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Mr Mark Fitt
Committee Secretary
Senate Standing Committee on Economics Legislation Committee
Parliament House
Canberra ACT 2600
By email: economics.sen@aph.gov.au

Dear Mr Fitt

# Treasury Laws Amendment (2017 Enterprise Incentives No.2) Bill 2017

The Australian Bankers' Association (ABA) appreciates the opportunity to provide its views on this Bill.

Generally, the ABA supports the two key measures in the Bill which are intended to:

1) create a safe harbour defence for company directors from personal liability for insolvent trading if their company is undertaking a restructure outside formal insolvency; and

2) stay the enforcement of certain contractual rights (ipso facto clauses) and other rights while a company is seeking to restructure under certain formal insolvency processes or where the company has come, or is, under administration.

## 1. Safe harbour for company directors from personal liability for insolvent trading

The proposed safe harbour is similar with how banks work with their business customers which are experiencing financial difficulties where there is the likelihood that a work-out with a customer will be successful. As drafted, the Bill supports these endeavours.

The Government's objective, which the ABA supports, is to reduce the incidence of directors appointing prematurely a voluntary administrator to their business. This can be due to a concern that the company may continue to trade whilst insolvent (or may become insolvent by continuing to trade) in circumstances where the directors believe, in good faith and on rational grounds, that the ultimate outcome for creditors would be beneficial if the business continued to trade. The current position under the law is considered to be a disincentive for directors continuing to trade with a potentially viable business but which may become insolvent by continuing to trade.

The ABA believes that the approach in the Bill will provide protections for the directors, creditors and employees of a financially troubled company while the future viability of the company is assessed and hopefully restructured successfully. These protections are critical if the company is to have the necessary breathing space.

A key element of the model is that the safe harbour will operate as a defence for directors faced with a claim of insolvent trading. The ABA supports the intent of the Bill which is to avoid adding a further insolvency regime for companies in such circumstances and instead provide a defence which places an evidential burden (defined in the Bill) on the directors to establish a *prima facie* defence. This is to adduce or point to evidence suggesting that a course or courses of action are reasonably likely to lead to a better outcome for the company.

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To be able to rely on the defence there are prescribed factors in the Bill for directors to weigh which are typical of the conduct and observance of sound business management and accounting and record keeping practices which are expected under the law and by regulators, investors, creditors and the community.

A successful defence must require the directors to act in good faith in taking a course of action which is reasonably likely to lead to a better outcome for the company in a timely fashion to ensure that if, at any time (and after continuing consideration), a view is formed that it is not in the interests of the company (which the ABA believes should include the general body of its creditors) to continue to operate the company, then an administrator or liquidator (as the case required) should be appointed immediately.

The ABA has no further comments to make on these aspects of the Bill.

# 2. Stay of enforcement of Ipso Facto clauses in certain contracts

The ABA is generally supportive of the Bill which is intended to cause the stay in the enforcement of *ipso facto* clauses in certain contracts where a company is seeking to restructure with the intention of avoiding an insolvent liquidation.

## 2.1 Period of the stay (for scheme of arrangement and voluntary administration)

In cases where a rehabilitation or restructure is not successful, and there is the ensuing likelihood of a winding up of the company, as the Bill currently reads the stay remains in place until the “affairs of the company have been fully wound up” (see section 415D(2)(b)(iv)), despite the case that liquidators rarely continue to trade-on a business.

Unless the court decides to abridge the period of the stay this could have the effect of preventing lenders from enforcing guarantees until many months (even years) after the commencement of the winding up. This is because an unsatisfied written demand for payment served on the debtor company is often a prerequisite to enforcement including in respect of a guarantee securing payment of the debt.

We believe that this is an inadvertent consequence of the current drafting, and that it does not reflect a policy intention to change the current law.

The ABA believes that the Bill should make it clear that the stay ends on the making of the winding up order or the creditors’ resolution to wind up the company. Otherwise, there is the further consequence that any charge holder (which does not hold security over all or substantially all of the assets of the company) would be unable to exercise its enforcement rights that are otherwise stayed, when liquidation commences.

One illustration of this point is with existing sections 440B(1) and 440F of the Corporations Act on the one hand, and proposed section 451E(1) and (2) on the other, which seem to conflict (in respect of the rights of a secured creditor or lessor) insofar as the expiry of the stay.

Further, if the Bill is intended to cover statutory rights, it will be necessary to expressly provide for that as the rights the subject of the stay are limited to rights that arise "by express provision … of a contract, agreement or arrangement”.

## 2.2 Schemes of arrangements and secured creditors

The stay provisions in sections 415E to G of the Bill would, as they can be read, prevent a secured creditor (having security over all or substantially all of the assets of the company) appointing a receiver and manager (where it would otherwise be able to do so by reason of any application under existing section 411 of the Corporations Act being announced, filed or granted). Put another way, there does not appear to be protection afforded to secured creditors in this regard analogous to existing section 441A in voluntary administrations. This may be inadvertent and the ABA would be grateful for further consideration to be given to this issue and for an amendment to be recommended by the Committee to reflect the comparable position under section 441A.

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## 2.3 Preservation of earlier events of default post the stay period

In each case in the Bill (schemes of arrangement, managing controllers and voluntary administrations), counterparties are prevented from enforcing rights after the expiry of the stay if the reason for seeking to enforce a security is directly or indirectly related to any variety of past circumstances.

The ABA believes that this restriction should be limited to instances where the primary reason for seeking to enforce is related to the defined cases in the Bill and applies only where the restructure or rehabilitation has been successful (that is, should not apply if the company is being wound up).

## 2.4 Extension of stay beyond ipso facto insolvency events (schemes, managing controller appointment, appointment of administrators)

The ABA is concerned about the drafted breadth of the following provisions: s415E(1)(d), s434J(1)(b) and s451E(1)(b) (each of which is expressed in similar terms).

Whilst these sections are understood to be designed to operate as anti-avoidance provisions with the intent of ensuring that a right of enforcement arising by something similar to (but not necessarily due to) a prescribed insolvency event would also trigger the stay, the language seems to go well beyond this.

Paragraph 2.10 of the Explanatory Memorandum to the Bill describes the intention of the ipso facto stay provisions as follows:

*"Notwithstanding the operation of the stay, a counterparty maintains the right to terminate or amend an agreement with the debtor company for any other reason, including for a breach involving non-payment or non-performance."*

For example, even where it is clear that there has been an isolated, separate payment default or breach occurring under a contract it could be claimed that the stay on enforcement has been triggered because of the words "the company's financial position" in the relevant sections.

For the avoidance of doubt the ABA believes that the right referred to in paragraph 2.10 of the Explanatory Memorandum should be expressly protected in the Bill.

## 2.5 Restriction on superior ranking secured creditor appointing (effectively replacing) receivers and managers appointed by a lesser ranking secured creditor

Section 434J appears to provide that a secured creditor holding security over all or substantially all of the assets of the company would be prevented from appointing a receiver and manager over the top of another lesser ranking secured creditor's appointment of a receiver and manager on the ground that the appointment of the receiver and manager by the other creditor would be typically an event entitling the senior secured creditor to appoint its own receiver and manager.

Unless this outcome is intended, the ABA assumes this is inadvertent and requests that the Committee to recommend this is addressed in the Bill.

## 2.6 Exclusion of certain rights by regulations

1) The ABA welcomes the provisions in section 451H which accord priority to the Payment Systems and Netting Act (Netting Act) and International Interests in Mobil Equipment (Cape Town Convention) Act 2013 to the extent of any inconsistency between sections 451E to G of the Bill and these Acts.

   In relation to the "contracts, agreements or arrangements" to be prescribed by regulation consideration is expected to be given to the extent to which the application of section 451H will be sufficient to cover Real Time Gross Settlement (RTGS) which is a system protected under Part 2 of the Netting Act. The ABA submits that the Bill should ensure

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that RTGS is covered as a system within the meaning of "contract, agreement or arrangement" for the purposes of the exclusions under the proposed regulations.

The ABA will be including this in its response to the forthcoming Treasury consultation on the proposed regulations for which provision is to be made in the Bill.

2) It is understood that rights associated with set off rights are intended to be protected by regulation. It is unclear whether a secured creditor which has appointed a receiver and manager to a debtor company will be precluded from exercising its right of acceleration or any other contractual right necessary to ensure a valid appointment and receivership. The ABA believes this should be made certain in the regulations.

The ABA and its members would be pleased to provide assistance to the Committee in dealing with any queries it may have arising from this submission.

Yours faithfully

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Ian Gilbert
Director Banking Services Regulation
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