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Dear Sirs

Insolvency Law Reform - Submissions of Henry Davis York

We refer to our submissions dated 27 May 2016 regarding the matters set out in the Proposal Paper issued in April 2016.

We express our views below on the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017 (**Exposure Draft Bill**) released on 28 March 2017.

1 Executive Summary

Part 1 - Safe harbour for insolvent trading

1.1 The Exposure Draft Bill proposes amendments to the Corporations Act 2001 (Cth) (**Act**) that are intended to operate as a carve-out from a director's duty to prevent insolvent trading by a company.

1.2 HDY is generally supportive of the submission of the Australian Restructuring Insolvency and Turnaround Association (**ARITA**) on the provisions of the Exposure Draft Bill and we offer the following additional comments and observations:

(a) **Evidential burden of proving safe harbour**: the proposed provision places a low initial evidentiary burden on the director seeking to rely on the safe harbour provision. HDY considers the evidential burden to be reasonable as it facilitates the identification of the relevant issues, and is not contrary to the principle that it is for the plaintiff to establish the alleged wrong of the defendant.

(b) **"Better outcome"**: the definition of "*better outcome*" requires a comparison with the outcome of a company becoming a 'Chapter 5 body corporate'. HDY considers that this may add unnecessary complexity and the test should reflect the objectives of part 5.3A of the Act and existing recognised

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principles of Australia's rescue culture to say "*than the outcome of the company being immediately wound-up*".

(c) **"Pay all its debts"**: the phrase "*pay all its debts*" does not align with the definition of solvency in section 95A of the Act. We consider the former to impose a higher threshold for the prevention of misconduct by officers or employees, and we support this outcome.

(d) **"Appropriately qualified entity"**: the term "*appropriate qualified entity*" has not been defined. While we support the flexibility of this term as generally applicable to any size of company, HDY considers that further limitation of the term will assist in preserving the integrity of the proposed provision. For example, we consider that a definition of the term "*appropriately qualified entity*" could include members of certain approved organisations, such as ARITA, and other equivalent organisations as prescribed by regulations. In the alternative, HDY accepts ARITA's submission that an adviser entity must hold professional indemnity insurance that covers provision of the advice.

(e) **"Employee entitlements"**: the term "*employee entitlements*" is defined to align with section 596AA(2) of the Act. Whilst some clarity is provided by this definition, HDY considers that the definition should be more comprehensive by stating that such employee entitlements as accrued annual leave are included or are not included in the definition.

(f) **Suggested additions to section 588GA(2)**: HDY commends the overall structure of section 588GA(2). HDY takes this opportunity to suggest the following additions to the section:

(i) **Section 588GA(2)(b)**: inclusion of the word "*books*" after "*financial records*" to be consistent with section 588GB.

(ii) **Section 588GA(2)(f)**: a new subsection (further detailed below) to include a good faith test which we consider reflects the intent and purpose of the proposed provision.

(iii) **Section 588GA(2)(g)**: a new subsection (further detailed below) to impose an obligation to appropriately document any restructuring plans relied upon in section 588GA(2)(e).

(g) **Section 588GB**: this section makes books or information not admissible to support the defence if a director fails to comply with the relevant notices or orders to make available books of the company. HDY supports this provision as it is a practical measure to ensure compliance with relevant notices. We concur with ARITA's submissions regarding the expansion of the proposed provision to include information requested under sections 438B and 438C of the Act, and relating to a failure to provide a Report as to Affairs to a liquidator or administrator.

1.3 We elaborate on these points at sections 2 to 6 below.

Part 2 - Stay on enforcing rights merely because of arrangements or restructures

1.4 The Exposure Draft Bill proposes amendments to the Act that make a right under a contract, agreement or arrangement not enforceable "*merely because*" the company is under voluntary administration or a scheme of arrangement.

1.5 HDY is generally supportive of the submission of ARITA on the provisions of the Exposure Draft Bill and we offer the following additional comments:

(a) **Potential avoidance**: that creditors are prohibited from enforcing contracts "*merely because*" of a scheme of arrangement or voluntary administration leaves open the very real possibility of creditors exercising their rights under a contract because of other reasons as a disguise when in truth the prime motivation will be due to voluntary administration or a scheme of arrangement is one of those reasons. This in turn might undermine the effectiveness of the operation of the stay.

(b) **Inconsistency with the rights of all asset security holders**: the provisions of the Exposure Draft Bill have the potential to be inconsistent with existing provisions of the Act which permit secured creditors holding all asset security agreements to enforce their security during the "*decision period*" of a voluntary administration. Specifically, the broad application of the moratorium under section 451E extends to all contracts, agreements and arrangements (unless an exclusion applies). An all-asset security agreement would therefore be caught by the provisions and will be unenforceable during any time of the voluntary administration. HDY does not understand that this inconsistency reflects any policy intent of the proposed reforms and the drafting should be clarified to ensure that the rights of all-asset security holders are not unintentionally impinged upon by the enactment of the Exposure Draft Bill provisions.

(c) **Stay does not extend to DOCAs or receiverships**: HDY notes the Exposure Draft Bill does not propose to extend these provisions to receiverships or deeds of company arrangement (**DOCA**s). By excluding receiverships and DOCAs, the proposed reforms are excluding two very important tools for company restructuring and enabling the continuation of a viable business. HDY submits that the legislative text should expressly provide that the moratorium also applies automatically when a company undergoes restructure through receivership and DOCAs.

(d) **Clarifying whether an ipso facto moratorium can be included in the DOCA**: Section 444A(4)(c) of the Act provides that a DOCA must specify the nature and duration of any moratorium period for which the deed provides. Typically, the stays incorporated in a DOCA are those that are applicable to unsecured creditors during a voluntary administration. It is unclear whether, by virtue of section 444A(4)(c) and with the enactment of the Exposure Draft Bill, the ipso facto moratorium could also be incorporated into a DOCA. HDY submits that the scope of the moratorium should be clarified in the Exposure Draft Bill.

(e) **Additional credit**: it is unclear whether the provisions in the Exposure Draft Bill which relieves a creditor providing "*additional credit*" (proposed sections 415D(6) and 451E(6) respectively) to a company subject to a scheme of

arrangement or a company in voluntary administration is intended to be limited to a financial institution providing additional credit under a credit facility or more broadly to all entities trading with the company under credit terms. If the former, this should be specified; if the latter, it will be too broad and undermine the efficacy of the reform.

(f) **Other minor drafting issues:** we have identified other issues which might be adequately clarified with additional drafting refinement.

1.6 We elaborate on these points at sections 7 to 12 below.

Part 1 - Safe harbour for insolvent trading

2 General

2.1 The proposed safe harbour provision contained in the Exposure Draft Bill proposes amendments to the Act that operate as a carve-out from a director's duty to prevent insolvent trading by a company contained in section 588G of the Act.

2.2 We accept the carve-out model as being consistent with the Government's policy objective to "*encourage honest directors to innovate and take reasonable risks*" as a director need not face possible contravention of the insolvent trading provision provided that the requirements for safe harbour are satisfied. In that regard, we also commend the manner in which the Exposure Draft Bill provides guidance as to what is required to take advantage of safe harbour and lessen the impact of the current insolvent trading laws.

2.3 However, from a broader policy choice perspective, we continue to query whether the retention of strict insolvent trading laws within the Act allows the proper fostering of a sustainable rescue culture.[1] That said, we accept, for the purposes of this submission that such an analysis is not entirely relevant and accordingly this submission is made on the basis that it is accepted policy that safe harbour reform is the current way forward for Australian insolvency legislation.

2.4 In that context, the lens we have applied in undertaking our review of the Exposure Draft Bill has been to assess whether the proposed "*one size fits all*" provision is able to be practically implemented by directors of companies of all sizes. In particular, we submit that it would not be appropriate in most circumstances for a director of a micro, small or medium enterprise (**MSME**) to be held to the same standard as a large corporation in assessing whether a course of action was reasonably likely to lead to a better outcome. It is important that the size and nature of the company can be taken into account in the application of the proposed provision.

2.5 In summary, HDY is generally supportive of the submission of ARITA concerning the Exposure Draft Bill and the proposed safe harbour provisions. We offer the following additional comments and observations.

3 Evidential burden of proving safe harbour

3.1 It is proposed that a director wishing to rely on the safe harbour bears an evidential burden in doing so. Evidential burden, as defined, is identical in wording to the evidential burden of proof which may be imposed on a defendant in certain criminal proceedings as set out in the Criminal Code.[2]

3.2 The concept of "*evidential burden*" in criminal proceedings has been described as follows:

"An 'evidential burden' requires only that the accused must adduce sufficient evidence to raise an issue before it has to be determined as one of the facts in the case. The prosecution does not need to lead any evidence about it, so the accused

[1] See HDY's submission on Insolvency Law Reform in response to the Proposal Paper dated 27 May 2016
[2] Rule 13.3 of the Criminal Code, Schedule to Criminal Code Act 1995 (Cth).

needs to do this if he wishes to put the point in issue. But if it is put in issue, the burden of proof remains with the prosecution. The accused need only raise a reasonable doubt about his guilt."[3]

3.3 The proposed burden of proof placed on a director seeking to rely on the safe harbour carve-out appears to be consistent with this concept. That is, a director is required to adduce limited evidence that he or she intended to avail themselves of the safe harbour provisions and the course of action taken. Failing to do so or providing a mere statement of reliance on safe harbour or that an unspecified course of action was reasonable, is not enough.[4] The person seeking to enforce the insolvent trading provision then bears the onus of establishing that the course of action taken was not reasonable.[5]

3.4 We concur with the approach taken and consider that it should always be for the plaintiff to establish that the alleged wrong has been committed in line with the common law principle that the prosecution is to prove the guilt of an accused person.[6] Notwithstanding this and the fact that ASIC and liquidators have broad investigative powers to obtain relevant evidence, we consider it acceptable that the director be held to a low initial evidentiary burden in order to more efficiently make known the relevant issues to be considered. This is consistent with the common law position that placing an evidential burden on a defendant does not breach the presumption of innocence.[7]

4 Definitions and concepts used in the Exposure Draft Bill - section 588GA

4.1 "Better outcome"

(a) Section 588GA(5) of the Exposure Draft Bill provides a definition of the term "better outcome". We question whether the proposed comparison to the outcome of the company becoming a Chapter 5 body corporate adds unnecessary complexity in its application and may limit the application of the safe harbour. A director seeking to avail themselves of safe harbour would need to assess whether the course of action they are taking or intend to take is reasonably likely to lead to a better outcome than the appointment of liquidators, administrators or receivers, or the entry into a deed of company arrangement, or another compromise with creditors.

(b) In our submission, the definition of "*better outcome*" should reflect the objectives of part 5.3A of the Act and existing recognised principles of Australia's rescue culture to say "*than the outcome of the company being immediately wound-up*".

4.2 "Appropriate"

(a) The use of the word "*appropriate*" appears throughout the Exposure Draft Bill, in particular in sections 588GA(2) of the Act where the term "*appropriate* " is used in subsections (a) and (b) We support the

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[3] *Traditional Rights and Freedoms - Encroachments by Commonwealth Laws* (ALRC Interim Report 127) published 3 August 2015, citing Lord Hope in *R v DPP; Ex parte Kebilene* [2000] 2 AC 326, 378 - 79.
[4] Paragraphs 1.18 and 1.42 of the Draft Explanatory Memorandum (**EM**) to the Draft Treasury Laws Amendment (2017 Enterprise Incentives No. 2 Bill) Bill No. X, 2017.
[5] Paragraph 1.18 of the EM.
[6] *Lee v The Queen* [2014] HCA 20 (21 May 2014) [32].
[7] *R v DPP; Ex parte Kebilene* [2000] 2 AC 326, 379.

accommodating nature of the word "*appropriate*" in all instances, except its use in 588GA(2)(c). We consider this section in greater detail below.

(b) The use of the word "appropriate" was considered in *In Re Minister of Foreign Affairs and Trade; the Commissioner of the Australian Federal Police and the Commonwealth of Australia v Geraldo Magno and Ines Almeida* [1992] FCA 566 where French J in the Full Federal Court held that:

"Like 'reasonable' which finds its way into various statutory discretions, 'appropriate' is a relative term which taken by itself imports a requirement to consider the circumstances of any given case as a whole."

(c) HDY generally supports the use of the term appropriate in section 588GA, as the term is one which can be adapted to the circumstances of the case as French J noted in *Almeida*. HDY considers this an important part of the Exposure Draft Bill as the safe harbour protections need to be adaptable to different situations. For instance, the restructure of a MSME as opposed to an ASX listed entity may have significant differences. It will then fall for consideration as to whether the steps taken or the financial records maintained in that particular circumstance were "*appropriate*".

(d) This level of flexibility allows the safe harbour provisions to operate effectively as a "*one size fits all*" model as opposed to the previously proposed models where the appointment of a restructuring advisor was required, which could have been cost prohibitive for MSMEs.

4.3 "Pay all its debts"

(a) Section 588GA(2)(a) of the Exposure Draft includes the phrase "*to pay all its debts*". The suggested wording is different to the definition of solvency at section 95A of the Act.

(b) We assume the intent behind the use of the phrase "*to pay all its debts*", rather than the statutory definition of solvency, is to impose a higher threshold for the prevention of misconduct by officers or employees. In this regard, if the misconduct affects the company's ability to pay all its debts, as opposed to all of its debts as and when they become due and payable, then any misconduct would be theoretically easier to prove.

(c) HDY supports imposing this concept of misconduct.

4.4 "Appropriately qualified entity"

(a) While we support the adaptability of the term "*appropriately qualified entity*", we consider that further limitation of the term will assist in preserving the integrity of the proposed provision.

(b) The term "*appropriately qualified entity*" as set out in section 588GA(2)(c) is not defined elsewhere in the proposed safe harbour provision or amendments to other relevant legislation. We are concerned that without parameters being set on what an "*appropriately qualified entity*" is, this subsection may be more vulnerable to exploitation by dishonest directors or pre-insolvency advisers who are unqualified to provide restructuring advice and risk worsening the condition of a company by his or her advice. We

consider it prudent for a definition of an "*appropriately qualified entity*" to be set out in further regulations.

(c) Any such definition should be broad enough to suit all ranges of companies from MSMEs to large corporations, yet narrow enough to require certain minimum levels of qualification or experience. We consider that one option may be to define an "*appropriately qualified entity*" to be accredited members of certain approved organisations, such as ARITA, or other equivalent organisations, as prescribed by the regulations, to ensure all entities providing advice have the benefit of relevant education about restructuring, turnaround and insolvency, independence and high ethical standards.

(d) HDY accepts that an alternative may be to accept ARITA's submission that an adviser entity must hold professional indemnity insurance that covers the provision of the advice.

(e) We note that the selection of an "*appropriately qualified entity*" is the responsibility of the director. We accept this concept as consistent with the Government's policy objective to "*encourage honest company directors to…take reasonable steps to restructure*".[8] However, to ensure the independence of the "*appropriately qualified entity*", HDY submits that the definition could also exclude officers of the company.

4.5 "Employee entitlements"

(a) We acknowledge that the term "*employee entitlements*" (as referred to in the note to section 588GA(4)) has been defined to align with subsection 596AA(2) and this provides some clarity as to the meaning of "*the entitlements of its employees*".

(b) However, we note that the definition is silent about whether, and if so, how, companies are required to "*provide*" for such employee entitlements such as accrued annual leave. Is a company required to set money aside specifically for this purpose and to what extent should this provide for future entitlement. Accordingly, we consider, consistent with ARITA's submission, that further clarity as to what the provision requires a director to do would be a welcome addition to the proposed drafting.

5 Suggested additions to section 588GA(2)

5.1 The overall structure of section 588GA(2) of the Exposure Draft Bill is commendable. HDY supports the section as it is currently drafted, but takes this opportunity to suggest some additions for consideration.

5.2 In section 588GA(2)(b) of the Exposure Draft Bill, HDY suggests that the scope of this section be expanded by the inclusion of the word "*books*" immediately after the term "*financial records*". This definition is then consistent with the terminology used in the Exposure Draft Bill in section 588GB, which refers to the books of the company.

[8] Paragraph 1.13 of the Explanatory Memorandum.

5.3 HDY considers that it may be beneficial to the intent and purpose of the legislation to include a good faith test in 588GA(2). This could be a new subsection 588GA(2)(f) which could appear as follows:

"is acting in good faith in the best interests of the company and creditors as a whole and for a proper purpose in developing or implementing any course of action."

5.4 HDY considers that the inclusion of a good faith, complementary to that imposed in section 180 of the Act, is necessary to ensure that the course of action is undertaken and implemented in a manner so as to preserve the integrity of the safe harbour provisions and the application of duties of directors to this situation.

5.5 The final addition that HDY suggests is a further subsection 588GA(2)(g) as follows:

"is appropriately documenting, and keeping a record of any and all plans developed and/or implemented in accordance with subsection (e) above."

5.6 This objective of this provision is to ensure any restructuring plans are properly recorded or documented to avoid a scenario where a director could attempt to rely on a safe harbour defence without any documentary evidence to support the assertions that they had attempted to implement a restructure in accordance with section 588GA(2). This would assist a director seeking to rely on safe harbour in discharging the evidential burden.

6 Section 588GB: books or information not admissible for the defence

6.1 We regard the inclusion of section 588GB as a practical measure to ensure that directors comply with the relevant notices or orders to make available the books of the company. Further, the inclusion of this section may have the effect of ensuring that the relevant information that administrators and liquidators may require when considering the safe harbour provision is made available to them, and we consider this a positive step towards practical implementation of the safe harbour provision.

6.2 We concur with the submission made by ARITA concerning the expansion of the proposed provision to include information requested under sections 438B and 438C of Part 5.3A of the Act.

6.3 Similarly, we concur with ARITA's submission in respect of a failure to provide a Report as to Affairs to a liquidator or voluntary administrator.

Part 2 - Stay on enforcing rights merely because of arrangements or restructures

7 Potential avoidance

7.1 It will very often be the case that a company entering into voluntary administration or scheme of arrangement proceeding will have defaulted on some of its contractual obligations - late payment, breach of covenant, breach of warranty, insolvency, or other event of default. In fact, it will often be the case that such defaults are a driving factor for the company entering into such proceedings.

7.2 It is likely that, with the advent of the "*safe harbour*" provisions, contracts of well-advised creditors will also include provisions that operate such that the appointment of a restructuring adviser or otherwise taking a "*course of action*" under the proposed section 588GA will be an event of default and give rights to creditors to take enforcement steps.

7.3 As such, that creditors are prohibited under sections 415D(1) and 451E(1) from enforcing contracts "*merely because*" of the company entering a scheme of arrangement or administration leaves open the very real possibility of creditors exercising their rights under a contract for other reasons (which in all likelihood are closely related to the company entering into such a process). Those creditors would therefore fall outside of the "*merely because*" test, even though the main or driving commercial imperative for taking an enforcement step might be the scheme of arrangement or administration.

7.4 In those circumstances, well-advised counterparties to those contracts may simply seek to rely on the company's other default(s) to exercise their rights under the contract, notwithstanding the automatic stay on ipso facto clauses envisaged in the Draft Exposure Bill. These other "*events of default*" could include clauses which essentially turn on the question of whether the company is insolvent: clauses in respect of breaches of covenant, material adverse effect, or changes to the company's business operations or financial condition. The possibility that counterparties could simply rely on the these other "*events of default*" to terminate or amend contracts has the potential to undermine the efficacy of the stay on ipso facto clauses.

7.5 HDY submits that consideration should be given to deleting altogether the words in proposed subsection 1 of 415D and 451E "*merely because the Company is*". This would have the effect of creating a more general moratorium on enforcement, and such an approach would be more consistent with the existing approach to moratoriums which currently apply to voluntary administration and schemes of arrangement as outlined in the Appendix to this submission. Alternatively, HDY submits that consideration ought to be given to the ipso facto moratorium under Chapter 11 of the United States' Bankruptcy Code. Section 365(e)(1) of the United States' Bankruptcy Code has a broader test than the "*merely because*" test to also include "*the insolvency or financial condition of the debtor at any time before the closing of the case*" or the prior appointment of a receiver (termed custodian). The section reads:

> Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on—
>
> > (A) the insolvency or financial condition of the debtor at any time before the closing of the case;
> > (B) the commencement of a case under this title; or
> > (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.[9]

7.6 HDY submits that replacing the "*merely because*" test used in the Exposure Draft Bill to a broader moratorium on enforcement of a contract because of the financial condition or insolvency of the company or the prior appointment of a receiver would strengthen the effectiveness of the provisions in achieving the policy objectives of the reforms. However, HDY considers this alternative submission to be an inferior proposal than simply deleting the words "*merely because the Company is*" as set out above.

8 Inconsistency with the rights of all-asset security holders

8.1 As identified in the Appendix to this submission, the Act provides for the rights of a secured party, owner or lessor, and rights in respect of property the subject of security interests under Subdivision B, Division 7, Part 5.3A of the Act (sections 441AA to 441EA).

8.2 Critically, the regime provides that where a person holds security over the whole, or substantially the whole of the property of a company under administration, the stay on enforcement does not apply to that person if that person exercises its rights during the "*decision period*."

8.3 The "*decision period*" is defined under section 9 as being the period of 13 business days from the date of appointment of the administrator, or when notice of the administrator's appointment was given to the secured creditor.[10]

8.4 The provisions of the Exposure Draft Bill impose a general moratorium unless an exclusion applies under section 451E(4). There appears to be no exclusion for all-asset security agreements referred to in section 451E(4) and nor is it listed in the List of Excluded Contract types.

8.5 As such, the provisions of the Exposure Draft Bill have the potential to be inconsistent with existing provisions which permit secured creditors holding all asset security to enforce their security during the "*decision period*" of a voluntary administration.

8.6 Specifically, the broad application of the moratorium under sections 451E(1) extends to all asset security agreements and such security agreements will be

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[9] 11 U.S.C. §365(e)(1)

[10] "decision period" is defined under section 9 to mean *for a secured party in relation to a security interest in property (including PPSA retention of title property) of a company under administration, means the period beginning on the day when: (a) if notice of the appointment of the administrator must be given to the secured party under subs 450A(3) - such notice is so given; or (b) otherwise - the administration begin; and ending at the end of the thirteenth business day after that day.*

unenforceable during any time of the voluntary administration under the provisions of the Exposure Draft Bill.

8.7 If the intent of the legislation is for the stay on ipso facto clauses to extend to secured creditors who have a secured interest over the whole or substantially the whole of the company's property, this would be a major policy shift. For the reasons set out in our submission dated 26 May 2016 in response to the Government's Proposals Paper, HDY opposes such a shift. Further, either Subdivision B, Division 7, Part 5.3A or the Exposure Draft Bill provisions would need to be amended to resolve their inconsistency and to enable their smooth operation.

8.8 Alternatively, if (as HDY submits should be the case) the legislative intent is that the stay should not apply to the rights of all-asset charge holders, the Exposure Draft Bill provisions would need to make this clear. On a matter of such significance, it would be appropriate that this be included in the legislative text itself and not be left to the regulations as part of any exclusion.

9 Stay does not extend to DOCAs or receiverships

9.1 HDY notes and agrees with the Explanatory Memorandum which identifies the importance of the moratorium on ipso facto clauses to enable a successful restructure and going concern of viable businesses:

> The amendments in Schedule 1, Part 2 of this Bill will make ipso facto clauses which would allow contracts to be terminated solely due to an insolvency event unenforceable if a company is undertaking a restructure.
>
> This reform is aimed at enabling viable businesses to continue to trade in order to recover from an insolvency event instead of these clauses preventing their successful rehabilitation.[11]

9.2 This intent is consistent with the Australian Government's Proposals Paper of April 2016, ARITA's submission dated 27 May 2016 and its most recent submission in respect of the Exposure Draft Bill (at 2.3), and a large number of other submissions which all proposed that the ipso facto moratorium should extend to operate in restructurings undertaken through receiverships and DOCAs. Also, we note that Treasury represents that "*the amendments will also make 'ipso facto' clauses unenforceable if a company has entered into a formal insolvency process*"[12].

9.3 As it currently stands, the Exposure Draft Bill proposes the ipso facto moratorium applies to circumstances where a company enters a scheme of arrangement under section 411 of the Act, or enters into voluntary administration under Part 5.3A of the Act. The Exposure Draft Bill contains no provisions which would extend ipso facto moratorium to a receivership or, at the end of a voluntary administration, a DOCA (see proposed section 451E(2)(a)).

9.4 By excluding receiverships and DOCAs, the proposed reforms are excluding two very important tools for a company restructuring and enabling the continuation of a viable business. In this sense, the broad statements in the Explanatory Memorandum and Treasury about ipso facto clauses being unenforceable if "*a*

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[11] Page 5 of the Explanatory Memorandum. Similar comments are also made at 2.3 to 2.11 of the Explanatory Memorandum.

[12] http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2017/NISA-Improving-corporate-insolvency-law

company is undertaking a restructure" are inaccurate because a company subject to a DOCA or receivership may also be undertaking a restructure. Further, and more importantly, HDY submits that the reform may struggle to achieve its policy objective if DOCAs and receiverships are excluded, this approach is inconsistent with the Government's own proposal paper and other important submissions. Consequently, HDY submits that the legislative text should expressly provide that the moratorium also applies automatically when a receiver is appointed or DOCA executed. .

10 Can a moratorium on ipso facto clauses be included in a DOCA?

10.1 Section 444A(4)(c) of the Act provides that a DOCA must specify the nature and duration of any moratorium period for which the deed provides. It places no restriction on the scope of the moratorium but typically, these stays extend the stays that apply to unsecured creditors under voluntary administration.

10.2 With the introduction of the Exposure Draft Bill, it is open to argue that a proposed DOCA could also pick up the broader stays proposed under the Exposure Draft Bill applicable to a voluntary administration and apply them to a DOCA.

10.3 HDY submits that it would be preferable to clarify the scope of the moratorium available to be incorporated under section 444A(4)(c) and, in particular, whether this would include the stays proposed under the Exposure Draft Bill.

11 Additional credit

11.1 The proposed sections 415D(6) and 451E(6) respectively relieve a creditor from providing "*additional credit*" to a company once it is subject to a scheme of arrangement or voluntary administration, if the creditor is restricted from exercising their ipso facto rights.

11.2 The term "*additional credit*" is undefined and open to different interpretations:

(a) we understand the policy intent to be limited to relieving a financial institution providing "*a new advance of money or credit*"[13] under a credit facility as defined in Regulation 7.1.06 of the Corporations Regulations 2001;

(b) however, the expression is potentially broad enough to include any form of credit under a supply arrangement with a trade creditor or supplier in the course of ordinary business operations. This could mean that, during the course of the administration or scheme of arrangement, the trade creditor could require the company to settle invoices on a cash on delivery basis or other similar terms, when previously it relied on credit terms or an accounts payable arrangement. If that is the case, then this could place additional liquidity strain on an already financially distressed entity and significantly limit the effectiveness of the ipso facto moratorium.

11.3 If, as we understand it, the former possible interpretation described in 11.2(a) reflects the policy intent, this should be clarified in the legislative text; if the latter interpretation described in 11.2(b) is intended, it might potentially be too broad and undermine the efficacy of the reform.

[13] Explanatory Memorandum at 2.11

12 Other minor drafting issues

12.1 Extension orders

(a) HDY agrees with the submissions made by ARITA (at 2.5).

(b) The proposed section 451E(3) provides that the Court may, on the application of an administrator or deed administrator, order that the period of the stay be extended if the Court has granted an order under section 444F of the Act (limiting the rights of secured creditor/owner/lessor) and the Court considers that it is "*appropriate in the interests of justice*" for the period to be extended (**Extension Order**).

(c) This means that the jurisdiction to extend the ipso facto moratorium will depend, as a precondition, on a stay order preventing a secured creditor from exercising their rights. While no explanation for this form of mechanism has been provided, we assume that it is intended only to be available as part of a holistic restructuring plan which adequately protects affected creditors and otherwise is in the best interests of the company.

(d) The current drafting only caters to allow Extension Orders in situations where there is a secured creditor (as it envisages application of section 444F), and does not appear to take into account the situation where there is no secured creditor. Although it is admittedly not as common, there are situations where there is no secured creditor of the company, in which case there would be no capacity for the Court to extend the stay beyond the period of administration under the proposed section 451E(3). We suggest that the proposed section 451E(3) be amended to also empower the Court to grant an Extension Order in circumstances where there is no secured creditor.

12.2 "Company is wound up"

(a) HDY agrees with the submissions made by ARITA (at 2.6).

(b) The proposed section 451E(2)(c) provides for the stay period, which begins when the administration of the company begins and ends "*when the company is wound up*" if there is a resolution or order for the company to be wound up.

(c) A possible interpretation of the phrase "*when the company is wound up*" and in particular the words "*wound up*" connote the winding up of company has ended or is complete and thus, the stay would operate during the period of winding up or liquidation of a company if the company had first entered into administration. We do not understand this to be the legislative intention. If so, it should be clarified.

(d) Specifically, if it is intended that the stay period would end upon a resolution of creditors at the second creditors' meeting to resolve that the company be wound up, or when the court orders that the company be wound up, we suggest that the Exposure Draft Bill either cross-reference or adopt the words already provided for under section 435C(2) and (3) of the Act, or amend the proposed section 451E(2)(c) by inserting the words "*when the*

resolution passes or Court orders" in lieu of the words "*when the company is wound up.*"

Yours faithfully
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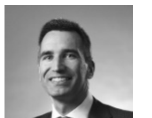
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Appendix - Existing moratoriums under the Act

The Act presently provides for the following moratoriums in Part 5.1 schemes of arrangement and Part 5.3A voluntary administration:

Restructuring mechanism	Restriction	Detail
Part 5.1 Schemes of arrangement		There is no moratorium presently available to a company under Part 5.1 unless it forms part of a compromise arrangement approved by the Court pursuant to s 411.
Part 5.3A Voluntary administration	Winding up proceedings	A Court must adjourn a hearing of a winding up application if it is in the interest of creditors that the company continue under administration rather than be wound up (s 440A(2)), which would normally be the case unless an applicant can show otherwise.
	Security holder (specific assets)	A person that holds security (other than all asset security - see below) cannot be enforced during the period of administration (s 440B)
	All asset security holder	A person that holds security over the whole, or substantially the whole of the property of a company under administration (ss 441AA, 441A) or perishable property (s 441C), the stay on enforcement does not apply to that person if that person exercises its rights during the "*decision period*" which is 13 business days from the date of receipt of notice of the administrators' appointment.
	Lessors and owners	Lessors and other owners of property in the possession of the company are restricted from taking possession of such property, unless they have leave of the Court or the consent of the administrator (s 440B(2)).
	Proceedings	Proceedings against a company or in relation to any of its property cannot be commenced or continued, unless the Court gives leave, the administrators consent or the proceedings are criminal (s 440D).
General (applies to voluntary administration, deed administration, receivership, liquidation, and provisional liquidation)	Suppliers of essential services	Suppliers of essential services are precluded from insisting on payment for debts incurred prior to the appointment of an external administrator (s 600F(1)).