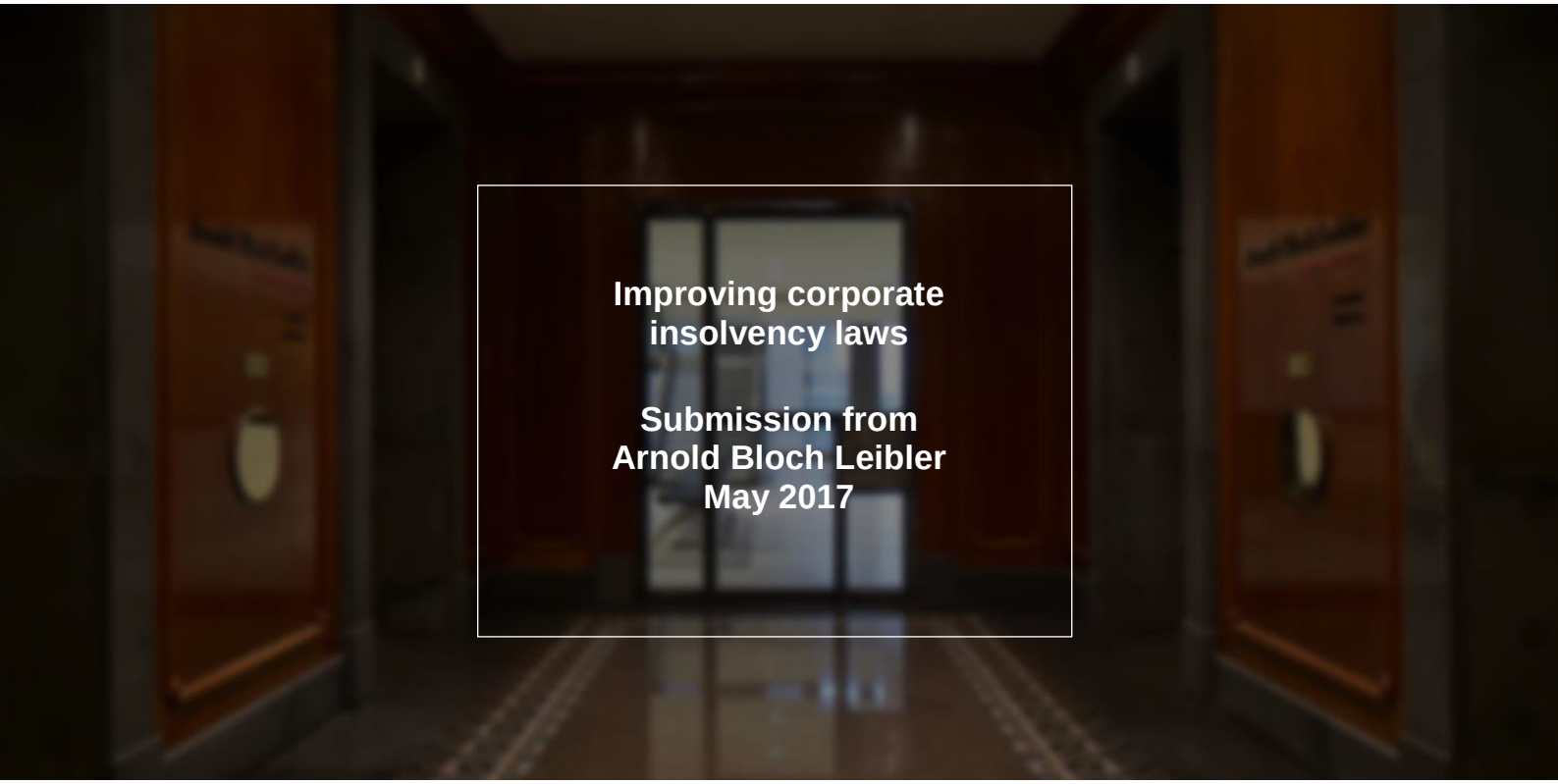
Arnold Bloch Leibler

Lawyers and Advisers



Improving corporate insolvency laws

Submission from
Arnold Bloch Leibler
May 2017

1. Introduction

1.1. This submission has been prepared by Arnold Bloch Leibler in response to the Australian Government's request for feedback on the draft legislation released by the Honourable Kelly O'Dwyer MP, the Minister for Revenue and Financial Services.

1.2. As a general observation we welcome the proposed reforms as a significant improvement to the current insolvency legislative framework. ABL has continually advocated for law reform in relation to restructuring, including through submissions to the Productivity Commission regarding the 'Business Set-up, Transfer and Closure' inquiry and draft report.

1.3. This submission is also borne out of our experience in larger corporate solvent and insolvent reconstructions over the last 20 years including Ansett 2001+, Newmont Yandal 2003+, Alinta 2010-2011, Centro 2007+, Timbercorp 2010+, Gunns 2012 +, Nine Entertainment 2012-2013, One.Tel 2014, Lehman Brothers final resolution 2015, Arrium 2016, Boart Longyear 2017, Slater & Gordon (currently underway) as well as other large restructurings not in the public domain.

2. The Proposed Safe Harbour Defence

Preliminary comments

2.1. Arnold Bloch Leibler's position is that section 588G(2) of the *Corporations Act 2001* (Cth) (**Act**) ought not apply to ASX listed companies at all. Directors of publicly listed companies already face heightened duties and risks relating to continuous disclosure obligations and financial reporting requirements, in addition to their statutory and general law duties as directors.

2.2. The financial reporting requirements and continuous disclosure obligations imposed on publicly listed companies are significant. Creditors or potential creditors of these companies have a large amount of information available to them about the company's financial position. This enables them to assess credit risk and reduces the need for additional protective measures such as director liability for insolvent trading.

2.3. Australia's insolvent trading laws are stricter than any other jurisdiction and reflect a culture of protecting the interests of creditors without fair regard to other interests such as the need to stimulate innovation, change, disruption and profit. We advocate for changes to the laws so as to balance the rights of and protections for creditors with the rights of boards and management to undertake honest commercial risk-taking endeavors.If the government seeks to better balance the competing interests of all stakeholders, it should ensure that our insolvency laws do not unnecessarily stigmatise and penalise failure, and therefore more extensive reform is required.

The current draft

2.4. The proposed safe harbour defence applies:

(a) *after the person starts to suspect the company may become or be insolvent, the person starts taking a course of action that is reasonably likely to lead to a better outcome for the company and the company's creditors; and where*

(b) *the debt is incurred in connection with that course of action, during the period starting at that time, and ending at the earliest of any of the following times*.

2.5. There are two key issues with the defence in this form. The first is that '*a course of action that is reasonably likely to lead to a better outcome for the company and the company's creditors'* is an inherently subjective concept. What appears reasonable to

one person may appear unreasonable to another person considering the action with the benefit of hindsight and through the prism of subsequent corporate failure.

2.6. The second is that the defence appears to apply to each debt incurred by a company in the relevant period, such debts needing to be *'in connection with that course of action'*.

Evidential burden

2.7. The draft legislation provides that the person wishing to invoke the safe harbour bears an 'evidential burden'. 'Evidential burden' is defined to mean *'the burden of adducing or pointing to evidence that* ***suggests a reasonable possibility*** *that the matter exists or does not exist.'* (Emphasis added)

2.8. The drafting is difficult to reconcile with the draft explanatory memorandum which states:

> *To fall within the protection of the safe harbour a director will generally only be required to provide evidence about the course of action that was taken. A liquidator (or other person) seeking to make the director personally liable for any debts incurred while the company was insolvent will bear the onus of establishing that the course of action by the director was not reasonable in the circumstances.*

2.9. In our view, the evidential burden on the liquidator (or other person) articulated in the explanatory memorandum ought to be clarified and expressly set out in the legislation.

Factors to be considered in determining whether a course of action is reasonably likely to lead to a better outcome for a company and its creditors

2.10. The draft explanatory memorandum states at paragraph 1.31 that the proposed section 588GA(2) is intended to provide an indicative and non-exhaustive list of factors to be considered in determining whether a course of action is reasonably likely to lead to a better outcome for a company and its creditors.

2.11. Whilst we agree that the factors listed are an appropriate starting point, as currently drafted, section 588GA(2) fails to clarify whether the factors are prescriptive or indicative only. The section should include the words '*the Court may have regard …*' to clarify the purpose of the provision.

2.12. As noted above, the concept of 'reasonably likely' is inherently subjective. The draft explanatory memorandum at paragraph 1.16 recognises that '*[w]hether a course of action is reasonable will vary on a case-by-case basis depending on the individual company and its circumstances'.* It further states that directors *'whose recovery plans are fanciful, will fall outside the bounds of the safe harbour'*. This requires the court to undertake a commercial analysis of a restructuring proposal after it has failed. In our view, this is undesirable and does not provide sufficient certainty for directors who continue to trade in the 'twilight zone' of solvency.

Application to individual debts incurred

2.13. As noted at paragraph 2.6 above, the defence as drafted needs to be separately applied in respect of each debt the subject of an application under section 588G(2) of the Act, as each debt needs to have been 'incurred in connection with that course of action' which is intended to produce a better outcome for the company. It is neither feasible nor desirable for directors of large companies to monitor every debt being incurred by the company.

Obligation on the director to take a course of action

2.14. A strict reading of the draft provision requires 'the person' relying on the defence to start taking a course of action. In our view, the obligation to take a course of action would be better framed as an obligation of 'the company'. It is entirely possible that a director may

start to suspect the possibility of insolvency but, at the same time, be confident that management is already undertaking a course of action which is reasonably likely to lead to a better outcome for the company.

Requirement for company to be providing for employee entitlements and compliance with taxation laws

2.15. Arnold Bloch Leibler agrees that these carve-outs are appropriate.

Exclusion of books and information withheld from a liquidator or administrator

2.16. We agree that directors who fail to comply with their obligations to deliver up books and records to a liquidator or administrator should not subsequently be entitled to rely on those books and records for their own purposes.

2.17. The exception contained in the proposed section 588GB(3) only applies where a person proves that they did not possess the book or information and that there were no reasonable steps that they could have taken to obtain the book or information.

2.18. In our view, the exception should be drafted so as to apply where a person proves that they took all reasonable steps to comply with the requisite notice.

2.19. Proving a negative is exceptionally difficult and it is difficult to see what evidence might be available to a director outside of their own sworn statement to the effect that they did not possess the book or information.

2.20. Further, it may be that there are books or information not in the physical possession of a director at the time when a notice was issued by a liquidator or administrator and that they failed to take steps to obtain the book or information because they were simply unaware of its existence at the time. The provision should at the very least confer a discretion on the Court to allow such evidence to be relied on where a director has in the circumstances honestly and reasonably complied with the notice.

3. Ipso Facto Clauses

3.1. As a preliminary point, we are pleased that the proposed legislation has been drafted in a manner which will preclude the enforceability of contractual provisions which purport to do more than just terminate the contract, including provisions which accelerate payment obligations or apply a higher price to the services provided.

3.2. The stay on enforcing rights merely because of arrangements or restructures has been drafted so as to apply where a company makes an application to convene meetings for a scheme of arrangement pursuant to section 411 of the Act or where a company is under voluntary administration.

3.3. In our view, this leaves companies exposed in the period leading up to a restructure.

3.4. Ipso facto clauses are based on a definition of 'insolvency event' which are regularly drafted to include the following type of wording:

> ***a resolution is passed, proposal put forward, or any other action taken which is preparatory to or could result in*** *(amongst other things) any:*
>
> - *arrangement or composition with one or more of its creditors or any assignment for the benefit of one or more of its creditors; or*
> - *any reorganisation, moratorium, deed of company arrangement or other administration involving one or more of its creditors.*

3.5. The current draft legislation does not impose a stay on enforcing rights in respect of arrangements until the Part 5.1 body is the subject of an application under section 411.

3.6. Publicly listed companies are required to make disclosure of proposed schemes well before an application under section 411 is filed. By way of example, Atlas Iron Ltd announced that it had entered into a debt restructure agreement with its secured lenders and the fact that the restructure was to be implemented by a creditors' scheme of arrangement, on 23 December 2015. The originating process for the section 411 application was not filed with the court until 24 March 2016. Entering into the debt restructure agreement would have constituted a breach of the ipso facto clause as set out above.

3.7. Accordingly, the proposed stay should be expanded to apply to circumstances where a company has resolved to pursue a restructure by way of scheme of arrangement and where that restructure is continuing to be actively and reasonably pursued by the company.

4. Future Reform

4.1. In our preliminary submissions to the Productivity Commission in February 2015, Arnold Bloch Leibler advocated for changes to the voluntary administration regime which were designed to reduce the stigma associated with it. In our view, revisions to the voluntary administration regime are necessary and ought to form part of the next round of insolvency reform. We refer to and reiterate paragraphs 3.2 to 3.19 of our submissions made in February 2015.

Contact details
Arnold Bloch Leibler

Level 21
333 Collins Street
Melbourne VIC 3000
(03) 9229 9999

Level 24
2 Chifley Square
Sydney NSW 2000
(02) 9226 7100

www.abl.com.au