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James Mason
Manager
Corporations and Schemes Unit
Financial Systems Division
The Treasury
Langton Crescent
Parkes ACT 2600
Email to: insolvency@treasury.gov.au

Dear Mr Mason,

National Innovation and Science Agenda – improving bankruptcy and insolvency laws

I am a Chartered Accountant and former registered liquidator, with more than 20 years' experience in financial and professional services at Nab, ANZ Bank, and Ernst & Young.

In my current role I lead complex loan workouts across the Institutional and Corporate platforms at Nab, and I am an ARITA Vic./Tas. board member.

I very much appreciate the opportunity to provide feedback on the *National Innovation and Science Agenda – improving bankruptcy and insolvency laws* Proposals Paper, which for clarity represent my personal views and are not made on behalf of either Nab or ARITA.

General comments

Reducing the default bankruptcy period

I do not support the proposal to reduce the default period of bankruptcy from three years to one year.

The proposal would significantly reduce the time available for bankruptcy trustees to finalise their investigations in time to lodge an objection. For that reason any proposal to reduce the default period should be accompanied by a corresponding significant revision to the objection process, so that poor conduct or inadequate disclosure can be raised "within time."

Safe Harbour - Insolvent Trading

I agree that we should create a Safe Harbour defence to support directors who take an active role in restructuring their company whilst having regard to the overall interests of creditors. That defence should be framed around key pillars as below:

- The safe harbour should operate as a defence to insolvent trading claims. It is not necessary or optimal to create a new form of insolvency regime or quasi–regime such as that involving the formal appointment of a restructuring adviser.
- Directors should not have access to a safe harbour as a result of simply appointing a person as a restructuring adviser (RA), and they should have an overarching duty to act in the best interests of creditors overall.
- If an RA is appointed then that person should have appropriate skills and experience, their role should be supported, and their advice acted upon except with good reason.

- Care should be taken about attempting to prescribe a particular qualification for RAs. A Restructuring Adviser, if appointed, should be capable of providing assistance to a company having regard to the nature of its business and its particular problems and issues – rather than the holder of a particular qualification.
- An RA must be accountable to the directors with the directors accountable for the overall outcome.
- It is imperative that access to the defence does not require disclosure. Confidentiality is critical in such situations because publicity about possible financial difficulties becomes self-fulfilling if suppliers shorten credit terms or customers take their business elsewhere. For that reason:
  - There should be no notification to ASIC
  - There should be a specific prohibition against disclosure for ASX listed companies.

The Ipso facto model

A restriction of the operation of ipso facto clauses is potentially a very significant and positive reform. I would like to identify specific issues warranting careful treatment, as follows:

- We should avoid a situation where an insolvency that has been "cured" by a restructuring can still trigger an ipso facto clause.
- There are a range of financial contracts which rely on netting and set-off. These should be outside the operation of the ipso facto restriction.

  For example, banks will sometime provide a group overdraft to a group of companies against an overall net balance limit, which removes the requirement for the business to make intra-group transfers on a daily basis. If an ipso facto prohibition applied to these arrangements then actual balance transfers would be reinstated with no net effect on any party other than increased administration for the operator of the bank accounts.
- Insolvency is an event of default in almost all loan arrangements, allowing secured lenders to accelerate or enforce their security subject to the restrictions contained in section 440B of the Corporations Act. Currently lenders may be prepared to waive other events of default such as payment default and breach of financial covenant because they will be able to rely on the ground of insolvency.

  If lenders' rights to accelerate were to be subject to the operation of the provision, then lenders will be less likely to provide waivers, to ensure that they retain the right to accelerate. This will impact on the assessment of solvency by both auditors and directors. It would be an unexpected outcome if reforms intended to facilitate restructuring in fact de-stabilised businesses and/or prompted directors to enter into formal insolvency rather than seek to restructure their business.
- There are insurance policies which provide businesses with protection against the insolvency of their customers. Ipso Facto restrictions should not have application to these policies.

Responses to specific queries

Proposal 1.1

The Government proposes to retain the trustee's ability to object to discharge and to extend the period of bankruptcy to up to eight years

Query 1.1

The Government seeks views from the public on whether the criteria for lodging an objection and the standard of evidence to support an objection should be changed to facilitate a trustee's ability to object to discharge.

Response: **Yes, if the time available to conduct an investigation is to be shortened significantly then the standard of evidence required should be reduced significantly. Alternatively, it may be appropriate to create an interim objection which extends the bankruptcy for say a further two years whilst the trustee conducts further investigations, particularly if those investigations relate to transactions in which the bankrupts or associated parties have been involved.**

Proposal 1.2.1

The Government proposes to change the Bankruptcy Act to ensure the obligations on a bankrupt to assist in the administration of their bankruptcy remain even after they have been discharged to allow for the proper administration of bankruptcy.

Query 1.2.1a

The Government seeks views from the public on which particular obligations on a bankrupt should continue even after a bankrupt is discharged.

Response: In addition to the other post-bankruptcy obligations referred to in the Proposals Paper, all of the obligations in s.77 of the Act should continue to apply.

Query 1.2.1b

The Government seeks views from the public on what incentives and mechanisms should be in place to ensure compliance with obligations after discharge.

Response: A person that is discharged from bankruptcy after 12 months but then not complying with their post-bankruptcy obligations to the trustee should:

- **be ineligible to act as a director of a company.**
- **be potentially subject to prosecution for non-compliance**
- **have their income contribution period extended to eight years (ie as if an objection had been lodged).**

Proposal 1.3.1b

The Government proposes to retain the permanent record of bankruptcy in the National Personal Insolvency Index.

Query 1.3.1

The Government seeks views from the public on whether it is appropriate to reduce the retention period for personal insolvency information in credit reports.

Response: It would not be appropriate to reduce the retention period for personal insolvency information in credit reports

Proposal 2.2

It would be a defence to s588G if, at the time when the debt was incurred, a reasonable director would have an expectation, based on advice provided by an appropriately experienced, qualified and informed restructuring adviser, that the company can be returned to solvency within a reasonable period of time, and the director is taking reasonable steps to ensure it does so. The defence would apply where the company appoints a restructuring adviser who: (a) is provided with appropriate books and records within a reasonable period of their appointment to enable them to form a view as to the viability of the business; and (b) is and remains of the opinion that the company can avoid insolvent liquidation and is likely to be able to be returned to solvency within a reasonable period of time. The restructuring adviser would be required to

exercise their powers and discharge their duties in good faith in the best interests of the company and to inform ASIC of any misconduct they identify.

Query 2.2 Subject to the further information on the proposal set out in the sections below, the Government seeks views from the public on whether this proposal provides an appropriate safe harbour for directors.

Response: The appointment of a restructuring adviser should be a defence rather than a new form of insolvency regime. I agree that directors should seek expert advice and assistance where appropriate. I do not believe that is possible or helpful to identify a specific qualification for that person or to impose that person with specific duties arguably in such a way that it derogates the director's own duties.

There should not be any requirement for a RA to inform ASIC of misconduct. Identification of misconduct should not be a focus for an RA adviser as it would be a distraction from their key objective and in some cases it would be inconsistent with confidentiality.

Query 2.2.1a

The Government seeks views from the public on what qualifications and experience directors should take into account when appointing a restructuring adviser and whether those factors should be set out in regulatory guidance by the Australian Securities and Investments Commission, or in the regulations.

Response: Directors should be required to ensure that a RA has skills and experience relevant to their objectives and requirements for addressing the company's financial and business situation. I do not believe that it is possible or helpful to mandate a specific qualification.

Query 2.2.1b

The Government seeks views from the public on which organisations, if any, should be approved to provide accreditation to restructuring advisers if such approval is incorporated in the measure.

Response: I do not believe that it is possible or helpful to mandate a specific qualification or mandate a specific body to provide accreditation.

Query 2.2.1c

Is this an appropriate method of determining viability?

Response: I support the proposed test of viability - whether the company can avoid insolvent liquidation, and be returned to solvency within a reasonable period of time.

Query 2.2.1d

What factors should the restructuring adviser take into account in determining viability? Should these be set out in regulation, or left to the discretion of the adviser?

Response: This should be left to the RA and directors to determine

Query 2.2.1e The Government seeks views from the public on whether these are appropriate protections and obligations for the restructuring adviser, and what other protections and obligations the law should provide for.

Response: The RA is not running the company or its business, but rather advising the directors. There should be no need for any protections for the RA as the duties and obligations fall on the directors and not the RA.

Safe harbour would not prevent, upon a subsequent liquidation of the company, any civil claim against a director in relation to any outstanding employee entitlements which accrued during the safe harbour period. Similarly, the period during which the safe harbour defence applies should be disregarded for the purposes of calculating any reach-back period for director related party transactions

Query 2.2.2a Do you agree with this approach?

Response: Yes

Query 2.2.2b

Do you agree with our approach to disclosure?

Response: No. Confidentiality is critical to achieve a restructuring. There should be no positive requirement for disclosure, and in addition a prohibition against ASX disclosure.

Query 2.2.3

The Government seeks views from the public on in what other circumstances should the safe harbour defence not be available.

Response: Subject to meeting the actual requirements of the defence itself, the availability of the defence – or not - should be clear to a director at the relevant time. For example non-availability to an undischarged bankrupt is certain at the relevant time, however non-availability due to a later *discretionary* finding on the part of a Court or ASIC would be unfair.

Query 2.3 The Government seeks your feedback on the merits and drawbacks of this model.

Response: I prefer Model B to Model A, however there are parts of Model A which could usefully provide guidance to directors if added to the Model B approach.

As regards the reference to early engagement with shareholders – I would argue against any measures that would compromise the confidentiality of a restructure.

Proposal 3.2 The Government proposes that any term of a contract or agreement which terminates or amends any contract or agreement (or any term of any contract or agreement), by reason only that an 'insolvency event' has occurred would be void. Any provision in an agreement that has the effect of providing for, or permitting, anything that in substance is contrary to the above provision would be of no force or effect.

Query 3.2.a Are there other specific instances where the operation of ipso facto clauses should be void? For example by prohibiting the acceleration of payments or the imposition of new arrangements for payment, or a requirement to provide additional security for credit.

Response:

- **The restriction should operate by making ipso facto clauses unenforceable rather than void. The restriction should be permanent so that a counter-party may not later rely on such a clause.**

- **Ipso facto is in fact an important and positive part of some financial contracts (for example, credit insurance policies and group set-off arrangements). There should be careful analysis before applying any restriction to such arrangements.**
- **There should be no interference with the long-standing rights of lenders to accelerate on the ground of insolvency. To do so would provide lenders with a reason to refuse to waive other defaults.**

Query 3.2b Should any legislation introduced which makes ipso facto clauses void have retrospective operation?

Response: The restriction should not apply to insolvencies already underway at the date of commencement, but they should apply to contracts that are entered into prior to the date of commencement.

Query 3.2.b Are there any other circumstances to which a moratorium on the operation of ipso facto clauses should also be extended?

Response: As detailed in the answer to 3.2.b.

Query 3.2.1 Does this constitute an adequate anti-avoidance mechanism?

Response: I support a carefully drafted anti-avoidance provision along these lines

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Query 3.2.2 What contracts or classes of contracts should be specifically excluded from the operation of the provision?

Response:

For the reasons given in 3.2.b, financial and securitisation contracts should be excluded from the operation of the provision.

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Query 3.2.3 Do you consider this safeguard necessary and appropriate? If not, what mechanism, if any, would be appropriate?

Response: There should be a process by which parties can obtain clarification as to the operation of the law but I do not support a regime whereby persons could argue for a one-off exemption against the restriction.

Please feel free to call me on 0404 885 062 if that would be of assistance.

Yours sincerely,

Geoff Green