HENRY DAVIS YORK

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

Dear Sirs

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

We welcome the introduction of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017 (**Bill**) which represents a culmination of years of discussion in the industry about ways to improve the commercial insolvency and restructuring regime in Australia.

Henry Davis York has one of Australia's leading restructuring and insolvency practices. Our team is consistently recognised by our clients, peers and industry bodies for its pre-eminence, evidenced by the complexity, scale and sensitivity of the matters entrusted to us. We have had leading roles in Australia's most important and high profile corporate collapses, major insolvencies and ground-breaking restructurings in recent years, and many of the matters our team has advised on have involved 'firsts' which have led to landmark judgments and changes in the law.

We make the following submissions in relation to the Bill:

Tackling phoenix activity and director misbehaviour

Appointing an 'appropriately qualified entity' during the safe harbour

The term 'appropriately qualified entity' has not been defined in the Bill. The Explanatory Memorandum states that 'appropriately qualified' is used in the sense of 'fit for purpose' and 'is not limited merely to the possession of particular qualifications.' Further, the Explanatory Memorandum notes that the person who appoints the entity or advisor should themselves determine the appropriateness of the decision having regard to various issues including: the advisor's experience and the nature, size, complexity and financial position of the business to be restructured.

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While we support the flexibility of this term as generally applicable to any size of company, we consider that further limitation of the term will assist in preserving the integrity of the proposed provision. Without parameters being set on what is an 'appropriately qualified entity', the safe harbour regime may be more vulnerable to exploitation by pre-insolvency advisers who are unqualified to provide restructuring advice and risk worsening the condition of a company by his or her advice. The risk of such advisers was explored in the Four Corners broadcast on the ABC network on 12 April 2017 entitled *Calls to crack down on pre-insolvency advisers.* It would be a shame if what is otherwise universally recognised as a positive and important reform opened the door to such advisers obtaining legitimacy.

We suggest that the term 'appropriately qualified entity' could be defined in the Bill's accompanying regulations to prescribe members (or a certain class of members) of certain approved organisations, such as the Australian Restructuring Insolvency and Turnaround Association (**ARITA**), and other equivalent organisations. In the alternative, we submit that an adviser entity must hold professional indemnity insurance that covers provision of the advice.

Director identification numbers

The Federal Opposition has proposed introducing director identification numbers for individual directors. Professor Helen Anderson, Professor Ian Ramsay, Professor Michelle Welsh and Mr Jasper Hedges published a report entitled Phoenix Activity: Recommendations on Detection, Disruption and Enforcement (2017). It was the last of three significant reports they made about unlawful phoenix activity and contained a large number of recommendations including that all directors have the benefit of a director identification number to track their correct details for all companies which they establish or of which they are directors. In the report, the authors identified that it was their most important recommendation and key to many of their other recommendations as it would assist in identifying so-called repeat offenders who might otherwise slip through the gaps in director personal information gathering identified in the report.

While worthy of exploration, the introduction of this regime is unlikely to be a panacea to eliminating phoenix activity. To that end, we note that there is currently underway a whole-of-government initiative to tackle phoenix activity which includes potential reform to the Fair Entitlements Guarantee Scheme and which is currently subject to public consultation. In our view, this whole-of-government strategy ought to be progressed separately and the passage of the ipso facto and safe harbour reforms should not be unnecessarily delayed in circumstances where it is enjoying bipartisan support. Further, for the reasons outlined above, the Committee's attention should be directed towards improving and tightening the categories of restructuring advisor, that is, amending or properly defining the 'appropriately qualified entity' wording.

Extension of the stay period to liquidations

The Bill provides that the stay on ipso facto clauses does not apply if a company goes into liquidation directly, without going through voluntary administration or a scheme of arrangement. However, if it goes first into a voluntary administration, then liquidation, the stay continues until 'when the company's affairs have been fully wound up' (see proposed sections 415D(2)(b)(iv) and 451E(2)(c)). This connotes that the stay ends when the winding up of the company has ended or is complete and thus, the stay would operate during the period of winding up or liquidation of a company if the company had first entered into voluntary administration or scheme of arrangement.

This seems not only inconsistent (as there is no provision for a stay on ipso facto rights should a company go straight into liquidation/winding up without first entering into voluntary administration or a scheme of arrangement) but unjust that creditors would be required or forced to continue to supply a company during its liquidation.

The stay period should end upon a resolution of creditors at the second creditors' meeting to resolve that the company be wound up, or when the court orders that the company be wound up. The Bill could be amended to cross-reference or adopt the words already provided for under section 435C(2) and (3) of the Corporations Act 2001 (Cth), or amend the proposed sections 415D(2)(b)(iv) and 451E(2)(c) by inserting the words '*when the resolution passes or Court orders*' in lieu of the words '*when the company's affairs have been fully wound up*.'

Inconsistency with the rights of all asset security holders

The stay on ipso facto clauses contained in the Bill has the potential to be inconsistent with existing provisions of the Corporations Act which permit secured creditors holding all asset security agreements to enforce their security during the '*decision period*' of a voluntary administration.

The Corporations Act provides for the rights of a secured party, owner or lessor, and rights in respect of property the subject of security interests under Subdivision B, Division 7, Part 5.3A of the Act (sections 441AA to 441EA). One common enforcement scenario is where a creditor enforces security over the whole, or substantially the whole, of the property of a company within the 'decision period' once a company enters into voluntary administration (section 441A of the Corporations Act). The 'decision period' is defined under section 9 of the Corporations Act to be a period of 13 business days from the date of appointment of the administrator or when notice was given to the secured creditor.

The broad application of the moratorium under the proposed section 451E extends to all contracts, agreements and arrangements (unless an exclusion applies). An all-asset security agreement could potentially therefore be caught by the new moratorium and be unenforceable during any time of the voluntary administration, including during the 'decision period' of a voluntary administration. We do not understand that this inconsistency reflects any policy intent of the proposed reforms and the drafting should be clarified to ensure that the rights of all-asset security holders are not unintentionally impinged upon by the enactment of the new provisions in the Bill.

If it is the intent of the Government is for the prohibition on the exercise of rights under ipso facto clauses to extend to secured creditors who have a secured interest over the whole or substantially the whole of the company's property, this would be a major policy shift. In the context of the proposed reform, it is likely to lead to the perverse outcome whereby secured creditors would be in a race to appoint a receiver to a company before directors appoint administrators. Put another way, directors attempting to achieve a work-out or restructure under the cover of the proposed safe harbour provisions might find their efforts cut short by secured creditors concerned that their rights might be curtailed if an administrator were to be appointed.

Alternatively, if (as we submit should be the case) the legislative intent is that the stay should not apply to the rights of all-asset charge holders, the Bill provisions would need to make this clear. On a matter of such significance, it would be appropriate that this be included in the legislative text itself and not be left to the regulations as part of any exclusion. As a minimum, clarification about how these two apparently contradictory provisions might work together is required to enable business certainty.

We would be pleased to provide further detail or explanation in respect of our submissions and the restructuring and insolvency regime in Australia, including to appear at any hearings before the Senate Committee.

Yours faithfully,
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