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The Manager, Corporations and Schemes Unit
Financial Systems Division
The Treasury
Langton Crescent
PARKES, ACT 2600

Dear Sir/Madam

Improving Bankruptcy and Insolvency Laws – Proposals Paper (April 2016)

I refer to the above Paper and make the following submission respecting item **2.2 Safe Harbour Models A and B**.

Model A is designed to work in an environment of privacy and in recognition of this, submissions have been invited on how that would work in the context of a company's continuous disclosure obligations. That invitation recognizes the possible impact privacy could have on the market and those who buy and sell securities.

However I see a more fundamental concern: what about the directors of a distressed company's creditors? How are they to discharge their duties and protect their companies from the insolvency of others? Currently they have some protection via the insolvent trading provisions in the *Corporations Act* but a deliberate consequence of Model A would be to moderate that protection.

I suggest that in the event Model A was introduced, prudent directors would have to ensure that their trading terms required disclosure should a customer company enter safe harbour. In addition, they may require regular confirmations that a company has not entered safe harbor since making its credit application/last safe harbor disclosure.

In that event, either the distressed company remains silent (and well drawn terms could treat silence as constituting an admission) or it admits that it is in safe harbor. This is because any denial contrary to fact, would put the company and potentially its officers and advisors in breach of s 18 of the Australian Consumer law and its State equivalents.



Further any attempt to add s 18 carve outs to protect a safe harbor regime, would be disproportionate to the issue at hand (which may be amenable to solution via Model B), become a precedent inviting other exceptions and give state imprimatur to misleading and deceptive conduct that may cause significant financial loss.

Turning to **Query 2.2.2b**, Model A creates a real tension with a company's continuous disclosure requirements. Further what about directors' disclosure and sign-off requirements in the context of annual accounts and the issue of securities?

I suggest that these problems illustrate the fundamental flaw with Model A: that its efficacy depends on privacy and silence which is contrary to the principles of an informed market whether for goods and services or issued securities.

In contrast, **Model B** supports directors attempting in good faith and on reasonable grounds to turn around their companies, has the virtue of being the minimalist approach and is consistent with the trade and commerce culture mandated by section 18.

It is also consistent with the recent decision of the Full Court of the Federal Court of Australia in *Grant-Taylor v Babcock & Brown Limited (in liquidation)* [2016] FCAFC 60 (21 April 2016). There in the context of a class action alleging breaches of the continuous disclosures regimes including regarding the fact of insolvency of the company, Allsop CJ, Gilmour and Beach JJ upheld the trial judge saying:

[The trial judge] found that the only solvency issue facing BBL as at 29 November 2008 was whether its obligation to repay noteholders in 2015 and 2016 made it insolvent on that date. Further, he found that various restructuring proposals were under consideration and that the directors could reasonably have concluded that BBL's fortunes might turn around over such a long period, enabling repayment of the noteholders when the notes matured almost a decade later. His Honour noted that such findings were consistent with contemporaneous legal advice that the directors had received. No challenge has been made out on his Honour's factual findings as to the opinion then held by the directors and the *reasonableness* of the opinion so held. [184]

This is an example of how Model B would work in practice and indeed, even suggests that there may not be any need for legislative change at all.

If you would like to discuss any aspect of this submission further, please contact me.

Yours sincerely



Penelope Pengilley

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