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Mr James Mason
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Dear Mr Mason

EXPOSURE DRAFT: IMPROVING CORPORATE INSOLVENCY LAW - SAFE HARBOUR AND IPSO FACTO REFORM

Part 1 - Safe harbour for insolvent trading

In my submission, the draft law delivers a strong framework. It provides a director with a defence to insolvent trading where they pursue restructuring efforts which are reasonably likely to be value accretive for the company and its creditors taken as a whole. It identifies things that a director of a company facing financial difficulties ought to be doing, and as such, has the real potential to encourage and facilitate behaviours that represent best practice in pursuing corporate turnaround.

It is, in my submission, likely to lead to a cultural change where the fear of insolvent trading is replaced with a focus on steps that need to be taken to enhance value. As an adviser, the draft law if enacted will equip me with the ability to provide helpful guidance to a director of an insolvent company on what the person should do to avoid liability for insolvent trading, beyond merely suggesting that they must appoint an administrator or resign.

I do not consider the draft law to be overly complex. Rather, I consider it to be sufficiently plain, whilst balancing the need to prescribe some necessary aspects of conduct which is required of a director of a financially distressed company if they are to be permitted to trade a company whilst insolvent.

I endorse the proposed law and provide comments below directed towards clarifying certain aspects *(**EM** means Explanatory Memorandum)*:

EM 1.13, 1.17 and 1.44 The EM suggests that the defence is to be available to the 'honest' director, however that term is not used in the text of the law.

As I read the law, the defence is available to a person who takes a course of action such as the action set out in s 588GA(2),

which is reasonably likely to lead to a better outcome for the company and the company's creditors, whilst the company complies with its obligations to employees and in respect of tax.

The element of honesty per se is not required to be established (as is the case, for example, with s 1318 of the Corporations Act).

I assume that it is not intended that honesty be an element of the defence and submit that that is correct. That being so, query the reference to the term in the EM which has the potential to be confusing. Conversely, if it is, then that should be captured in the text of the law.

EM 1.18, 1.41 to 1.43

The EM suggests that the person's burden of proof in connection with s 588GA(1) under s 588GA(3) is limited. Such limitation is not however expressed in s 588GA(3).

The EM states that the director "will generally only be required to provide evidence about the course of action that was taken" [1.18] and the "liquidator will bear the onus of establishing that the course of action was not reasonable in the circumstances" [1.18]. Further on, the EM provides additional guidance which seems to water down 1.18. Namely, the director will be required to provide "some evidence to satisfy the Court that there is a reasonable possibility that they were taking a reasonable course of action" [1.42]. The liquidator is then required to show that the course of action was not reasonable [1.43].

Whilst I support the EM proposal in principle, I am unclear on precisely what is intended, and the intent is not reflected on the face of the legislation. I recommend that the intent in the EM be clear and express on the face of s 588GA(3).

EM 1.27 and 1.29

The test proposed in s 588GA(1)(a) is an objective test, dependant on the company's circumstances including its size, nature and complexity.

In my submission, this is correct. The role of the board is to independently with objectivity, oversee and monitor the formation and implementation of the relevant course of conduct. In my experience, too often, a company's board fails to exercise proper governance in a turnaround situation. I have personally observed company boards who do no more than accede to the subjective views of management, who fail to exercise objective independent thought, and in so doing participate in the demise of the company.

EM 1.28, 1.30, 1.37

The EM introduces the concept of viability. The EM says that "Once it becomes clear that the company cannot be viable in the long term, the course of action will no longer meet that description and the protection of the safe harbour will cease".

In my submission, this does not arise, or does not arise clearly, on the face of the text of s 588GA(1) & (5).

Accordingly, it would be helpful for the text of the law and or the EM to be clarified.

The issue to be addressed, is that a course of action may lead to a better outcome for the company's creditors, even where the company is not viable. An orderly wind down outside of voluntary administration may derive greater value which is beneficial to creditors but will not see a survival of the company. Case example: a company's directors determine that the company is insolvent and not viable; a company contract and associated assets and employees are transferred at arm's length for market value outside of administration, avoiding a fire sale, preserving jobs, and avoiding a damages claim from the contracting party in liquidation (**Orderly Wind Down Steps**). The company is then placed into administration then liquidation, with remaining employees being terminated and remaining assets being sold at fire sale value. As a result of the Orderly Wind Down Steps the return to creditors in liquidation is greater than it would have been had those steps not been taken, but no surplus return to the company or its shareholders is available.

On first reading s 588GA, I assumed that the defence would apply to a director who took the Orderly Wind Down Steps.

However, on reading the EM and in particular, the references to viability [1.28, 1.30, 1.37], and noting the inclusion of the word "*both*" in the meaning of "*better outcome*", I consider the position to be unclear.

Does government intend that the Orderly Wind Down Steps fall outside of the defence because:

(a) at the time the steps are taken, the directors know that the company cannot be returned to viability, and at best, they are able to sell some or all of the assets at a higher value than can be achieved in a liquidation, thereby securing at best, a greater return to creditors; and

(b) the outcome for the company is not improved (it being nil with or without the steps)?

Alternatively, does government intend that the Orderly Wind Down Steps be a relevant course of action falling within the defence because:

(a) viability refers to 'the viable part of the company'; and

(b) the outcome for the company is improved, because the deficiency is lower?

Consistent with my previous submissions, I note that the former position focuses directors' attention on turning the company around. The latter position is broader and more consistent with the UK approach, permitting also steps that deliver a better outcome in liquidation where a turnaround is not possible.

I recommend that the position be clarified on the express text of the law and the EM.

EM 1.32 and 1.33

I read s 588GA(2) as being both prescriptive and cumulative (albeit not exhaustive).

First, the text of ss(2) stipulates what is required to work out whether a course

of action is reasonably likely to lead to a better outcome. My reading of "but without limiting" is that the company might do other things too.

Second, the word "and" included after each and every ss(2)(a)-(e) tells me that the list is cumulative and that all of these things need to be done.

The EM however suggests that this is not the case.

In my submission, an amendment to the text of the law is warranted, so that it is consistent with the EM (or vice versa, as is intended).

For example, I suggest that ss(2) include words after "… is reasonably likely to lead to a better outcome for the company and the company's creditors," to the effect "the Court may have regard to whether the person:" [*note, it appears that the words 'the Court may' or 'the Court shall' are inadvertently missing in any event*].

Further, in ss(2)(a)-(d), the word "and" at the end of each sub-section be deleted and "and/or" or "any one or more of" language be inserted.

As to the preferable position, a prescriptive and cumulative list is a narrow approach which mandates best practice. The risk is that by being too prescriptive, access to the defence in practice becomes too difficult and so it fails to deliver the intended benefit. Accordingly, in my submission the position set out in the EM is preferable.

EM 1.62 The EM is inconsistent with the text of the law. I suggest a tweak to the EM so that it is consistent with Section 4, namely, that the amendments apply to actions taken before, at or after the commencement of the part of the bill, and to debts incurred at or after.

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

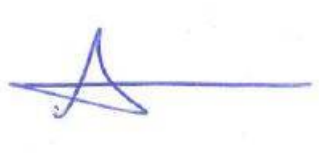
I support the government's approach to Part 2, which proposes that a counter-party to a company contract cannot rely upon the entry into a creditors' scheme of arrangement or voluntary administration alone, as basis to terminate the contract. However, in the event that the company proceeds into liquidation, the counter-party would then be free to terminate the contract.

Under the proposed law, the right to terminate a contract as a result of the financial condition of the company including its insolvency will remain on foot. As such, if directors resolve that the company is insolvent or evidence is filed in the scheme proceedings to the effect that the company is insolvent, or there is otherwise evidence that the company is insolvent (for example, the administrator is of the view that the company is insolvent), the counter-party may rely on such evidence to terminate in any event.

The law may accordingly, be of limited practical use. It would be helpful if the law was broader, and captured also "merely because the company is or may become insolvent" for the proposed period of the stay.

Thank you for the opportunity to comment on the proposed new law. I am happy to discuss any aspect of this submission with you as is helpful.

Yours sincerely



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