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21 April 2017

Mr James Mason
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: insolvency@treasury.gov.au

Dear Mr Mason

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

The Australian Shareholders' Association (ASA) represents its members to promote and safeguard their interests in the Australian equity capital markets. ASA is an independent not-for-profit organisation funded by and operating in the interests of its members, primarily individual and retail investors, self-managed superannuation fund (SMSF) trustees and investors generally seeking ASA's representation and support. ASA also represents those investors and shareholders who are not members, but follow the ASA through various means, as our relevance extends to the broader investor community.

In May 2016, ASA responded to the public consultation on the proposals paper that set out two options for a safe harbour for directors from personal liability for insolvent trading. We welcome the opportunity to comment on the Exposure Draft of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2 Bill).

We note that the Exposure Draft introduces a safe harbour that will operate to carve directors out from the civil insolvent trading provisions of section 588G(2). In our original submission we did not support Safe Harbour Model B, which proposed an 'honest and reasonable belief' carve-out to the insolvent trading provisions.

Our concern with that proposal was that clear limits would be required as to its operation. The Productivity Commission Report (*Business Set-up, Transfer and Closure*, released in December 2015) had noted the difficulties in proving intention, state of mind and personal knowledge, as well as the considerable scope to mount a defence based on the circumstances.

Notwithstanding our original opposition to a carve-out, we note that the Exposure Draft introduces limits on the operation of the carve-out, including that:

- directors must show that they were taking a course of action reasonably likely to lead to a better outcome for the company and its creditors as a whole

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- directors cannot take a passive approach to the business's position or allow a company to continue trading as usual during financial distress, or entertain fanciful recovery plans. As the Explanatory Memorandum states, 'hope is not a strategy'
- the safe harbour is open only to directors who have been taking appropriate steps so that the company complies with the obligation to maintain proper books and records, provide for the entitlements (including superannuation) of employees and meets its taxation reporting obligations, and
    - where an administrator or liquidator is appointed, the safe harbour does not apply where directors withhold books or information about the company in an attempt to prevent a liquidator or administrator from investigating the company's activities and taking appropriate action, which action may include pursuing recovery against the directors personally for the company's debts if it appears that the directors did not take a course of action reasonably likely to lead to a better outcome than through proceeding to an immediate administration or the liquidation of the company
    - where an administrator or liquidator is appointed, the safe harbour does not apply if books and information that were not available at the time of their appointment are later prepared in a way to make it retrospectively appear that a director would have fallen within the safe harbour provisions.

We also refer to the indicative and non-exhaustive list of factors set out in the Exposure Draft that a court can consider in determining whether a course of action is reasonably likely to lead to a better outcome for a company and its creditors, including whether directors have:

- taken steps to prevent misconduct by officers and employees of the company
- taken appropriate steps to ensure the company maintains appropriate financial records
- obtained appropriate advice
- kept themselves informed about the company's financial position, and
- been developing or implementing a plan to restructure the company to improve its financial position.

We welcome the limits set out in the Exposure Draft and the clarification in the Explanatory Memorandum that the safe harbour is not intended to be a mechanism for a company to continue trading past the point where it is viable, and the limits set out above are intended to ensure that the carve-out is not used in this way.

However, we note that:

- it will be left to the courts to decide if the circumstances in each case merit the application of the safe harbour
- there is considerable scope to mount a defence based on the circumstances of a company, and
- the onus of proof rests on a liquidator (or other party) alleging a contravention of section 588G to provide evidence and argue that the safe harbour does not apply because the director did not take a reasonable course of action.

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Ipso facto clauses

We refer to the proposal to make regulations to set out types of contracts and contractual rights which will be excluded from the broad stay operation on the operation of ipso facto clauses.

We agree with the proposal that the stay should not apply where an ipso facto clause:

- is required or contemplated by a Commonwealth or State law, or an international obligation to which Australia is a party, or
- is inherent to the type of contract., that is, by removing the ipso facto clause it would render the contract unworkable or a nonsense.

However, we do not make comment on the proposed List of Excluded Contract types. We leave it to those with specialist knowledge of these fields to provide comment.

Yours sincerely

Judith Fox

Chief Executive Officer