



Newsletter – no. 3/2016

With a decade of insolvency experience gained in Brisbane and the UK, Leon Lee has joined Stanley Morgan Accountants as a new Director. Leon is experienced with both personal and corporate insolvencies of all sizes.

Staying focused on the positive : More insolvency reform

In tune with the Federal Government's current mantra to encourage more private enterprise, more proposed changes to Australia's insolvency laws have been released. More often than not, entrepreneurs will fail several times before they achieve success, according to the Federal Government, and our current insolvency laws put too much focus on penalising and stigmatising the failures.

In essence, by making business failure somewhat more manageable, the theory is that more people will be motivated into private enterprise. There is no indication yet as to when, or if, these changes will become law, but there appears to be momentum (subject to the outcome of the forthcoming federal election).

Bankruptcy-lite

It is proposed that the current 3 year standard bankruptcy period be replaced by a 1 year period. Additionally, credit restrictions and industry/association membership exclusions will be relaxed for undischarged bankrupts. However, the income contribution regime will remain in place for 3 years (i.e. the year of bankruptcy, plus the following two years after discharge).

Business judgement v. insolvent trading

A business judgement test of sorts appears to be focus of two alternate 'safe harbour' proposals aimed at providing further defence to directors from potential insolvent trading claims by a liquidator.

The first proposal will provide directors with a restructuring option that allows them to retain control of their company whilst receiving formal advice. Such advice would need to be provided by an appropriately experienced and qualified individual, like an insolvency or restructuring expert.

The second option provides three criteria which, if met, would eliminate an insolvent trading claim. The three criteria are:

- a) If debt was incurred as part of reasonable steps to maintain or return the company to solvency within a reasonable period of time; and
- b) The directors held the honest and reasonable belief that incurring the debt was in the best interests of the company and its creditors as a whole; and
- c) Incurring the debt does not materially increase the risk of serious loss to creditors.

No *ipso facto*

In an effort to improve turnaround prospects for a struggling business, the third proposed reform is to prohibit *ipso facto* clauses. In summary, such clauses act to terminate contracts in the event of an insolvency event. Without a franchise or suppliers, for instance, a business may find it virtually impossible to trade-on either to financial recovery, or to effectuate a going concern business sale. Inherently, this diminishes the likely return to all creditors.

Ipso facto clauses would be outlawed from being enforced upon the appointment of a Voluntary Administrator, Deed Administrator, Receiver/Controller, or upon a company entering into a Scheme of Arrangement.

Commentary

It is noted that the proposed bankruptcy reform does not affect the vesting of divisible property, nor does it necessarily streamline the administration from the perspective of a bankruptcy trustee. However, by improving the capacity of individuals to earn income after bankruptcy, and by retaining the 3 year contribution regime, ultimately the prospects of a return to creditors should improve.

The proposal in relation to insolvent trading is welcome as it provides practical guidelines to separate insolvent trading with the best of intentions from insolvent trading due to mismanagement, or an unfounded belief in a turnaround. It will be interesting to see the impact of the reform (assuming the proposals become legislation) on the return to creditors.

The exclusion of *ipso facto* clauses in certain external administrations is positive, and ultimately has good prospects of improving the return to creditors.

Further information

To review a full copy of the Federal Government's proposals paper, visit the website of the Australian Government Treasury department. The closing date for submissions on the proposals is 27 May 2016.

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