Further Submission from Arnold Bloch Leibler

to the Productivity Commission

Business Set-up, Transfer and Closure

Response to Productivity Commission Draft Report May 2015

July 2015

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Lawyers and Advisers

1 Introduction

1.1 This further submission has been prepared by Arnold Bloch Leibler in response to the Productivity Commission's draft report released in May 2015 in relation to 'Business Set-up, Transfer and Closure' (**Draft Report**) and, in particular, the request for further submissions in respect of the reforms proposed in Chapter 15 of the Draft Report.

1.2 We welcome the opportunity to make this further written submission to the preliminary submissions we provided in February 2015 (**Initial Submission**).

1.3 Our Initial Submission was directed to business closure (or avoiding business closure through effective restructuring in, or outside of, the statutory insolvency administration regimes). We are supportive of a number of the proposed reforms in the Draft Report as improvements to the existing statutory framework that regulates corporate reconstruction and insolvency arrangements. We encourage the Commission to embrace a re-branding of the Part. At a recent hearing we were asked for an alternate name. We suggest for discussion purposes only say, "Managed Corporate Restructuring" (**MCR**). Such a name highlights the key purpose of the Part - restructuring of corporations. It is "managed " and administered by a restructuring practitioner. Insolvency practitioners should also embrace the restructuring title. MSR avoids using "voluntary" as the process is not "voluntary". A re-branding will attract media and comment. Preservation of the status quo will not result in change. Rebranding may assist. And if it does not, the status quo remains.

1.4 We set out below our comments in relation to the reforms proposed in the Draft Report.

2 Submissions in response to draft recommendations

Draft Recommendation 15.1 - Amending s 436A of the Corporations Act 2001

2.1 For the reasons set out in our Initial Submission,[1] Arnold Bloch Leibler supports and agrees with the Productivity Commission's Draft Recommendation 15.1 that section 436A of the *Corporations Act 2001* (Cth) (the **Act**) be amended so as to remove the ability of directors to appoint an administrator to a company that is already insolvent.

[1] Initial Submission, paragraphs 3.15 - 3.19

2.2 We acknowledge that there are inherent difficulties in determining whether a company is actually insolvent, or likely to become insolvent at some future time. However, directors and their advisors are already familiar with navigating that issue in the context of the insolvent trading regime. Accordingly, we consider that the proposed amendment will encourage a re-orientation of the voluntary administration regime away from being viewed as a winding up mechanism and towards a rehabilitative or restructuring regime. Further, where appointments are made to companies that are not actually insolvent, the perception and risks of Part 5.3A of the Act being abused for collateral purposes, including for 'phoenix' activity or directors seeking to avoid scrutiny by a liquidator, are reduced. The efficacy of such changes will be determined by the profession.

Draft Recommendation 15.2 - Safe Harbour for Directors

2.3 Arnold Bloch Leibler supports and agrees with the Productivity Commission's Draft Recommendation 15.2, for insertion of a provision for 'safe-harbour' into the Act to protect directors who act in good faith to continue to trade a company in the 'twilight zone' of solvency to rehabilitate or restructure a business for the benefit of the company's creditors and stakeholders.

2.4 As set out in our Initial Submissions[2], we consider the 'safe harbour' provision should be formulated as an additional defence to the existing insolvent trading regime. We comment on the additional elements of the proposed 'safe harbour' as follows:

(a) Advisors appointed during the 'safe-harbour' period should be permitted to act as administrators, receivers or liquidators in any subsequent insolvency process for the company *with leave of a Court or specialist panel*. While there is a risk of conflict where the restructuring advisor is subsequently appointed, there may be circumstances where the timing and need to utilise the statutory restructuring mechanisms quickly to complete or facilitate a reorganisation (such as a 'pre-pack') make it difficult for a new practitioner to be appointed and familiarise themselves with complex arrangements where there are real commercial time pressures. In such cases, the advisor should be able to be appointed with leave of the Court or a specialist panel.

(b) If there is to be a requirement for the company to inform ASIC and/or the ASX (for listed companies) of the appointment of an adviser as a component of the 'safe harbour' defence, we query whether that notification be publicly

[2] Initial Submission, paragraphs 3.41 - 3.45

recorded as this may give notice to stakeholders and counterparties that the company may be distressed and action taken to terminate contracts, tighten available credit or limit exposure without the protection of a full moratorium that is engaged on the appointment of an administrator.

(c) We advocate that the 'safe harbour' provision should be able to be invoked as a defence to an insolvent trading claim whenever its elements are satisfied. Certain professional directors and advisors (who may be regarded as 'shadow directors') have particular skills in and are regularly appointed to turnaround situations. Accordingly, we do not see any need to impose time limits on the period that the 'safe harbour' would apply or otherwise limit the frequency of its availability (provided its elements are made out in the particular circumstances in question).

Draft Recommendation 15.3 - pre-packaged sales

2.5 Pre-packaged sales are not specifically regulated by the statutory insolvency regime or voluntary administration. Such transactions are already being undertaken under the current framework, particularly by voluntary administrators who are not subject to the duties on sales imposed on receivers under s 420A of the Act.

2.6 We do not consider that any specific 'safe harbour' is necessary to facilitate such transactions. However, we support the Commission's proposal that an additional layer of protection for creditors be added to the voluntary administration regime to the effect that related party pre-packaged transactions can be impugned if they are not for reasonable market value. Under the current law, Administrators who sell a company's business are afforded considerable latitude in that the Courts will only interfere with the exercise of an administrator's power of sale where they act in a manner that no reasonable administrator would act.[3]

Draft Recommendation 15.4 - ipso facto protection

2.7 Arnold Bloch Leibler supports and agrees with the Productivity Commission's Draft Recommendation 15.4, for the *Corporations Act 2001* (Cth) to be amended to include a suspension on contractual counterparties' ability to terminate contracts on the basis of the fact of an insolvency event or formal appointment.

[3] See *Hausmann v Smith* (2006) 24 ACLC 682.

2.8 To the extent that a 'safe harbour' defence was to involve the appointment and notification of a registered restructuring advisor, we agree that the suspension of the enforcement of *ipso facto* clauses should be extended to that 'safe harbour' period.

2.9 The Commission has requested views on whether provisions are needed to ensure contractual 'work arounds' do not undermine the intent of draft recommendation 15.4. We consider that a substance test similar to the prohibition in Chapter 11 of the US Code U.S.C. § 365(b)(2)(B) should capture any contractual stipulation triggered by an appointment.

3 Further recommendations

Moratorium for Schemes

3.1 For the reasons set out in our Initial Submissions,[4] we support a proposal to enhance the flexibility and efficacy of schemes of arrangement as a means of corporate reorganisation by the introduction of a moratorium similar to that which applies to voluntary administration.

3.2 In our view, the risks of abuse of scheme arrangements under Part 5.1 of the Act that might arise from the introduction of a moratorium is limited due to the high degree of court supervision that already exists in relation to the scheme provisions.

3.3 The introduction of a moratorium in relation to a Scheme may avoid millions of dollars of costs being expended while parties negotiate an implementation deed prior to the drafting of the Scheme.

Specialist Reconstruction Panel

3.4 As advocated in our Initial Submissions, we support the implementation of a specialist reconstruction panel, similar to the Takeovers Panel.

3.5 The proposed panel would not replace or supplant the role of the Courts but rather streamline and augment the existing curial supervisory regime in relation to insolvency administrations.

3.6 In our view the panel would have a confined ambit to make decisions in relation to specialist or routine matters arising in insolvency and restructuring administrations. The Court rules could also be amended to permit a power to refer matters to the panel in respect of defined issues.

[4] Initial Submission, paragarphs 3.37 - 3.40.

3.7 For example, we would envisage that increasingly common applications by administrators to extend time periods or the manner of convening meetings and giving notices could be referred to the panel. Such applications often need to be heard on short notice and the Court processes and availability of judicial officers to urgently determine such applications can add costs, burden courts and add delay to relatively uncontroversial and routine matters.

4 Conclusion

4.1 While Australia's current statutory framework governing corporate insolvency and reconstruction is generally effective, we consider it can be improved to promote and encourage rehabilitation of businesses and greater entrepreneurial endeavour.

4.2 We support and welcome many of the proposed reforms and recommendations in the Draft Report and in particular:

(a) the amendment of s 436A of the Act to assist rebranding voluntary administration as a rehabilitative regime rather than a winding up mechanism to say Managed Corporate Reconstruction;

(b) the introduction of a 'safe harbour' defence for directors and restructuring advisors undertaking good faith steps to restructure companies in the 'twilight zone' of solvency;

(c) the introduction of a temporary suspension on the enforcement of ipso facto clauses during voluntary administration and as a component of a moratorium introduced to facilitate reconstructions under schemes of arrangement;

(d) the establishment of a specialist reconstruction panel as a lower cost and streamlined means of dealing with routine or specialised issues and applications that arise in insolvency and restructuring administrations and work-outs.

4.2 Thank you for the opportunity to comment on the Draft Report. Please feel free to contact Leon Zwier on (03) 9229 9646 should you have any questions or wish to discuss our submissions generally.

Arnold Bloch Leibler

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