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The Manager, Corporations and Schemes Unit
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By email to insolvency@treasury.gov.au

ASA SUBMISSION – IMPROVING BANKRUPTCY AND INSOLVENCY LAWS PROPOSALS PAPER

Dear Sirs

The Australian Shareholders' Association (ASA) represents its members to promote and safeguard their interests in the Australian equity capital markets. The ASA is an independent not-for-profit organisation funded by and operating in the interests of its members, primarily individual and retail investors, self-managed superannuation fund (SMSF) trustees and investors generally seeking ASA's representation and support. ASA also represents those investors and shareholders who are not members, but follow the ASA through various means, as our relevance extends to the broader investor community.

We refer to the proposals paper entitled "Improving bankruptcy and insolvency laws" dated April 2016. Our response focusses primarily on the second proposal in the paper on 'safe harbour' for directors from personal liability for insolvent trading, but we include brief comments in relation to the other proposals. In preparing this response, we have had regard to the Productivity Commission Report on *Business Set-up, Transfer and Closure* released in December 2015.

Safe Harbour Model A

We are broadly supportive of the proposal set out in Proposal 2.2. We believe there must be clear limits to when the defence can apply, as the restructuring process cannot go on indefinitely. Thus is it important that any appointed restructuring adviser must remain of the view that the company can be returned to solvency and avoid insolvent liquidation. We do however have reservations about the application of the safe harbour as we believe there that application of the proposal will present practical difficulties.

Query 2.2 – The wording of the proposal suggests that the restructuring adviser will have formed a view whether or not the company can be returned to solvency on appointment, but in reality, the adviser will need a period of time (which may well be weeks after the appointment) to come to that view. It is not clear from the proposed wording whether the safe harbour will operate from the time of appointment to the date the restructuring adviser is able to form its view. We assume

the intention is that the safe harbour would be available from the time of appointment until the company is advised that a negative view has been formed by the restructuring adviser, or until the restructure is complete, whichever is earlier. It is important that the restructuring adviser is able to provide an opinion within a reasonable amount of time.

Query 2.2.1a – Given the adviser's critical role in a safe harbour, it is important that the restructuring adviser is appropriately experienced, qualified and informed. The adviser should have a high level of understanding of company restructures and insolvency law and at least five years' industry experience. It is also important that the adviser is independent. Any requirements as to the adviser's qualifications and experience should be included in the regulations, rather than simply in ASIC guidance.

Query 2.2.1b – We agree that the restructuring adviser should be an accredited member of an approved organisation. However, accreditation for a restructuring adviser should be from one organisation, not a myriad of different organisations. We would have thought the Australian Restructuring, Insolvency and Turnaround Association (ARITA) would be an appropriate organisation to provide accreditation.

Query 2.2.1c – The Government's approach to determining viability is appropriate.

Query 2.2.1d – We would expect the restructuring adviser to take into account the company's financial situation, particularly cash flow, assets and liabilities, and any material contracts it has entered into. The willingness of banks to continue to lend money to the company will also be relevant. We believe these factors should be set out in ASIC guidance rather than regulations, as this would provide some scope for discretion. It is important that any other factors considered appropriate by the adviser are fully explained.

Query 2.2.1e – We assume the appointment of any restructuring adviser will be done by the directors on behalf of the company.

Query 2.2.2a – We agree with the approach outlined in the paper.

Query 2.2.2b – We acknowledge the reasoning behind not requiring companies to disclose that they are operating in safe harbour, however we have difficulty understanding how this will operate in conjunction with the continuous disclosure rules for listed companies as we would expect that the acknowledgment by directors of financial difficulty and the appointment of a restructuring adviser would likely be an event requiring disclosure under the continuous disclosure rules. We accept that the majority of company exits relate to small and medium businesses to which the continuous disclosure rules do not apply. Nonetheless, we believe the safe harbour should be disclosed at least to counterparties otherwise new contracts may be entered into which would otherwise be avoided.

Query 2.2.3 – We are concerned about including an ASIC or Court determination of ineligibility as a situation where the safe harbour is not available, as our view is that reliance should not be placed on ASIC or the Court to make a determination (the latter we would have thought would

follow from an application from ASIC). It would be more feasible to set out the particular types of prior misconduct which would automatically result in the safe harbour not being available.

Safe Harbour Model B

We do not believe there should be an 'honest and reasonable belief' carve out to the insolvent trading provisions. This is because for a safe harbour to be successful, there must be clear limits as to its operation. As the Productivity Commission Report notes, the rate of successful enforcement of insolvent trading actions is low – with only 103 insolvent trading cases between the law's introduction in 1961 and 2004, and ASIC having commenced action for five companies between 2005 and 2011. The Report notes the difficulties in proving intention, state of mind and personal knowledge, as well as the considerable scope to mount a defence based on the circumstances.

Our view is that the availability of a "carve out" as proposed in the paper would introduce further complexities and uncertainty in terms of application thereby limiting the effectiveness and operation of the carve out.

Reducing the default bankruptcy period

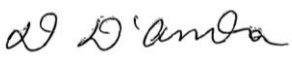
Our view is that one year is too short. The paper notes that the intention is to facilitate entrepreneurship and innovation, however as expressed it would apply to everyone. We believe that the changes should only apply to entrepreneurs and appropriate restrictions should apply (for example, based on capital, assets or size of the business).

Ipso facto clauses

The proposed changes appear to be appropriate. However we believe that the retrospective effect of the voiding of ipso facto clauses should be subject to the ability of the creditor to renegotiate terms to compensate for the greater risk undertaken within a period of 12 months after the relevant date. If no action is taken by that party within 12 months, the retrospective aspect of the legislation could then into effect.

Please do not hesitate to contact me if you have any queries.

Yours faithfully,



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