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To whom it may concern

Improving bankruptcy and insolvency laws

PwC welcomes the opportunity to comment on the proposed changes to Australia's bankruptcy and insolvency laws, one of the initiatives released in the Australian Government's National Innovation and Science Agenda (NISA).

Changing the way that Australians view and respond to risk is at the heart of these proposals. We support the Government's intention to encourage the community to take a more open minded approach to reasonable, commercial risk taking and a measured response to the concept of business failure. It is critical that corporate governance professionals, such as company directors and restructuring advisers, who are instrumental in helping corporate Australia to innovate and succeed, are adequately protected.

As a firm we are a strong advocate for the need to build an innovative Australia and believe that our national success in doing so will have a direct impact on our country's future prosperity. Our nation's risk culture will either help or hinder that vision from becoming a reality.

Please find enclosed our high level feedback on the specific consultation questions posed by the Government.

We would welcome the opportunity to discuss our views further. Please contact me via (02) 8266 5141 or derrick.vickers@pwc.com or Kristin Stubbins via (02) 8266 2208 or kristin.stubbins@pwc.com.

Kind regards

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1 Reducing the default bankruptcy period

We have no comment in relation to this proposal.

2.2 Safe Harbour Model A

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.

PwC's view: This is a step in the right direction but is open to abuse. The Government should also consider extending safe harbour to a sale of the company or business

PwC believes that this proposal would provide an appropriate safe harbour for directors. However, we would encourage the Government to consider the following additional recommendations:

- Clarify that an external administration is included in the definition of "insolvent liquidation" (or consider using a different term, eg "insolvent external administration"). Failing this amendment, a restructuring adviser could commence a restructure even where they believe that a return to solvency would likely require creditors to accept a future deed of company arrangement that does not pay debts in full. This would not prevent a restructuring adviser from negotiating with some or all creditors to either extend payment terms or compromise debts to maintain solvency.

- A "reasonable period of time" to return to solvency should largely be determined by a suitably qualified and experienced restructuring adviser, but it should be supported by an "honest and reasonable person" test. Guidance should be drawn from the parameters already set out by the Court (eg, *Hall v Poolman* and *The Stake Man Pty Ltd v Carroll*). While this may not extend the existing parameters, the proposed safe harbour provisions encapsulated in statute should bring more clarity and certainty to the protections of directors seeking to restructure their company.

- Extend the proposals to include safe harbour for a sale process of the company or business, under the advice of a restructuring adviser. A sale under this scenario would be in the interests of the company (and others) and could provide a significant improvement in sale value compared to a sale in an administration or liquidation. If the sale transaction is insufficient to meet all debt obligations in full, then it should be reviewed by an administrator or liquidator who is independent to the restructuring adviser.

- Model A provides fewer protections for creditors' interests than compared to Model B. However, with the assistance of a restructuring adviser and the proposed amendments above, we expect that in most cases there should be reasonable balance between protecting creditors during a restructure and allowing the best chance of a successful restructure or a more favourable sale of the business. Balance is also required to not unduly discourage entrepreneurial activity. PwC believes that sufficient protection of creditors is provided by:
    - The ongoing requirements of directors to comply with their duties under s180 to 184 of the *Corporations Act 2001*;
    - The proposed requirements and appointment of the independent restructuring adviser;
    - The protections available under the *Personal Property Securities Act 2009*; and
    - The creditors' own judgement in determining whether or not to continue to supply a customer.

Regarding the proposed duty to inform ASIC of misconduct, we assume that the duty will be similar to what is required of auditors, pursuant to Sec 311 of the *Corporations Act*.

2.2.1 The restructuring adviser

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.

PwC view: Only advisors with appropriate skills, expertise and qualifications should be able to hold themselves out to be restructuring advisors

The onus should not solely be on the directors of the company to ensure that the experience and qualifications of a restructuring adviser are appropriate for the nature and circumstances of the company. The directors are unlikely to have experienced an organisational restructure and as a result may not know what skills, experience and qualifications a suitable restructuring adviser should have. This lack of knowledge may result in directors appointing an accounting, finance or legal adviser who does not possess the adequate skills to return the company to solvency.

For this reason, we believe that any practitioner seeking to be appointed as a restructuring adviser should be accredited by an appropriate organisation. Accreditation should only be granted once the practitioner has passed appropriate restructuring specific education and experience requirements that evidence their ability to restructure a company.

As a transitional arrangement, it will be necessary to allow provisional accreditation to suitably qualified and experienced practitioners (such as a Registered Liquidator). We suggest that practitioners granted a transitional license should complete the requirements for full accreditation within 12 months of the new provisions coming into effect.

We believe the restructuring adviser should be licensed, so it would be appropriate for the key requirements to be disclosed in the Corporations Regulations with additional commentary via a guidance note from ASIC.

Allowing a company to seek advice from its existing advisors would likely increase the chance that a company seeks appropriate advice when a restructure is required. As the restructuring advisor would be appointed by the company and owe any duties to the company under the proposed safe harbour provisions, they cannot be independent of the company when acting in this role. Provided that the existing adviser is accredited and licensed, we believe that companies should be allowed to appoint its existing adviser as a restructuring adviser.

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.

PwC view: The government should take an open minded approach to the organisations that could provide accreditation to restructuring advisers

In order to provide sufficient choice of adviser, we encourage the Government not to overly restrict the organisations that could be approved to provide accreditation to restructuring advisers. Rather, we believe that any organisation seeking to be approved should be required to demonstrate that their proposed accreditation would ensure that only appropriately educated and experienced restructuring advisers would be granted accreditation.

We recommend a single organisation to be responsible for overseeing the organisations that provide accreditation and the registration of restructuring advisers. It would also be important that any oversight body could remove the ability of a restructuring adviser to practice, following an appropriate disciplinary hearing.

At present, ASIC is charged with the registration and deregistration of liquidators. We would support ASIC undertaking a similar approach with restructuring advisers.

A non-restructuring specific accreditation (including existing accreditation from the Law Society, CPA Australia, Chartered Accountants Australia and New Zealand and registered and official liquidator accreditations) should not be sufficient for a practitioner to be selected as a restructuring adviser beyond an agreed transition period. While the education and experience required to attain these accreditations may be important in assisting in a restructure, we do not believe they ensure that the practitioner would successfully lead a restructure.

Query 2.2.1c. The role of the restructuring adviser would be to form an opinion as to whether the company is "viable". The Government considers that the test of viability is whether the company can avoid insolvent liquidation, and be returned to solvency within a reasonable period of time. Is this an appropriate method of determining viability?

PwC view: With the suggested amendments set out in Response 2.2 above, we believe that this is an appropriate method of determining viability.

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?

PwC view: We believe the factors that should be taken into account in determining viability should be left to the discretion of the adviser as well as being subject to an "honest and reasonable person" test.

As suggested in *Hall v Poolman*, a "reasonable expectation" of avoiding insolvent liquidation and returning the company to solvency within a reasonable time would need to be a "certain" or "probable" outcome, rather than merely "possible" to "no way of knowing".

We note that a test of the viability of a business is not a test of the existing financial position of the company, but a judgement on the future financial position and performance of the company. As such, the test requires objective judgement that is likely to involve consideration of all the circumstances of the company with similarities to an assessment of solvency which has been the subject of much consideration by the Courts.

As with determining the solvency of a company, determining the viability of a company needs to be based upon sound judgment of an appropriately experienced practitioner assessing the particular circumstances of the company.

Query 2.2.1e. In order to carry out their role, the restructuring adviser would have a number of obligations and protections.

The restructuring adviser would be:

- *appointed by the company, not the directors, and thus owe any duties to the company;*
- *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;*
- *not be civilly liable to third parties for an erroneous opinion provided that it was honestly and reasonably held;*
- *unable to be appointed in any subsequent insolvency without the leave of the Court; and*
- *specifically carved out of the expanded definition of director contained in the Act (i.e. would not be a shadow or de facto director);*

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.

PwC view: Restructuring advisers must be well protected in order to enable them to undertake their role confidently and with certainty

The protections and obligations outlined in the Government's *Improving Bankruptcy and Insolvency Laws Proposal Paper* are relevant and appropriate. However, additional protection for the restructuring adviser and their relevant firm should be considered. For example:

- Ensuring the restructuring adviser cannot be liable to the directors, insolvency practitioners or other agency, party or government body in the event the company goes into liquidation, provided that the restructuring adviser acted honestly, in the best interest of the company and provided reasonable advice in fulfilling their role. This would include specifically excluding a restructuring adviser from the risk of shadow directorship.

- Granting the restructuring adviser and their relevant firm exclusion from any preference or other claims in the event the company they are advising goes into liquidation. This would cover all work undertaken by the restructuring adviser and their relevant firm including consulting work completed prior to the appointment of a professional restructuring adviser under the safe harbour protection. This may require providing a restructuring adviser with the same priority as an administrator is allowed under s443D of the *Corporations Act*, including incorporating this right in s556 of that Act.

2.2.2 Other features of safe harbour

The safe harbour proposed operates as only a defence to the insolvent trading provisions contained in s588G of the Corporations Act. Directors remain subject to all the other obligations that the law provides, including the existing unreasonable directors related transaction provisions.

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?*

PwC view: There needs to be balance between protecting the rights of directors and protecting the rights of creditors

We agree that:

- Directors should remain subject to all the other obligations that the law provides, including the existing unreasonable directors related transaction provisions.

- Safe harbour should 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.

Actions against directors for related party transactions should still be available in the event of insolvency. Additionally, there may be the potential for abuse of the safe harbour provisions if it is entered into to “run down the clock” on certain director-related transactions that may have been recoverable if the company went into external administration instead of a safe harbour period. This being the case the time period from the engagement of the safe harbour provisions to the appointment of an external administrator (if this occurs) should be excluded from the calculation of any claw back period.

The Government should consider expanding this to non-director related transactions to include all antecedent transactions. This would reduce creditor pressure for preferential treatment (and similar) in the lead up to, and commencement of, a safe harbour period.

Query 2.2.2b. Safe harbour is intended to encourage directors to acknowledge financial difficulty early and to attempt informal workouts where appropriate. Experience of informal workouts in the Australian and overseas markets has shown that privacy is an important factor in their success.

While the Government thus does not propose to require that companies disclose whether they are operating in safe harbour, no relaxation of a company's continuous disclosure obligations is proposed. Do you agree with our approach to disclosure?

PwC view: We agree that companies should not be required to disclose whether they are operating in safe harbour and believe that the Government should consider amending continuous disclosure obligations

Disclosure of the appointment of a restructuring adviser is likely to have an adverse effect on the viability of the company. It would likely concern creditors who would be inclined to tighten their trading terms; it also may cause customers to seek alternative sources of supply.

Under existing continuous disclosure rules for listed companies, the business may be required to disclose the appointment of a restructuring adviser and/or the financial circumstances leading to the need to appoint such an adviser. We understand that this would need to be assessed in relation to the particular circumstances of the company – there is no 'blanket rule'.

In order to provide appropriate inducement for the appointment of a restructuring adviser, it may be necessary to specifically remove the need to disclose the appointment of a restructuring adviser if the circumstances leading to such an appointment had been disclosed to the market. This would require further consideration by the Government.

2.2.3 Where safe harbour is not available

Query 2.2.3. The Government seeks views from the public on in what circumstances should the safe harbour defence not be available.

PwC view: The safe harbour defence should not be available to directors who do not act honestly and reasonably

We agree that safe harbour protections should not be available to a person who was:

- disqualified from managing a corporation at the time the debt was accrued; or
- determined by ASIC or the Court to be ineligible to rely on the defence because of prior poor conduct.

We also agree that ASIC or the Court may determine that a person is ineligible to rely upon the defence for a specified future period if it is satisfied that previously the person has breached their director's duties and:

- as a result of the breach, property that would have been available to meet the claims of a creditor was not available; and
- the creditor (including the Commonwealth Government through the Fair Entitlements Guarantee) has consequentially suffered loss.

PwC believes that safe harbour should not be available in the following circumstances:

- when a company has failed to lodge multiple Business Activity Statements); or
- when there has been significant failure to pay:
  - employee claims;
  - PAYG;
  - employee superannuation; or
  - Employee claims which accrue during the safe harbour period.

However, we believe that a safe harbour defence could still apply where there has been a minor (rather than significant) failure or where an "honest or reasonable person" test is satisfied.

2.3 Safe Harbour Model B

Section 588 does not apply:

(a) if the debt was incurred as part of reasonable steps to maintain or return the company to solvency within a reasonable period of time; and

(b) the person held the honest and reasonable belief that incurring the debt was in the best interests of the company and its creditors as a whole; and

(c) incurring the debt does not materially increase the risk of serious loss to creditors.

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

PwC view: Model B does not enhance the promotion of a viable restructure or the protection of creditors to the extent of Model A

The proposed Model B provisions have merit and may be a less costly option favoured by smaller companies. However, it is worth noting that arguably the 3 limbs are already general duties of directors and therefore do not advance the protection of creditors or promotion of viable restructuring to the extent of Model A.

We note that the directors in place prior to the company becoming insolvent were responsible for trading the business into an insolvency position. In most circumstances, this would highlight that these directors do not have the expertise or separation of interests to consistently act in the best interest of the company and its creditors.

If Model B provisions were added to the *Corporations Act* we believe they should be enhanced by the Model A provisions, including the requirement that the company engage a restructuring adviser.

3.2 The Ipso Facto Model

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.

PwC view: Ipso facto clauses should be void where the actions of a creditor directly contribute to the company becoming insolvent in order to prevent parties seeking to benefit from forcing a company to breach Ipso Facto clauses.

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

PwC view: Both existing and new contracts with ipso facto clauses should be held to the same rules.

The alternative of having different rules apply would create confusion in practice and scope for parties to roll contracts (rather than enter into new ones) and thereby avoid having to relinquish the Ipso Facto clauses within the existing contracts.

Query 3.2.c. In this model an insolvency event would include:

- *an administrator having been appointed in respect of the company;*
- *the company undertaking a scheme of arrangement for the purpose of avoiding administration or insolvent liquidation;*
- *a receiver or controller being appointed;*
- *the company entering a Deed of Company Arrangement.*

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

PwC view: Attempting a restructuring process should not in itself allow contracts to be voided

While not an insolvency event, we think the Government should consider stating that no contract can be voided simply because a company is attempting the revised restructuring process (ie. the appointment of a registered restructuring adviser as outlined in Model A). To be clear, that would mean that safe harbour is not available as a contractual default.

We also note that "termination for convenience" clauses could be a mechanism by which parties to contracts could retain the benefit of ipso facto clauses under the proposed model. We propose that convenience clauses were also void during the period of insolvency or restructure, unless the party seeking to terminate could show significant other cause for cancellation.

3.2.1 Anti-avoidance

As an anti-avoidance mechanism, it is proposed that any provision in an agreement that has the effect of providing for, or permitting, anything that in substance is contrary would be of no force or effect. Nothing in the proposal would extend the operation of the provision beyond ipso facto clauses; counterparties would maintain a right to terminate, amend, accelerate or vary an agreement with the debtor company for any other reason, such as for a breach involving non-payment or non-performance. Nothing in the operation of the provision would require any creditor to provide a further advance of money or credit.

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

PwC view: All other rights of a creditor as outlined in the contract should be retained.

A creditor should not be bound by an agreement as a result of the company in question suffering an insolvency event, where the creditor would otherwise have been able to terminate the contract.

3.2.2 Exclusions

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

PwC view: We support the proposed approach and have no further comment on further exclusions.

3.2.3 Appeal

We intend to include a provision that affected counterparties may apply to the court to vary contract terms if they can show that they have suffered hardship.

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

PwC view: The proposed appeal provisions should only be available in exceptional circumstances

We agree with the concept of including a provision to allow affected counterparties to apply to the Court to vary contract terms, if they can demonstrate that they have suffered hardship.

We also note that this should be only in exceptional circumstances, as addressed in Query 3.2.1. All existing rights of a creditor should be maintained and therefore they would be able to exit the contract for a number of reasons, including non-payment or non-performance.