1 October 2021

Manager
Market Conduct Division
The Treasury
Langton Crescent
Parkes ACT 2600

Email: **SafeHarbourReview@treasury.gov.au**

Dear Sir/Madam

Submission to Treasury – Review of the insolvent trading safe harbour

Introduction

The Australian Credit Forum (**ACF**) welcomes the opportunity to make a submission to Treasury in respect of reviewing the insolvent trading safe harbour.

The ACF was established in the early 1970's by a group of senior credit professionals. The group recognised the need to develop an association where members could meet on a regular basis to exchange thoughts and ideas to strengthen their own knowledge but also the standards of the industry.

The association meets on a regular basis to discuss and review existing and proposed changes to the Federal and State Governments legislation that might have an impact on their company's credit policies and practices in their day-to-day role as credit professionals.

The members of ACF are drawn from all areas of the credit profession across a range of industry groups including but not limited to senior credit managers, members of the legal profession, insolvency practitioners, credit insurance underwriters and brokers, mercantile agents and credit reporting agencies. The depth and diversity in experience of the members ensures that a broad cross section of the credit industry considers the impact of all relevant legislation.

Overview

Response to consultation paper

In view of the membership base of the ACF, the ACF has chosen to respond to the following questions.

1. **Are the safe harbour provisions working effectively?**

    (a) What are the safe harbour provisions?

        (i) S588G of the Corporations Act – a director of a company may be personally liable for debts incurred by the company if at the time the debt is incurred there are reasonable grounds to suspect that the company is insolvent.

            (A) Breaching these provisions can result in civil and criminal against the company's directors.

        (ii) 2017 – the Government introduced a safe harbour for company directors from personal liability for insolvent trading if the company is undertaking a restructure (or "course of action").

(A) Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017.

(iii) The aim of the reforms was to promote a culture of entrepreneurship by providing breathing space for distressed businesses to facilitate restructuring their affairs and continuing to do business.

(iv) The safe harbour also encourages directors to seek advice earlier on how to restructure and save financially distressed, but viable companies, rather than entering into administration or liquidation prematurely to avoid personal liability.

(b) The ACF submits that the safe harbour provisions are currently ineffective. The definitions included within the Act do not specify what constitutes a better outcome, how that outcome should be measured or indicate how the reasonably likely test is measured and/or accessed. It is the ACF's view that directors need to have their suppliers/creditors positions and the effect their actions have on the ongoing business relationship at the forefront of their considerations when forming their opinions and that they must act in the interests of the Company as a whole.

(c) The legislation currently does not require directors to prove that a course of action, if adopted, will lead to a better outcome. There is also a lack of qualification as to who is an appropriately qualified entity for the purposes of overseeing and assisting in the formulation of safe harbour plan and in practice, we have seen advisors who may not be appropriately qualified engaged by directors to assist them in attempting to avail themselves of safe harbour.

(d) The ACF submits that an appropriately qualified entity needs to be a qualified insolvency/turnaround practitioner that is regulated and recognised by ASIC and to have demonstrated experience in creating and implementing a turnaround plan, accessing the solvency of a company and understanding the consequences and likely outcomes of a formal insolvency appointment on a Company.

2. **What impact has the availability of the safe harbour had on the conduct of directors?**

(a) The ACF submits that the safe harbour has had little impact on the conduct of directors.

(b) Further the ACF submits that there should be a similar moratorium placed on unfair preference and the use of these claims against creditors who are forced to continue to support and provide credit to directors and their Company.

(c) Members of the ACF have had little experiences with safe harbour because it is not registered as to which directors take up the provisions.

3. **What impact has the availability of the safe harbour had on the interests of creditors and employees?**

(a) Whilst it is difficult to ascertain statistically as there is no ability to quantify which Company directors have attempted to available themselves of safe harbour, the ACF submits that the availability of the safe harbour has had a negative impact on the interests of creditors and employees.

(b) The lack of transparency by a board, as there is no requirement to advise stakeholders (including creditors) of the formulation of a plan and its implementation, appears to allow directors to take a course of action that may be more beneficial to their personal interest than those of the Company and its creditors.

(c) There is a clear disconnect between the directors statutory and fiduciary duties to act in the best interests of the Company and the potential outcome that protects a director from being pursued for insolvent trading personally if the plan fails and the Company ends up being externally administered. This also removes a potential recovery resource

that would ordinarily be available to a liquidator for the benefit of creditors should the turnaround fail, and the Company is placed into external administration.

(d) As noted above, the lack of specification around what constitutes a better outcome, how it is to be measured and the components of the reasonably likely test do not translate into the consideration first and foremost for creditors rights, and the effect that a particular course of action taken under the guise of a safe harbour plan implemented by directors will have on them.

4. **What was your experience with the COVID-19 insolvent trading moratorium, and has that impacted your view or experience of the safe harbour provisions?**

(a) The ACF submits that the COVID-19 insolvent trading moratorium has had a negative impact on the interests of creditors and employees overall. The blanket safe harbour period through to 31 December 2020 resulted in a delay to the ordinary business life cycle process which is still yet to be fully played out. Whilst the ACF appreciates the need for swift policy decisions being made in extremely difficult circumstances, the accompanying stimulus measures were more than sufficient to assist the majority of businesses through the worst of the pandemic and the resulting lockdowns.

(b) The inability for creditors to enforce on debts that had accrued prior to the moratorium period due to the changes to the statutory demand regime significantly reduced pressure that may have otherwise been applied to directors to take the steps necessary to wind up insolvent businesses. This in turn allowed further time for assets to be dissipated that may have been otherwise available to be distributed to creditors.

5. **Are you aware of any instances where safe harbour has been misused?**

(a) The ACF is of the opinion that the safe harbour provisions are frequently misused by company directors.

(b) This is likely due to ambiguity around when they can be utilised and the competing interests that arise between the position of the creditors and employees in comparison to the personal liability of directors. As noted above, the lack of specification around what constitutes a better outcome, how it is to be measured and the components of the reasonably likely test do not translate into the consideration first and foremost, or creditors rights and the effect that a particular course of action taken under the guise of a safe harbour plan implemented by directors will have on them.

6. **Are the pre-conditions to accessing safe harbour appropriate?**

(a) The ACF is of the opinion that the **following preconditions are appropriate:**

Safe harbour is not available if the company has failed, within the previous 12 months to comply with:

its obligation to pay its employees (including their superannuation); and

its tax reporting obligations.

(b) The ACF is of the opinion that the above preconditions **are appropriate** as they balance the needs of the employees of the business with the need to ensure that the statutory accounting lodgement obligations are maintained which are both fundamental in a turnaround scenario. The assessment criteria for the above are also well defined and are non-subjective.

(c) The ACF is of the opinion that the **following preconditions are not currently appropriate:**

Directors need to show that they have developed and taken a course of action that at the time was reasonably likely to lead to a better outcome for the company than proceeding to immediate administration or liquidation

(d) The ACF is of the opinion that the **above preconditions are not appropriate** as the definitions included within the Act don't specify what constitutes a better outcome, how that outcome should be measured or indicate how the reasonably likely test is measured and/or accessed.

(e) The legislation doesn't require directors to prove that a course of action, if adopted, will lead to a better outcome. For the above preconditions to be effective, the need to be defined more appropriately and be supported by a well defined "suitably qualified entity".

7. **Does the law provide sufficient certainty to enable its effective use?**

(a) At present, the ACF admits that the law does not provide sufficient certainty for the appropriate and effective use of the safe harbour provisions. As mentioned, the vagueness and ambiguity with respect to a 'course of action' allows the provisions to be inappropriately misused.

8. **Are there any improvements or qualifications you would like to see made to the safe harbour provisions and/or the underlying prohibition on insolvent trading?**

(a) Whilst the ACF admits that the law does not provide sufficient certainty for the appropriate and effective use of the safe harbour provisions and they are ineffective, should they remain, the following improvements are required:

(i) Tighter definitions within the Act as to what constitutes an appropriate course of action for a board to take in circumstances where they are attempting to avail themselves of safe harbour, what constitutes a better outcome, how it is to be measured and the components of the reasonably likely test;

(ii) Transparency with stakeholders who are owed substantial monies by the Company in relation to the plan, its objectives and some measurable outcomes;

(iii) Added protection from preference claims for creditors that may be brought by a liquidator in circumstances where a board have availed themselves of the safe harbour regime prior to the appointment of an external administrator. Creditors should not be penalised for attempting to support their clients through a turnaround plan that ultimately fails.

Observations

The main overarching submission the ACF wish to make is that in conjunction with the safe harbour provision, a review should be undertaken regarding unfair preference claims and actions which are taken against creditors who are doing the right thing by supporting their clients. Creditors should not be penalised for helping their clients turn their business around.

The insolvency moratorium which was put in place in response to Covid 19 in March 2020 which finished on 31 December 2021 would not have been necessary if there was a mutually exclusive moratorium on preference action taken against creditors during the period.

A thorough review should be undertaken into the unfair preference regime and the significant impact this has on creditors.

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Anna Taylor
Chairperson - Legislative Sub-Committee
Australian Credit Forum