Corporations Act Reform Announced

Daniel Turk and Benjamin Bronzon | April 2017 | Commercial Disputes & Transactions

Summary

On 28 March 2017, the Commonwealth Government released exposure draft legislation dealing with reform of Australia's insolvency laws. Designed to promote a culture of entrepreneurship as part of the National Innovation and Science Agenda (NISA), the draft legislation will amend provisions of the *Corporations Act 2001* (Cth).

Safe Harbour

Section 588G of the *Corporations Act 2001* (Cth) imposes civil and criminal liability on directors of a company who cause the company to trade whilst insolvent.

The proposed draft Bill intends to create 'safe harbour' provisions for company directors to forgo personal liability for insolvent trading if the company undergoes restructure. The 'safe harbour' provisions will apply in certain circumstances such as:

- where directors have taken a course of action reasonably likely to lead to a better outcome for the company and its creditors; and
- the debt is incurred in connection with that course of action.

Protection will commence at the period starting at that time a director suspects the company is insolvent or is about to become insolvent.

Protection will cease when the earliest of any of the following occur:

- when the director ceases to take that course of action;
- when that course of action ceases to be reasonably likely to lead to a better outcome for the company and the company's creditors; or
- when the company goes into administration, liquidation, receivership, deed of company arrangement or scheme of arrangement.

The 'safe harbour' provisions will not be available to directors who fail to give returns or other documents required under the laws of tax or fail to provide for employee entitlements.

The draft Bill sets out a non-limiting list of factors when working out whether a course of action is reasonably likely to lead to a better outcome for the company and the company's creditors. These factors include:

- taking appropriate steps to prevent any misconduct by officers or employees of the company that could adversely affect the company's ability to pay all its debts; and
- taking appropriate steps to ensure that the company is keeping appropriate financial records consistent with the size and nature of the company; and
- obtaining appropriate advice from an appropriately qualified entity who was given sufficient information to give appropriate advice; and

- properly informing himself or herself of the company's financial position; and
- developing or implementing a plan for restructuring the company to improve its financial position.

Under the proposed 'safe harbour' provisions, directors will have the evidential onus in determining whether the 'safe harbour' provisions are available to them. The explanatory memorandum sets out that once a director provides such evidence to utilise the 'safe harbour' provisions, it is then up to the other party (i.e. liquidator in an insolvent trading claim) to establish that the director's course was not reasonable in the circumstances. If a director conceals, destroys or removes books of the company or fails to provide a liquidator access to books and record upon request, then a director may not be entitled to rely on books and records in support of using 'safe harbour' provisions.

Overall, this reform aims to promote diligent directorships and astute risk management in addition to eliminating directors prematurely placing a company into external administration.

Ipso Facto

As it stands, 'ipso facto' clauses allow certain contracts to be terminated due to an event of insolvency such as a company being put into external administration. Such clauses fail to account for the fact that a company may be in the position to continue to meet such rights, payments or obligations under contract.

This reform essentially makes 'ipso facto' clauses unenforceable in circumstances where a company enters into a formal insolvency process. In other words, these reforms will ensure a 'stay' on the enforcement of contractual rights of termination in circumstances where:

- the company applies or enters into a scheme of arrangement; or
- enters into voluntary administration.

The draft Bill also sets out that the stay will not apply to certain rights specified in the regulations.

Of course, the Courts will have the power to overturn the stay in the interests of justice.

Significantly, a counter-party under the subject contract with suspended rights to enforce under 'ipso facto' will not be obliged to provide additional credit.

This reform aims to promote successful restructures and prevent the value of a business being diminished when it is being sold.

In addition, reforms to the proposed reduction of the bankruptcy default period from three years to one year will be legislated separately by the Attorney-General.

The Bill provides such insolvency reforms to take effect at the later of 1 January 2018 or receipt of Royal Assent.

The Government has requested comments on the draft Bill by 24 April 2017.

For more information, please contact:

Benjamin Bronzon
Lawyer
T: 02 8257 5805
benjamin.bronzon@turkslegal.com.au

Daniel Turk
Partner
T: 02 8257 5727
M: 0408 667 220
daniel.turk@turkslegal.com.au