Building a better working world

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Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

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Re: Improving corporate insolvency laws: EY submission

1. Introduction

1.1. EY is pleased to respond to the Australian Government's request for feedback on the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017.

1.2. Having closely followed the evolution of the proposed legislation we broadly support the proposed reforms.

1.3. We believe deeper consideration should be given to the stakeholders who are likely funding the restructuring plan as well as the interplay between the proposed safe harbour and ipso facto legislative reforms.

2. The Proposed Safe Harbour Defence

2.1. ***Determining whether a course of action is reasonably likely to lead to a better outcome for the company***

Our primary observations in relation to the proposed section 588GA of the *Corporations Act 2001 (Cth) (***Act***)* relate to the required threshold Directors must obtain in pursuing a restructuring plan. As drafted, directors must satisfy themselves that the courses of action they are pursuing are "reasonably likely" to lead to a better outcome for the company. Our view is that this is threshold is too low and requires a more robust framework.

Directors are seeking the protections of 'safe harbour' and are likely using third party funding (new money) to achieve the restructure. Typically the third party funding is in the form of extended credit provided by creditors whom are already adversely effected by the debtor's failure to meet its obligations as it ordinarily would.

Our view is that, in these circumstances, the threshold should be:

a. It is probable that the restructure plan is capable of being executed upon; and
b. It is probable that a better outcome would be achieved for the company.

We believe directors operating businesses in a professional and bona fide fashion in accordance with their existing duties should be afforded safe harbour protections. These protections should only be available where 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.

2.2. ***Obtaining advice from an appropriate qualified entity who was given sufficient information to give appropriate advice***

Proposed section 588GA(2)(d) of the Act requires that the person obtains advice from an "appropriately qualified entity". We note that some are advocating for limitation of the definition to registered liquidators (or a specially qualified sub-class thereof) or tertiary qualified individuals only. We do not share this view.

We strongly support the broad interpretation of appropriately qualified entity and suggest that in an increasingly complex business environment, in order to qualify as an "appropriately qualified entity" the entity would need to demonstrate the following as a minimum:

a. Advisor/s with situational experience (in stressed and distressed circumstances);
b. Relevant deep industry / sector expertise;
c. Qualifications to assess outcomes in various scenarios (including insolvency);
d. Operational restructuring capability; and
e. Maintain appropriate insurances to respond to the increased litigation that would likely result (predominantly in connection with the increase in class actions around continuous disclosure).

3. Stay on enforcing rights – Ipso Facto clauses

3.1. EY broadly supports the proposed legislation in relation to ipso facto and believes it will improve the likelihood of going concern sales being achieved and ultimately will see an increase in the return to creditors.

3.2. We appreciate that the safe harbour provisions and the proposed legislation regarding ipso facto are not intended to be read in concert, however there are a number of observations that we make with respect to the relationship between the ipso facto and safe harbour provisions.

3.3. The proposed legislation seeks to prevent enforcement where a restructuring is to be effected through Pt 5.1 of the Act. Ipso facto clauses are much broader in their application and become 'enforceable' long before formal announcements or appointments are made pursuant to Pt 5.1, particularly in circumstance where section 411 of the Act applies.

3.4. We expect that boards, in practice, are less likely to formally resolve to invoke safe harbour. The continuous disclosure obligations however may prejudice disclosing entities insofar as ipso facto clauses may well be triggered, without the Pt 5.1 protections being enacted.

3.5. This is equally as applicable with respect to the period before external administration appointments are made, whether they be appointments of controllers under Pt 5.2 or voluntary administrations under Pt 5.3 of the Act.

3.6. EY's view, which we understand is counter to the views of others, is that ipso facto clauses should be deemed unenforceable in all circumstances (for contracts entered into after Royal Assent) without an order of the court, much along the lines that floating charges were required to be qualifying floating charges by virtue of the *Enterprise Act (UK) 2002*.

3.7. Ipso facto clauses entered into prior to Royal Assent would be qualifying ipso facto clauses.

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3.8. Some would suggest that these measures are draconian and counter to the concept of freedom of contract. This may well be the case, however both the safe harbour and ipso facto reforms are founded on the principle of rescue and going concern – enforcing ipso facto clauses appear counter intuitive to this objective.

4. Conclusion

4.1. In essence, EY support the legislation and believes it is a positive step in facilitating and fostering a rescue culture, which ultimately produces a better return to stakeholders. Our recommendations are based on supporting a culture of bona fide rescue without unduly exposing stakeholders to even greater loss or damage based on a mere 'reasonable likelihood' of a better outcome to the company and creditors.

Yours sincerely

[redacted]

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