Chapter 2

Views on the bill

2.1 This chapter provides a summary of the views expressed in submissions received by the committee.

Support for the bill

2.2 The majority of submitters were broadly supportive of the bill and encouraged its progress through the Parliament. Where submitters made recommendations or suggestions for changes to the bill, these were generally presented as means to improve the operation of the bill and ensure it best achieves its policy objectives.

2.3 EY submitted that the proposed amendments are 'a positive step in facilitating and fostering a rescue culture, which ultimately produces a better return to stakeholders'.[1]

2.4 Similarly, the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) described the bill as 'a good step to improve outcomes across the lifecycle of a small business', also noting that:

> …my office has a strong understanding of the impacts of insolvency and use of ipso facto clauses which have led to good small businesses being lost with unnecessary economic and social consequences.[2]

2.5 Some submitters emphasised the disincentives and impediments to effective restructuring under Australia's current insolvency law, and highlighted the unintended consequences of the current legal framework on Australian businesses, communities, and the economy as a whole. For example, the Law Council of Australia described the reforms in the bill as being 'long overdue', further submitting that:

> …aspects of the current law, namely the threat of personal liability for insolvent trading and the lack of protection against ipso facto clauses in contracts, make effective restructuring more difficult, and in some cases impossible. This harms the economy and the broader community through unnecessary business closures and more expensive and complex restructuring efforts.[3]

2.6 Expressing a similar view, the Australian Institute of Company Directors (AICD) contended that:

> Australia's existing insolvency laws are amongst the harshest in the world. The perverse and unintended consequence of the current framework is that directors are forced down the path of formal insolvency too early in

1 EY, *Submission 9*, p. 3.

2 Australian Small Business and Family Enterprise Ombudsman, *Submission 7*, p. 2.

3 Law Council of Australia, *Submission 10*, p. 1.

> circumstances where reasonable prospects of recovery exist, destroying value and jobs.[4]

2.7 The AICD further commented that 'the potential of the bill cannot be underestimated' and went on to explain how the proposed amendments will improve the operation of Australia's insolvency law for the benefit of companies and their stakeholders:

> These reforms will promote innovation and entrepreneurship by encouraging responsible and measured risk-taking by companies and directors. They will also enable companies facing financial difficulties but with reasonable prospects of turnaround to be restructured, saving jobs and value. Directors of ailing companies should be encouraged to take reasonable steps to turn around distressed businesses for the benefit of all stakeholders, and the economy overall.[5]

2.8 Chartered Accountants Australia and New Zealand (CAANZ) also noted its support for the objectives of the bill and expressed the view that the reforms would 'provide appropriate balance between supporting businesses to work through temporary difficulties and protection of rights for those transacting with them'.[6]

2.9 Mr Geoff Green was highly complementary of the bill in his submission to the inquiry, commenting that:

> In my view those responsible for drafting the legislation should be commended for the care that they have taken to balance different policy objectives and minimise unintended consequences, resulting in a package of very meaningful and worthwhile reforms.[7]

2.10 The remainder of this chapter will discuss comments made in relation to the safe harbour and ipso facto clause provisions of the bill in turn.

Views on safe harbour reform

2.11 Submitters were welcoming of the safe harbour reform proposed in the bill and generally agreed that its introduction would be an important step in supporting innovation and entrepreneurship in Australia.

2.12 The ASBFEO submitted that:

> Allowing a limited safe harbour for directors as proposed reaches an appropriate balance between preserving the efforts associated with starting up a business or restructuring an existing business while protecting the interests of other businesses that trade with them.[8]

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4 Australian Institute of Company Directors, *Submission 16*, p. 1.

5 Australian Institute of Company Directors, *Submission 16*, p. 1.

6 Chartered Accountants Australia and New Zealand, *Submission 8*, p. 1.

7 Mr Geoff Green, *Submission 3*, p. 1.

8 Australian Small Business and Family Enterprise Ombudsman, *Submission 7*, p. 1.

2.13 The Australian Bankers' Association (ABA) expressed its support for the bill's objective to reduce the incidence of directors prematurely entering into a formal insolvency process. The ABA also contended that the safe harbour protections proposed in the bill are critical to allowing companies the 'necessary breathing space' to assess the future viability of a company.[9]

2.14 The Law Council of Australia noted the inherent complexity of company restructuring processes and argued that while the 'safe harbour provision is not a panacea', it is 'an important step in the right direction that provides appropriate incentives to encourage directors to undertake restructuring efforts'.[10]

Support for carve-out safe harbour model

2.15 As noted in Chapter 1, the safe harbour model adopted in the bill contemplates safe harbour as a legislative carve-out, rather than a defence, requiring that a director meet an evidential burden in order to be entitled to safe harbour. Most submitters expressed support for this approach and argued that it is in line with the bill's objective of facilitating successful restructures outside of formal insolvency.

2.16 In its submission, Ashurst noted that the carve-out model would provide 'an extra level of protection for directors who are making honest and diligent attempts to restore a company to solvency'. Ashurst also explained the operation of a defence versus carve-out safe harbour model:

> A defence would mean that directors continued to have prima facie liability for insolvent trading in the specified circumstances, subject to their being able to establish the elements of the defence.
>
> By contrast, a carve-out would mean that a director would not be liable for insolvent trading unless the liquidator or other person taking action could establish that the director had failed to satisfy the safe harbour prerequisites.[11]

2.17 TMA Australia submitted that a traditional defence 'would be a cold-comfort to directors' and pointed out that such a model would likely result in under-utilisation of the safe harbour protections.[12]

2.18 The AICD reasoned that a defence model would be counter to the bill's primary objectives, explaining that:

> In the context of a safe harbour designed to facilitate genuine business turnarounds and restructures, this approach is neither appropriate, constructive, nor in accordance with common sense lawmaking. Placing the

9 Australian Bankers' Association, *Submission 13*, p. 1.

10 Law Council of Australia, *Submission 10*, p. 3.

11 Ashurst, *Submission 6*, p. 5.

12 TMA Australia, *Submission 5*, p. 3.

> legal burden on directors would perpetuate the overly strict legislative approach for which our insolvency regime is currently criticised…[13]

2.19 While welcoming of the safe harbour provisions, SV Partners expressed an alternative view with regard to the model put forward in the bill, asserting that 'the proposed bill's current form does not provide an adequate balance to allow for genuine recovery action and continued protection for creditors'. SV Partners argued that adopting a defence model, such as the safe harbour 'model A' proposed in the government's earlier consultations, would 'rectify this imbalance'.[14]

Wording of safe harbour provisions

2.20 As outlined in the previous chapter, the safe harbour provisions proposed in the bill will protect a director in relation to debts that a company incurs directly or indirectly in connection with developing and taking a course of action that is reasonably likely to lead to a better outcome for the company.[15]

2.21 A 'better outcome' for the company is defined in the bill as 'an outcome that is better for the company than the immediate appointment of an administrator, or liquidator, of the company'.[16]

2.22 Some submitters raised concerns regarding the wording of the safe harbour provisions and suggested that, as currently drafted, some aspects of the bill lack clarity or do not provide directors with sufficient certainty of the application of safe harbour.

References to 'the person'

2.23 In its submission to the inquiry, Jones Day argued that the proposed safe harbour provisions should be amended such that they apply when 'the company' rather than 'the person'—being the relevant director wishing to rely on safe harbour—begins taking a course of action reasonably likely to lead to a better outcome for the company. Jones Day advised that 'reference to 'the person' may potentially enable a director to undertake a unilateral course of action without ratification by the entire board of directors'.[17]

References to 'the company'

2.24 Herbert Smith Freehills asserted that it is unclear in the bill how the reference to a better outcome for 'the company' is to be interpreted, and suggested that this 'should be replaced by a reference to the company's creditors as a whole'. Herbert Smith Freehills reasoned that this approach would reflect 'that where a company is unable to pay its debts, it is creditor recoveries that are in immediate jeopardy'.[18]

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13 Australian Institute of Company Directors, *Submission 16*, p. 9.

14 SV Partners, *Submission 4*, p. 2.

15 Explanatory Memorandum, p. 11.

16 See proposed ss. 588GA(7).

17 Jones Day, *Submission 1*, p. 2.

18 Herbert Smith Freehills, *Submission 17*, p. 3.

Prescribed factors

2.25 Proposed subsection 588GA(2) to the bill provides an indicative list of factors that may be considered in determining whether a course of action is reasonably likely to lead to a better outcome for the company.

2.26 Jones Day expressed the view that directors need to be provided with sufficient certainty in the application of the safe harbour and, as such, alternative wording to subsection 588GA(2) should be explored:

> …so that the five prescribed factors to be taken into account in assessing whether a course of action is reasonably likely to lead to a better outcome for a company than immediate liquidation or voluntary administration are prima facie evidence of that fact.[19]

2.27 The AICD noted that, while it supports the flexibility awarded by the prescribed factors in subsection 588GA(2), it considers that it could be improved. The AICD endorsed the recommendation made in Jones Day's submission, commenting that 'we believe this amendment would enhance the certainty of the safe harbour and the cultural shift that the reforms seek to encourage'.[20]

Debts incurred 'directly or indirectly in connection with' a course of action

2.28 Ashurst expressed concern that the phrase 'directly or indirectly in connection with' is unclear and potentially limiting, as 'debts incurred in the ordinary course of the company's business may not even indirectly be "in connection with" the course of action'. In this respect, Ashurst contended that 'it should be sufficient that the debt is incurred while the course of action is being taken'.[21]

2.29 The Housing Industry Association (HIA) expressed a similar view, commenting that:

> …for the amendments to have a practical impact the company must be allowed to trade on whilst restructuring is taking place.
>
> However in practice, HIA anticipates that there is likely to be some confusion and debate over those debts that continue to be incurred as part of the ordinary trading activities of the company, in contrast to those debts incurred as part of the restructuring activity.

2.30 The HIA further noted that confusion with regard to debts incurred as part of ordinary trading activities would be problematic in the residential building industry, explaining that:

> Residential builders are reliant on receiving milestone progress payments to pay their employees and ordinary trade creditors, such as subcontractors and suppliers. They are also liable to their clients under liquidated damages provisions for project delays.

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19 Jones Day, *Submission 1*, p. 2.

20 Australian Institute of Company Directors, *Submission 16*, p. 6.

21 Ashurst, *Submission 6*, p. 5.

> In such circumstances, it is highly unlikely that ordinary trade payments will attract the benefit of the safe harbour and for these reasons HIA suspects that the new provisions are going to be difficult to be relied upon by many builders and contractors in the residential building industry.[22]

'Reasonably likely' to lead to a better outcome

2.31 As currently drafted, company directors are required to satisfy themselves that the courses of action they are pursuing are 'reasonably likely' to lead to a better outcome for the company. EY argued that 'this threshold is too low and requires a more robust framework'. EY further explained this view:

> 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.[23]

Better outcome than appointment of liquidator or administrator

2.32 The bill, as drafted, requires that the 'better outcome' achieved via the course of action taken by a director be better than the immediate appointment of an administrator or liquidator. Herbert Smith Freehills expressed concern that the inclusion of 'an administrator' in this comparison 'creates uncertainty as to how and when the broad range of potential outcomes under a Deed of Company Arrangement (DOCA) must be taken into account', and recommended that the comparison should be limited to liquidation only:

> When a company enters into administration, DOCA proposals may be submitted by any number of persons including shareholders, creditors, speculators and 'white knight' third parties. In some circumstances, it may be impossible for directors to foresee the range of potential DOCA proposals that may be forthcoming should their company immediately enter into administration. It may also be impossible for them to assess the viability and credibility of any such proposals which may be made.
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> We therefore recommend that the comparison should be limited to liquidation only. Administration is not an end itself and must inevitably lead to a further outcome. Requiring a comparison to administration outcomes therefore invites uncertainty and risk which may deter the pursuit of genuine turnaround and restructuring opportunities.[24]

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22 Housing Industry Association, *Submission 11*, p. 7.

23 EY, *Submission 9*, p. 1.

24 Herbert Smith Freehills, *Submission 17*, p. 5.

Determining the 'better outcome'

2.33 The AICD expressed concern that, under the definition of 'better outcome' as drafted, the bill:

> …requires directors to undertake a counterfactual evaluation of the various outcomes which may flow from one or more courses of action, and compare them with the immediate appointment of an administrator or liquidator.[25]

2.34 The AICD further submitted that 'this feature of the bill is unduly onerous, and likely to discourage reasonable restructuring efforts by responsible directors'.[26] In explaining their concern, the AICD argued that the 'counterfactual analysis required under the Bill is inherently uncertain as it involves predictions about possible future events'. In addition, the AICD reasoned that:

> In conducting the counterfactual analysis required by the Bill, directors will be making decisions in real time, under pressure and often with imperfect information. Yet, whether directors have met the requirements of the Bill and so enlivened its protection will be judged by a court retrospectively.
>
> …
>
> Hindsight review of directors' decisions is particularly problematic under the Bill as they are to be judged on a purely objective basis. Consequently, rational restructuring decisions by directors may be found wanting on an objective basis due to issues, events or information which, with the benefit of hindsight, emerge as more significant than they appeared to the directors who were acting with due care and diligence at the time.[27]

2.35 To address this concern, the AICD recommended the addition of the concept of a 'rational belief' into the proposed safe harbour provisions. The AICD noted that this term is already employed under other sections of the Corporations Act, and that its use in the context of the safe harbour provisions 'would give greater certainty to a responsible director acting with due care and diligence seeking to rely on the safe harbour when developing a course of action'.[28]

Qualification of an 'appropriately qualified entity'

2.36 As previously noted, proposed subsection 588GA(2) to the bill provides an indicative list of five factors that may be considered in determining whether a course of action is reasonably likely to lead to a better outcome for the company. One of these prescribed factors is 'whether the person is obtaining advice from an appropriately qualified entity who was given sufficient information to give appropriate advice'.[29]

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25 Australian Institute of Company Directors, *Submission 16*, p. 4.

26 Australian Institute of Company Directors, *Submission 16*, p. 4.

27 Australian Institute of Company Directors, *Submission 16*, p. 4.

28 Australian Institute of Company Directors, *Submission 16*, pp. 4–5.

29 See proposed para. 588GA(2)(d).

2.37 Some submitters noted that the term 'appropriately qualified entity' is not defined in the bill, and expressed concerns that this could risk unqualified and unregulated pre-insolvency advisors giving inappropriate advice and potentially facilitate illegal phoenix activity.[30] In this regard, several submitters recommended that the concept of an 'appropriately qualified entity' be set out in the legislation or its accompanying regulations.[31]

2.38 For example, the Law Council of Australia commented that:

> As presently drafted the provision allows directors to select whoever they may believe appropriate. Although it is likely that the courts will deny the safe harbour if an inappropriate person is selected as an advisor, we believe that leaving this up to the directors also leaves directors susceptible to largely unregulated pre-insolvency advisors who may give inappropriate advice and facilitate improper phoenix activities. 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.[32]

2.39 Similarly, the Australian Securities and Investments Commission (ASIC) advised that greater consideration of who might provide 'appropriate advice' would provide greater protection and certainty for trade creditors, further submitting that:

> …it is not clear whether the advisor requires any particular qualifications or experience or needs to maintain adequate insurance. An appropriately qualified and experienced advisor plays a key 'gatekeeper' role to safeguard against the potential risks of misconduct such as illegal phoenix activity (including giving independent advice as to whether the proposed course of action is reasonably likely to lead to a better outcome for the company). Greater certainty in this area might militate against the unintended consequence of potentially supporting growth in the unregulated and problematic part of the pre-insolvency advice market.[33]

2.40 The Australian Restructuring Insolvency and Turnaround Association (ARITA) recommended in its submission that, to mitigate against the exploitation of the safe harbour provisions by those that facilitate illegal phoenix activity:

> …restructuring advice should only be provided by a registered liquidator, or a specially qualified sub-class thereof. In the absence of such a requirement, the legislation should specify that the adviser entity must hold

30 Illegal phoenix activity is when a new company is created to continue the business of a company that has been deliberately liquidated to avoid paying its debts.

31 See, for example, Law Council of Australia, *Submission 10*, p. 3; Henry Davis York, *Submission 14*, p. 2; KordaMentha, *Submission 12*, p. 1.

32 Law Council of Australia, *Submission 10*, p. 3.

33 Australian Securities and Investments Commission, *Submission 2*, p. 2.

> professional indemnity insurance that covers that entity for the provision of relevant advice.[34]

2.41 ARITA contended that such a requirement regarding what constitutes an appropriately qualified entity 'may afford directors a higher level of protection both through advice from a qualified professional and greater certainty that they are eligible to access the safe harbour protection'.[35]

2.42 The Australian Institute of Credit Management (AICM) noted its support for ARITA's recommendation and argued that a mandatory requirement to seek advice from an appropriately qualified professional would help reduce the risk of commercial harm to creditors while maximising the chances of successful recovery.[36]

Agreement with flexible approach

2.43 In contrast to the views discussed above, a number of submitters expressed their support for the broad interpretation of an 'appropriately qualified entity' as currently drafted in the bill.

2.44 TMA Australia asserted that the existing wording relating to an appropriately qualified entity 'reflects the fact that the variety of appropriate advisors to a company are as diverse as Australian businesses themselves'.[37] TMA further emphasised this point, commenting that:

> Turnaround advisors range from a qualified engineer in far north Queensland with operational turnaround "know how" to an investment bank in Sydney with experience in complex cross-border restructures. 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.[38]

2.45 Clayton Utz also expressed support for the bill as currently drafted, submitting that:

> We continue to support the flexibility that the test in section 588GA(2) allows as currently drafted, bearing in mind that a turnaround for different corporate entities will depend very much on their different needs having regard to the nature, size, complexity and financial position of the business to be restructured and will vary on a case by case basis. [39]

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34 Australian Restructuring Insolvency and Turnaround Association, *Submission 18*, p. 2.

35 Australian Restructuring Insolvency and Turnaround Association, *Submission 18*, p. 2.

36 Australian Institute of Credit Management, *Submission 19*, pp. 1–2.

37 TMA Australia, *Submission 5*, p. 2.

38 TMA Australia, *Submission 5*, p. 2.

39 Clayton Utz, *Submission 15*, p. 3.

2.46 Similarly, the AICD noted that it does not support suggestions to limit the definition of an 'appropriately qualified entity', arguing that:

> An accreditation requirement imposed on advisers would unnecessarily restrict the class of persons from whom advice may be sought. Companies should be free [to] take advice from those with the appropriate skills and experience for the company's specific circumstances and turnaround requirements, irrespective of whether or not they belong to an accredited profession (e.g. registered liquidator, lawyer, accountant etc.). Also, it may be possible and appropriate for a company to appoint multiple advisers, all tasked with assisting in specific areas, and whose advices collectively inform the decisions of the board.[40]

Illegal phoenix activity

2.47 Notwithstanding comments relating to how an 'appropriately qualified entity' is constituted in the bill, a number of submitters contended that, overall, the introduction of a safe harbour should act as a disincentive to illegal phoenix activity.[41] For example, the AICD submitted that 'the reforms proposed in the bill will not encourage, increase or support illegal phoenixing activity'.[42]

2.48 The ASBFEO echoed this view, asserting that:

> The introduction of a safe harbour provision should be an incentive to directors try and save their businesses, generating greater accountability and loyalty to the ongoing existence of an entity. This may reduce incentives to 'phoenix' companies and this may create greater stability for stakeholders such as employees and suppliers.[43]

Director Identification Number

2.49 Several submitters noted the recent commentary regarding the Productivity Commission's recommendation to introduce a Director Identification Number (DIN) for company directors as a measure to reduce phoenix activity.[44]

2.50 ARITA expressed its support for the introduction of a DIN, and encouraged the committee to consider the implementation of this measure.[45]

2.51 While acknowledging concerns about the harm that illegal phoenix activity can have on the Australian economy, other submitters reasoned that initiatives to

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40 Australian Institute of Company Directors, *Submission 16*, p. 7.

41 See, for example, Australian Small Business and Family Enterprise Ombudsman, *Submission 7*, p. 1; Law Council of Australia, *Submission 10*, p. 2; Australian Institute of Company Directors, *Submission 16*, p. 6.

42 Australian Institute of Company Directors, *Submission 16*, p. 6.

43 Australian Small Business and Family Enterprise Ombudsman, *Submission 7*, p. 1.

44 See Productivity Commission, *Business Set-up, Transfer and Closure*, No. 75, September 2015, pp. 426–429.

45 Australian Restructuring Insolvency and Turnaround Association, *Submission 18*, pp. 2, 6–7.

combat phoenix activity, including the introduction of a DIN, would best be addressed by specific legislation. For example, the Law Council of Australia submitted that:

> We note that there are valid concerns about the harm that improper phoenix activity has on the economy and we share those concerns. However, the Committees believe that phoenix problems are better addressed by specific legislation, which is likely to be more effective than including provisions in the Bill.[46]

2.52 Henry Davis York expressed a similar view, commenting that the introduction of a DIN 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.[47]

Views on ipso facto clause reform

2.53 Submitters were broadly supportive of the ipso facto clause reforms proposed in the bill. Several submitters noted the foreseen outcomes of the measure for company creditors, who will ultimately benefit from increased returns as a result of more effective and meaningful restructuring processes.[48]

2.54 The AICD summarised its support for the ipso facto measure:

> To preserve enterprise value and jobs, the AICD supports a stay on the operation of ipso facto clauses that permit unilateral variation or termination solely due to a formal insolvency restructure. Provided all other contractual terms are being met, a counterparty should not be able to terminate the contract, accelerate payment, impose new terms of payment, require additional security for existing obligations, or claim forfeiture of the contract term.
>
> While imposing a stay on the operation of ipso facto clauses would, to some extent, restrict the contractual rights of individual creditors of distressed companies, creditors as a whole would benefit from the increased prospect of a meaningful turnaround of the business or of a higher return should a restructure ultimately be unsuccessful. Accordingly, we endorse the stay.[49]

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46 Law Council of Australia, *Submission 10*, p. 2.

47 Henry Davis York, *Submission 14*, p. 2.

48 See, for example, EY, *Submission 9*, p. 2; Australian Institute of Company Directors, *Submission 16*, p. 10.

49 Australian Institute of Company Directors, *Submission 16*, p. 10.

2.55 Mr Geoff Green expressed his strong support for the ipso facto reforms, contending that 'the reforms are so beneficial that I believe we should move away from the proposed very gradual implementation, and implement them more quickly'.[50]

Application to new contracts only

2.56 As noted in the Explanatory Memorandum, the ipso facto protections proposed in Part 2 to the bill 'only apply to rights arising under contracts, agreements or arrangements which are entered into after the commencement of this Part'.[51]

2.57 A number of submitters asserted that the application of the stay on the enforcement of ipso facto clauses to only new contracts will limit the effectiveness of the measure as contractual counterparties will avoid entering into new contracts.

2.58 Mr Geoff Green summarised this concern in his submission to the inquiry:

> Many contractual counter-parties currently holding ipso facto termination rights will avoid entering into new contracts. Instead they will seek to vary existing contracts, to preserve those termination rights. Those with greater negotiating leverage are most likely to be successful, i.e. by definition, extension will be more likely to occur where there is an imbalance of power. There will be some cases where contracts with ipso facto termination rights continue in existence for many years – with variation after variation after variation - and for most businesses, in practical terms the implementation will therefore be gradual.[52]

2.59 Similarly, Ashurst commented that the limitation of the stay on ipso facto clauses will 'distort commercial dealings, as suppliers will seek to amend existing contracts rather than enter into new contracts'.[53]

2.60 The Law Council of Australia expressed the view that restricting the application of the ipso facto clause changes to new contracts will 'create a competitive imbalance in the economy', submitting that:

> Where a contract is changed in the future this will not generally result in a new contract coming into effect unless that is expressly stated as creating a new and distinct contract. For many commercial dealings, a standard contractual framework will allow for numerous individual amendments over many years (even decades) without entering into a new contract. This means that all existing contracts will never come within the scope of the protections and the law will effectively create two classes of contracts, those that started before commencement in 2018 (even where there have been multiple changes over time) and those new greenfields contracts that only started from 2018. 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

50 Mr Geoff Green, *Submission 3*, p. 1.

51 Explanatory Memorandum, p. 41.

52 Mr Geoff Green, *Submission 3*, p. 1.

53 Ashurst, *Submission 6*, p. 10.

> have radically different rights in restructuring simply because one contract is pre-2018 and the other is post-2018.[54]

2.61 The Law Council of Australia recommended 'introducing a transitional period (perhaps of 12 months or 2 years) during which time contracts can be reviewed and amended by the parties to accommodate the ipso facto changes'.[55]

2.62 KordaMentha also argued that consideration be given to amending the application of the ipso facto reforms, observing that:

> It is likely to be a number of years before companies in financial distress will see the benefit of these changes. Consideration should be given to the stay extending to existing contracts in relation to new insolvency administrations which commence after the enactment date.[56]

Period of the stay

2.63 Under the bill, if a company enters into administration, the stay on the enforcement of ipso facto rights continues until the administration ends 'unless the administration ends because the company is being wound up, in which case the rights will not be enforceable until the time when the affairs of the company are fully wound up'.[57]

Deed of company arrangement

2.64 In its submission to the inquiry, Herbert Smith Freehills noted that, as currently drafted, there is no corresponding extension of the stay on ipso facto clauses where a company enters into a deed of company arrangement[58] (DOCA) as a result of administration instead of liquidation.[59]

2.65 Herbert Smith Freehills expressed concern that this may be counter to the objective of the bill of encouraging effective restructuring, explaining that:

> In our view, this is an anomalous result and is likely to be counterproductive in terms of encouraging restructuring. A DOCA is the primary mechanism for implementing a restructure through the administration process. It should be encouraged as the preferred outcome of administration in appropriate cases if restructuring is to be supported.
>
> The Bill as currently drafted creates an unusual situation where a company has the benefit of a stay on the exercise of ipso facto rights during its administration, but has no corresponding protection if it then enters into a

54 Law Council of Australia, *Submission 10*, p. 4.

55 Law Council of Australia, *Submission 10*, pp. 4–5.

56 KordaMentha, *Submission 12*, p. 2.

57 Explanatory Memorandum, p. 31.

58 A deed of company arrangement (DOCA) is a binding arrangement between a company and its creditors governing how the company's affairs will be dealt with, which is accepted by creditors as the outcome of a voluntary administration.

59 Herbert Smith Freehills, *Submission 17*, p. 5.

> DOCA. This may lead to liquidation being the preferred outcome of administration in some circumstances.[60]

2.66 Herbert Smith Freehills submitted that 'the stay that applies in administration should be continued for as long as a DOCA remains on foot following that administration'.[61]

Liquidation following voluntary administration

2.67 As noted, in cases where attempts to restructure a company under administration are unsuccessful, the stay on ipso facto rights continues where the company enters into liquidation until its affairs 'are fully wound up'. However, a number of submitters pointed out that there is no corresponding stay where a company enters into liquidation without first being subject to administration.[62]

2.68 Henry Davis York disagreed with the extension of the stay on ipso facto rights to companies that enter liquidation following administration, arguing that this approach is inconsistent and unjust, as 'creditors would be required or forced to continue to supply a company during its liquidation'.[63]

2.69 Ashurst echoed this view, reasoning 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. In that situation, the stay should end on the date the liquidator is appointed. It seems particularly anomalous for a stay on ipso facto clauses to continue automatically throughout a winding up that follows a scheme or a VA, while those clauses will only be stayed while a company is subject to a DOCA if there is a court order to that effect.[64]

2.70 Similarly, Herbert Smith Freehills contended that it is 'unclear why the stay applies in some liquidations but not others', further submitting that 'the stay on the exercise of ipso facto rights should not apply in any liquidations, noting that liquidation is not a recognised mechanism for implementing a restructure'.[65]

2.71 In contrast to the views discussed above, the Law Council of Australia noted its support for the ipso facto protections extending to liquidations that follow voluntary administration:

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60 Herbert Smith Freehills, *Submission 17*, p. 5.

61 Herbert Smith Freehills, *Submission 17*, p. 6.

62 See, for example, Ashurst, *Submission 6*, p. 10; Australian Bankers' Association, *Submission 13*, p. 2; Herbert Smith Freehills, *Submission 17*, p. 6.

63 Henry Davis York, *Submission 14*, p. 3.

64 Ashurst, *Submission 6*, p. 10.

65 Herbert Smith Freehills, *Submission 17*, p. 6. See also Australian Bankers' Association, *Submission 13*, p. 2.

> 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.[66]

Self-executing clauses

2.72 In its submission to the inquiry, ARITA brought attention to the operation of self-executing ipso facto clauses in contracts which take effect just prior to an application under section 411 of the Corporations Act, or the appointment of an administrator or managing controller. ARITA expressed concern that such self-executing clauses may 'escape the ipso facto clause prohibition', further submitting that:

> Consideration should be given to whether the regulation-making power is adequate to ensure that enforcement reasons which might self-execute just prior to a voluntary administration/managing controller appointment or s411 application can be effectively prescribed for the purposes of the intended ipso facto stay.[67]

Committee view

2.73 The committee notes that the stringency of Australia's insolvent trading laws has been publically debated for many years and that the reforms proposed in the bill have been the subject of extensive stakeholder consultation. The committee again thanks all individuals and organisations that have contributed to the inquiry.

2.74 The committee agrees that aspects of the current insolvency law—in particular, the threat of personal liability for insolvent trading and the operation of ipso facto clauses—put too much focus on stigmatising and penalising failure.

2.75 By encouraging company directors to take responsible and measured steps to turn around businesses in financial distress, the committee is confident that the reforms in the bill will support effective company restructuring and, in turn, promote innovation and entrepreneurship for the benefit of all stakeholders, and the Australian economy overall.

2.76 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.

2.77 The committee acknowledges recent commentary regarding the Productivity Commission's recommendation to introduce a Director Identification Number for company directors as a measure to reduce illegal phoenix activity. In this regard, the committee notes that the government is giving this proposal further consideration as

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66 Law Council of Australia, *Submission 10*, p. 5.

67 Australian Restructuring Insolvency and Turnaround Association, *Submission 18*, p. 8. See also EY, *Submission 9*, p. 2.

part of its ongoing work on insolvency reforms, and also points to the work of the Phoenix Taskforce.

Recommendation 1

2.78 The committee recommends that the bill be passed.

Senator Jane Hume
Chair