ibid., **proposed section 434J** inserted by **item 8** in Part 2 of the Bill.
135. Ibid., **proposed section 451E** inserted by **item 14** in Part 2 of the Bill.
136. **Item 17** of Part 2 of the Bill is an application provision which operates so that the provisions in Part 2 of the Bill do not operate retrospectively.
137. *Corporations Act*, **proposed paragraphs 415D(6)(a)**, **434J(5)(a)**, **451E(5)(a)**.
138. Ibid., **proposed paragraphs 415D(6)(b)**, **434J(5)(b)**, **451E(5)(b)**.
139. Ibid., **proposed paragraphs 415D(6)(c)** and **(d)**; **434J(5)(c)** and **(d)**; **451E(5)(c)** and **(d)**.
140. LCA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 4.
141. Ibid.

The law firm Ashurst also noted that the creation of two classes of contracts would ‘distort commercial dealings, as suppliers will seek to amend existing contracts rather than enter into new contracts’[142] and law firm Herbert Smith Freehills argued that the creation of two classes of contracts raises ‘potential fairness issues’ as it could ‘lead to materially different outcomes’ amongst stakeholders in formal insolvencies.[143]

To deal with the above issues, submissions to the Committee inquiry recommended amending the Bill to ensure:

- the *ipso facto* regime applies in relation to contracts entered into before, as well as after, the commencement of the Bill[144]
- a transitional period (between of 12 months or two years) should apply, during which time contracts can be reviewed and amended by the parties to accommodate the *ipso facto* changes, after which, *ipso facto* regime would apply to all contracts, regardless of when they were entered into[145] or
- the *ipso facto* regime should apply in relation to contracts entered into, renewed or modified (varied) after the enactment of the Bill.[146]

### *Applicable triggering events*

The Bill provides that certain rights cannot be enforced against a company which is undertaking a formal restructure if the rights arise by express provision (however described) of a contract, agreement or arrangement. This is a reference to the right to terminate which is a feature of *ipso facto* clauses.

Specifically, *ipso facto* clauses cannot be enforced against a company only because:

- the company, being a disclosing entity, publicly announces that it will apply to the court for an order to convene a meeting to consider a scheme of arrangement (but only where the company's application states that it is being made to avoid being wound up in insolvency)[147]
- the company (whether or not it is a disclosing entity) applies to the court for an order convening a scheme meeting (but only where the company's application states that it is being made to avoid being wound up in insolvency)[148]
- the company is the subject of a compromise or arrangement approved by the court (but only where the company's application to commence the scheme states that it is being made to avoid being wound up in insolvency)[149]
- a managing controller of the whole or substantially the whole of the company's property exists or has been appointed[150]
- the company has come under or been under voluntary administration[151]
- the company’s financial position whilst applying for or under a scheme, controllership or voluntary administration or for a reason prescribed by Regulations.[152]

142. Ashurst, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 10.
143. HSF, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 6.
144. HSF, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 6; Ashurst, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 10; G Green, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2; KordaMentha, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2.
145. LCA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., pp. 4–5.
146. Green, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2.
147. *Corporations Act*, **proposed paragraph 415D(1)(a)** and **proposed subsection 415D(5)**.
148. Ibid., **proposed paragraph 415D(1)(b)** and **proposed subsection 415D(5)**.
149. Ibid., **proposed paragraph 415D(1)(c)** and **proposed subsection 415D(5)**.
150. Ibid., **proposed paragraph 434J(1)(a)**.
151. Ibid., **proposed paragraph 451E(1)(a)**.

Whilst the above will prevent *ipso facto* clauses from being enforced for the duration of the stay, a counterparty's right to terminate or amend the agreement for any other reason (such as a breach involving non-payment or non-performance) is unchanged.[153] In addition, for the duration of the stay, any right under a contract, agreement or arrangement for a new advance of money or credit cannot be enforced by the company which is undergoing the restructure.[154]

### Issue: stay against enforcement of *ipso facto* clauses to appointment of liquidators

The stay does not generally extend to the appointment of liquidators—although there are exceptions to this rule which are discussed below. A number of submissions to the Committee inquiry into the Bill expressed the view that the proposed stay on the enforcement of *ipso facto* clauses should be extended to the appointment of liquidators.[155] For example, KordaMentha stated:

> We would however like to see the operation of the stay extended to Liquidation appointments (including Provisional Liquidation appointments) to maximise the chances of the sale of businesses as a going concern, which in turn maximises the returns available to creditors.[156]

Other stakeholders opposed this idea.[157] For example, law firm Herbert Smith Freehills noted 'the stay on the exercise of *ipso facto* rights should not apply in any liquidations' because 'liquidation is not a recognised mechanism for implementing a restructure'.[158] Likewise law firm Ashurst stated it did not:

> … favour restrictions on ipso facto clauses where a company is in liquidation … there seems to be no good reason for the ipso facto stay to continue where corporate reconstruction has been tried but has not succeeded. In that situation, the stay should end on the date the liquidator is appointed.[159]

The exception to the general rule is set out in **proposed subsections 415D(2)** and **451E(2)** of the *Corporations Act* which provide that the stay of enforcement of *ipso facto* clauses ends when the company's affairs 'have been fully wound up'.

The Law Council of Australia noted that this may encourage more companies to use voluntary administration (and presumably schemes) on the basis that if they transition into a liquidation, the protection against *ipso facto* clauses will continue until the affairs of the company are 'fully wound up'.[160] The Law Council explained:

> This offers protection in liquidation, despite there being no protection offered in a stand-alone liquidation. We support this on the basis that a liquidation arising from a voluntary administration may still be for the purpose of providing a better return to creditors than a stand-alone liquidation.[161]

This view was not universal, however, with law firm Ashurst arguing that 'there seems to be no good reason for the *ipso facto* stay to continue where corporate reconstruction has been tried but has not succeeded' and that 'the stay should end on the date the liquidator is appointed'.[162]

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152. Ibid., **proposed paragraphs 415D(1)(d)**, **434J(1)(b)** and **451E(1)(b)**.
153. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, p. 26.
154. *Corporations Act*, **proposed subsections 415D(9), 434J(8)** and **451E(8)**.
155. KordaMentha, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2; HDY, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., pp. 2–3.
156. KordaMentha, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 2.
157. HSF, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 6.
158. Ibid., p. 6.
159. Ashurst, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., pp. 10–11.
160. LCA, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 5.
161. Ibid.
162. Ashurst, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., pp. 10–11.

**Issue: administration stay extends to liquidation but not deeds of company arrangement**

DOCAs can only be used following an administration where the company is insolvent or likely to become insolvent, whereas schemes can be implemented regardless of the company's solvency status.

However, as schemes and DOCAs can both be used where the company is insolvent or likely to become insolvent, a scheme approved under Part 5.1 of the *Corporations Act* (section 411) in relation to a financially troubled company can be viewed as broadly equivalent to a DOCA.[163] This is because the end result of a successful scheme or DOCA is the restructuring of debts with creditors and the continued operation of the business rather than liquidation.

Herbert Smith Freehills argued that as currently drafted the Bill creates 'an unusual situation' where a company can benefit from the stay on the exercise of *ipso facto* rights during administration, but not (without court approval) if it then enters into a DOCA.[164]

This is because as currently drafted **proposed paragraph 415D(2)(b)** provides that the stay against the enforcement of *ipso facto* clauses in relation to a company covered by a scheme ends when:

- the entity fails to apply to the Court for approval of the Scheme within the specified period of time or the application is withdrawn or dismissed by the Court[165]
- the scheme ends[166] (this means where a scheme does not result in liquidation, the outcome is a similar result to exiting or completing a DOCA) or
- if the entity is to be wound up, after the liquidation is completed.[167]

In contrast, **proposed subsection 451E(3)** and **paragraph 451E(2)(b)** provide that the stay against the enforcement of *ipso facto* clauses in relation to a company in voluntary administration can be—by a court order—extended. Therefore the stay against the enforcement of *ipso facto* clauses could potentially (but not ***automatically***) apply to a company exiting voluntary administration and entering a DOCA.[168]

Law firm Herbert Smith Freehills noted the above and argued this 'may lead to liquidation being the preferred outcome of administration in some circumstances' rather than the successful rehabilitation of the company.[169]

Noting that DOCAs are a key mechanism for restructuring via administration, it can be argued that DOCAs should be encouraged as a preferred outcome of administration (compared to liquidation) if genuine corporate restructuring is to be supported and promoted.[170] A such, law firms Ashurst and Herbert Smith Freehills both argued that *ipso facto* restrictions should apply to DOCAs without the need to seek an extension order from the court, with Herbert Smith Freehills recommending that 'the stay that applies in administration should be continued for as long as a DOCA remains on foot following that administration'.[171]

This would ensure that companies entering into schemes and those that enter voluntary administration and then a DOCA are treated comparably.

### *Duration of the stay against enforcing ipso facto clauses*

The duration of the stay against enforcing *ipso facto* clauses depends on the type of external administration entered into (that is, a scheme, voluntary administration or the appointment of a controller).

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163. Ibid., p. 10.
164. HSF, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 5.
165. *Corporations Act*, **proposed paragraphs 415D(2)(b)(i)** and **(ii)**.
166. Ibid., **proposed paragraph 415D(2)(b)(iii)**.
167. Ibid., **proposed paragraph 415D(2)(b)(iv)**.
168. Ashurst, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 10.
169. HSF, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 5.
170. Ibid.
171. Ashurst, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., p. 10; HSF, Submission to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, op. cit., pp. 5–6.

### Schemes and duration of the stay

In the case of a scheme under Part 5.1 of the *Corporations Act*, the stay against the enforcement of *ipso facto* clauses:

- begins (in the case of a disclosing entity) when the public announcement is made or (for any type of company) when the scheme application is made and
- ends:
  - if the company (being a disclosing entity) fails to make the announced application: at the end of the longer of three months after the announcement or any extended period ordered by the court
  - when the application is withdrawn or is dismissed by the court or
  - if the compromise or arrangement finishes because of a resolution or order that the body be wound up—then when the company's affairs have been fully wound up.[172]

### Controllers and duration of the stay

In the case of managing controllers under Part 5.2 of the *Corporations Act*, the stay against the enforcement of *ipso facto* clauses begins when the managing controller is appointed and ends when:

- the managing controller's control of the company's property ends (in the event of one or more changes of managing controller, the end of the stay is when the control of the last managing controller ends) or
- the last of any court orders extending the stay ceases to be in force.[173]

### DOCAs and duration of the stay

In the case of administration of a company with a view to executing a DOCA under Part 5.3A of the *Corporations Act*, the stay against the enforcement of *ipso facto* clauses begins when the company comes under administration and ends on the latest of:

- when the administration ends
- on the day that the last made of any Court orders to extend the stay ceases to be in force or
- if the administration ends because of a resolution or order for the company to be wound up—when the company's affairs have been fully wound up.[174]

## *Extension of stay against enforcement of ipso facto clauses after the nominal end period*

An *ipso facto* clause remains unenforceable after the end of the stay period where the reason for enforcing the clause is:

- the company's financial position **before** the end of the stay period
- the company's **commencement** of the relevant form of external administration (scheme, controllership, voluntary administration) before the end of the stay period or
- a reason prescribed in the Regulations that **relates to circumstances** that existed during the stay period.[175]

This is aimed at preventing the 'perverse outcome' of an *ipso facto* clause that is stayed during an external administration 'being used against a company' once the external administration ended because it was under administration.[176]

## *Court power to override operation of the stay against enforcement of ipso facto clauses*

Upon application by the holder of the relevant *ipso facto* rights (for example, the counter-party to the company being restructured) a court may order that the stay is lifted provided it is appropriate in the interests of justice.[177]

172. *Corporations Act*, **proposed subsections 415D(2)** and **(3)**.
173. Ibid., **proposed subsections 434J(2)** and **(3)**.
174. Ibid., **proposed subsections 451E(2)** and **(3)**.
175. Ibid., **proposed subsections 415D(4)**, **434J(4)** and **451E(4)**.
176. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, pp. 31–32.

In addition, applications made to lift the stay in relation to a company that has applied for or is covered by a scheme, the court must also be satisfied that the scheme was not for the purpose of the company avoiding liquidation.[178]

### *Anti-avoidance powers of the court*

The Bill provides that the court may order one or more rights under a contract, agreement or arrangement are only enforceable:

- with leave of the court and
- in accordance with such conditions as the court imposes.[179]

The Bill states, by way of example, that the order could be sought for a right to terminate for convenience.

Before making such an order the court must be satisfied that the rights are being exercised, likely to be exercised or there is a threat to exercise the rights because of the triggering events which are outlined above.[180]

The application for such an order may be made by:

- for schemes of arrangement under Part 5.1 of the *Corporations Act*—by the entity or the person appointed to administer the scheme[181]
- for controllers under Part 5.2 of the *Corporations Act*—the controller[182] and
- for administrators under Part 5.3A of the *Corporations Act* with a view to executing a DOCA—by the administrator.[183]

The court must specify a period for which the order is to apply, having regard to:

- the provisions governing the length of the *ipso facto* stay and
- the interests of justice.[184]

The court will also be able to make interim orders, but when doing so must not require the applicant to give an undertaking as to damages as a condition of granting the interim order.[185]

The staying of rights under these provisions, will enable companies to more effectively restructure. Importantly, however, as with the stay against *ipso facto* clauses, a stay against these other rights will not prevent them from being enforced where the corporation fails to meet its payment or other obligations under the contract.[186]

### *Exceptions to the stay against enforcement of ipso facto clauses*

The stay against the enforcement of *ipso facto* clauses will not apply where:

- the relevant external administrator consents to enforcement of the *ipso facto* clause[187] or
- where the stay would interfere with certain rights of secured creditors that allow them to enforce their interests (such as enforcement by the holder of a substantial security interest, enforcement that began

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177. *Corporations Act*, **proposed sections 415E, 434K** and **451F**.
178. Ibid., **proposed subsection 415E(1)**.
179. Ibid., **Proposed subsections 415F(1), 434L(1), 451G(1)**.
180. Ibid., **proposed paragraphs 415F(2)(b), 434L(2)(b)** and **451G(2)(b)**.
181. Ibid., **proposed section 415F(2)(c)**.
182. Ibid., **proposed paragraph 434L(2)(c)**.
183. Ibid., **proposed paragraph 451G(2)(c)**.
184. Ibid., **proposed subsections 415F(3)**, **434L(3)**, **451G(3)**.
185. Ibid., **proposed subsections 415F(5)** and **(6)**; **434L(5)** and **(6)**; **451G(5)** and **(6)**.
186. Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, p. 38.
187. *Corporations Act*, **proposed subsections 415D(8), 434J(7)** and **451E(7)**.

before the beginning of a voluntary administration, enforcement of a security over perishable property, giving certain notices and so forth).[188]

### *Interaction with other legislation*

**Proposed sections 415G, 434M** and **451H** provide that the *Payment Systems and Netting Act 1998* (Cth) and the *International Interests in Mobile Equipment (Cape Town Convention) Act 2013* (Cth) will prevail over the *ipso facto* restrictions to the extent of any inconsistency.

188. **Items 9** to **13** (amending subsections 441A(3), 441B(2), 441C(2) and section 441E of the *Corporations Act 2001*); Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, pp. 33–34.

## *Appendix: previous consideration of corporate insolvency and* ipso facto *clauses*

### 2000—Productivity Commission

In December 2000, the Productivity Commission released a staff research paper which, amongst other things, examined institutional arrangements and policy mechanisms for dealing with insolvent businesses.[189] The paper makes the following comments about the consequences of placing creditors' interests first and foremost:

> … the fact that creditors are in control of the insolvency process means they will tend to exercise the option that maximises their return — even if there may be broader adverse economic and social consequences. And by favouring creditors, the insolvency code places the interests of other stakeholders—such as employees of affected businesses—in a vulnerable position. It also tends to overlook the potentially specialised human capital of the debtor/owner.[190]

### 2004—Joint Committee report

In June 2004, the Parliamentary Joint Committee on Corporations and Financial Services (Joint Committee) completed its inquiry entitled *Corporate insolvency laws: a stocktake*.[191] The Joint Committee noted that, in relation to voluntary administration:

> After a decade of operation it appears to be functioning effectively and providing adequate opportunities for businesses in financial difficulty to reorganise. **It generally strikes a reasonable balance between liquidation and reorganisation**. In the event that reorganisation or rescue is impossible, the VA procedure permits a prompt transition to a predictable, fair and orderly liquidation procedure in which losses are distributed appropriately and minimised to the extent possible. The flexibility that is inherent in the procedure in most cases achieves a balance between the interests of debtors and creditors. It has become an increasingly popular form of external administration. Voluntary administrations now form a significant, if not a major, part of the practice of most insolvency practitioners.[192] (emphasis added).

### 2004—CAMAC report

In October 2004, the Corporations and Markets Advisory Committee (CAMAC) released a paper entitled *Rehabilitating large and complex enterprises in financial difficulties*.[193] CAMAC was informed by two earlier reports which pre-date the Act[194] and by the responses to its 2003 discussion paper.[195] The final CAMAC report stated, in relation to voluntary administration:

> Any perception that VA is merely the first step towards liquidation could discourage directors from entering into VA until it is too late for the company to recover. However, there is no clear evidence of any such perception. In any event, perceptions may develop or change over time, depending on the success or otherwise of VAs in practice.[196]

In relation to *ipso facto* clauses, CAMAC noted that 'there are arguments for prohibiting the enforcement of *ipso facto* clauses during any form of external administration' including:

> … directors may be reluctant to put their companies into VA out of concern that this may result in creditors enforcing ipso facto clauses that in effect terminate the company's business. This delay may undermine a company's chance of financial recovery.[197]

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189. I Bickerdyke, R Lattimore and A Madge, *Business failure and change: an Australian perspective*, Staff research paper, PC, Canberra, December 2000.
190. Ibid., pp. 88–89.
191. Information about the submissions to the Joint Committee on Corporations and Financial Services, the report and the Government response to it are available on the inquiry homepage.
192. Joint Committee on Corporations and Financial Services, *Corporate insolvency laws: a stocktake*, June 2004, p. xxi.
193. Corporations and Markets Advisory Committee (CAMAC), *Rehabilitating large and complex enterprises in financial difficulties: report*, CAMAC, Sydney, October 2004.
194. Legal Committee of the Companies and Securities Advisory Committee, *Corporate voluntary administration: report*, CAMAC, Sydney, June 1998; Companies and Securities Advisory Committee, *Corporate groups: final report*, CAMAC, Sydney, May 2000.
195. CAMAC, *Rehabilitating large and complex enterprises in financial difficulties: discussion paper*, CAMAC, Sydney, September 2003, p. 20.
196. CAMAC, *Rehabilitating large and complex enterprises in financial difficulties: report*, op. cit., p. 20.
197. Ibid., p. 71.

Ultimately, however, CAMAC recommended 'there should be no change to the current position under which ipso facto clauses can be enforced'.[198]

### 2010—Senate Economics Committee

In September 2010, the Senate Economics Committee released the report of its enquiry into Liquidators and Administrators.[199] Whilst this inquiry was concerned with the conduct of the insolvency profession in Australia, its report *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework* [200] made the following observations about Australia's corporate insolvency framework generally:

> Both the Australian voluntary administration (VA) procedure and the Chapter 11 Bankruptcy process in the United States have as their goal the realisation of greater value through the restructuring of a distressed company rather than its immediate liquidation. **Unlike Part 5.3A of the *Corporations Act*, however, the chapter 11 process allows business owners the opportunity and the time to reorganise and restructure in order to pursue their long–term objectives (and not those of their creditors)**.
>
> The argument against the current system in Australia is that strict laws on insolvent trading promote the early involvement of advisors. These advisors identify the company's liability and recommend that as it is insolvent, an administrator needs to be appointed. **The business is handed over and, without exploring the options to restructure, liquidation proceeds**.[201] (emphasis added)

### 2010—Treasury consultation

Treasury released a discussion paper entitled *Insolvent trading: a safe harbour for reorganisation attempts outside of external administration*, in January 2010.[202] Launching the discussion paper, Chris Bowen stated:

> Concerns have been raised that the laws directed at preventing businesses from trading while insolvent may negatively impact on genuine work-out attempts; in particular, where restrictions on the availability of credit impede the ability of businesses to temporarily maintain solvency while work-outs are attempted.
>
> This discussion paper provides an overview of the current insolvent trading laws including the existing defences and relief provisions; the options available to companies facing insolvency; and the advantages and disadvantages of informal work-out attempts. The paper canvasses three possible options for reform: maintain the status quo; adopt a modified business judgement rule in respect of a director's duty to avoid insolvent trading; or adopt a mechanism for invoking a moratorium from the insolvent trading prohibition while work-outs are attempted.[203]

The discussion paper recommended a stronger safe-harbour for directors in relation to trading while insolvent. The effect of the proposed safe harbours was expected to be that directors would not be so quick to enter into voluntary administration and thereby would allow some extra time in which a company could attempt to trade out of its difficulties.[204] The discussion paper puts forward three options:

**Option 1**: do nothing, that is, make no change to the current law. Directors need to ensure that their company is solvent whilst attempting to reorganise outside of external administration.

**Option 2**: modify the business judgement rule. This would mean that a director's duty not to trade whilst insolvent would be considered to be satisfied if, in addition to the requirements in the business judgement rule in section 180 of the Act:

198. Ibid., p. 71.

199. The terms of reference, submissions to the Economics Committee and the final report are available on the inquiry homepage.

200. Senate Economics Standing Committee, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework*, The Senate, Canberra, September 2010.

201. Ibid., p. 138.

202. The Treasury, *Insolvent trading: a safe harbour for reorganisation attempts outside of external administration*, Discussion paper, Treasury, Canberra, January 2010.

203. Ibid., p. v.

204. Ibid., pp. 14–15.

- the financial accounts and records of the company presented a true and fair picture of the company's financial circumstances
- the director was informed by restructuring advice from an appropriately experienced and qualified professional with access to those accounts and records, as to the feasibility of and means for ensuring that the company remained solvent or that it was returned to a state of solvency within a reasonable period of time
- it was the director's business judgement that the interests of the company's body of creditors as a whole, as well as of members, were best served by pursuing restructuring and
- the restructuring was diligently pursued by the director.[205]

**Option 3**: invoke a moratorium from the duty not to trade whilst insolvent for the purpose of attempting a reorganisation of the company outside of external administration. The moratorium would apply for a limited period and would be subject to termination by creditors.[206]

The discussion paper and responses did not bring about a legislative outcome.

**2014—Senate Economics Committee**

In June 2014 the Senate Economics References Committee (the Committee) report on the performance of the Australian Securities and Investments Commission (ASIC) called for a review of Australia's corporate insolvency laws to ensure they facilitate corporate turnarounds.[207] The Committee recommended the Government commission a review of Australia's corporate insolvency laws to consider amendments intended to encourage and facilitate corporate turnarounds.[208]

**2014—Financial System Inquiry**

The Financial System Inquiry (FSI) touched tangentially on 'corporate administration and bankruptcy' stating that 'a few elements of the United States Bankruptcy Code's Chapter 11 insolvency framework' might merit consideration.[209]

The FSI Report also noted that stakeholders suggested that *ipso facto* clauses be suspended from operating during restructuring efforts. However, the FSI report considered that 'more work needs to be done to assess the potential value of these proposals' and it recommended that Government conduct stakeholder consultation on these matters.[210]

**2015—Productivity Commission Inquiry**

Most recently in 2015, the Productivity Commission released its report entitled *Business Set-up, Transfer and Closure*. As part of that report, issues regarding business restructuring and corporate insolvency were examined. The Productivity Commission found:

- the current culture, incentives and legal framework around voluntary administration inhibit its effectiveness as a genuine restructuring mechanism and
- while some specific reforms are warranted 'wholesale change to the Australian insolvency system is not justified'.[211]

The Productivity Commission made a number of recommendations, which in relation to the Bill included that:

- the Act should be amended to allow for a safe harbour defence to insolvent trading in certain circumstances

205. Ibid., p. 17.
206. Ibid., p. 20.
207. Details about the terms of reference and submissions to the Senate Economics Committee as well as the final report are available on the inquiry homepage.
208. Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, The Senate, Canberra, June 2014, recommendation 61, p. xxxiv.
209. Financial System Inquiry, *Financial System Inquiry: final report*, (Murray Report), Treasury, Canberra, November 2014.
210. Ibid., p. 266.
211. PC, *Business set-up, transfer and closure*, op. cit., p. 36.

- the Act should be amended such that *ipso facto* clauses that have the purpose of allowing termination of contracts solely due to an insolvency event are unenforceable in certain circumstances, whilst ensuring that the party experiencing the insolvency is in no way absolved of any other contractual obligations and
- the Act should be amended to create a moratorium on creditor enforcement actions during the formation of schemes of arrangement.[212]

The Bill largely reflects these recommendations.

**2016—Treasury proposals paper and consultation**

In April 2016, the Government released a proposals paper on measures to improve Australia's insolvency laws by introducing a safe harbour for directors, and changing the operation of '*ipso facto*' clauses.[213] Seventy-two submissions were received as part of that consultation process.[214]

**2017—Treasury exposure draft consultation**

Based on feedback from the 2016 proposals paper consultation process, an exposure draft was released for feedback and consultation by Treasury in March 2017.[215] Forty-five submissions were received as part of that consultation process.[216]



Members, Senators and Parliamentary staff can obtain further information from the Parliamentary Library on (02) 6277 2500.

212. Ibid., pp. 37–38.
213. NISA, *Improving bankruptcy and insolvency laws: proposals paper*, op. cit.
214. Ibid.
215. The Treasury, 'National Innovation and Science Agenda: improving corporate insolvency law: exposure draft', op. cit.
216. Ibid.