Business School

24 April 2017

Mr James Mason

Financial Systems Division

The Treasury

Langton Crescent

PARKES ACT 2600

Dear Sir

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

Thank you for the opportunity to comment. This submission, which deals with the safe harbour proposal only, is made in response to the Exposure Draft of the Treasury Laws Amendment (2017 Enterprise Incentives No.2) Bill 2017.

Yours faithfully

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**General Comments**

This submission supports the effort by Treasury to temper the stringent nature of the current law on insolvent trading.

The safe harbour proposal is a welcomed initiative. It addresses structural defects in the current operation of insolvent trading law which disincentives directors attempts at restructuring through the pain of personal liability.

It is anticipated that the safe harbour will go a considerable way to address the the difficult, but pragmatic, question of whether to trade or not to trade.[[1]](#footnote-1) The safe harbor proposal is likely to offer more assurance for directors, who trade in times of financial difficulty, that they may do so without the law pouncing and imposing personal liability at the first opportunity. The safe harbour proposal, in this way, adopts a more measured approach to personal liability for insolvent trading. It also seeks to provide a better alignment to achieve the twin goals of director accountability and corporate rescue through restructuring – the latter being impeded by the way in which the law on insolvent trading currently operates.

The safe harbor, appropriately, is unavailable to directors who fail to provide employee entitlements or fail to give returns or other documents required by taxation law. This measure helps to ensure that the promotion of a greater cultural appetite for business risk does not come at the expense of employees and the wider community, for example, through phoenix activities.[[2]](#footnote-2)

Against the backdrop of these general comments, the following specific responses are offered to the Exposure Draft dealing with the safe harbour.

**Specific Comments**

1. Inconsistent terminology

Based on the language used in the Explanatory Memorandum and in the Exposure Draft, it is unclear whether the safe harbour is intended to a statutory carve out or a defence.

The Explanatory Memorandum uses both concepts suggesting it means the same thing. If the safe harbour is intended to a defence, then the utility of the law reform effort to encourage informal business restructuring efforts is questionable. If intended as a defence, it is likely to send a negative signal to directors with the prospect of the restructuring goal being impeded by risk averse directors concerned that they would have to bear the entire onus of proof. This submission favours a statutory carve out, to better promote good faith restructuring decisions, and recommends that the Exposure Draft makes explicit references to facilitate this aim.

1. Use of phrase ‘better outcome for the company and the company’s creditors’ in s 588GA (1)

It is submitted that the meaning of this phrase is imprecise and therefore likely to be uncertain in its application.

This is because it appears that creditors here are being treated as a homogenous group (creditors as a whole),[[3]](#footnote-3) which is often not the case.[[4]](#footnote-4) Creditors (current, contingent, prospective) may well have competing interests. If so, must all the competing creditor interests be balanced to ensure a better outcome for all of them?

This submission recommends that further consideration be given to this key issue to ward off unintended consequences and disputes. Based on existing case law,[[5]](#footnote-5) it can be argued that the rest of the sentence is superfluous. There is ample judicial recognition that ‘company’ includes creditors and that the concept of director’s duties is broad enough to capture creditor interests.[[6]](#footnote-6) In such circumstances, it is recommended that the phrase in s 588GA (1) be amended to read as ‘better outcome for the company’.

1. Amend s 588GA(5) definition of better outcome

This definition of ‘better outcome’ is referenced with regard to, inter alia, ‘the outcome of the company becoming a Chapter 5 body corporate.’ According to the Explanatory Memorandum [at (1.380], this means effectively the company going into administration or being wound up. This statutory definition has an evaluative exercise embedded in it which is very broad in scope. An assessment by the director as to whether there is a ‘better outcome’, with reference to this expansive criterion, is likely to impose a large transaction cost on companies, particularly in the SME sector. Such an evaluation is dependent on the director’s necessary skills and knowledge. It is a moot point as to whether directors, particularly in the SME sector, are equipped with such specialist skills. This additional cost impost can be negated by amending the wording to narrow the scope and breadth of the evaluative exercise – by limiting the assessment of a ‘better outcome’ to a narrower situation, for example, when compared to an immediate appointment of an administrator or liquidator.

1. For discussion of these difficulties, see A Hargovan, 'Director's Liability for Insolvent Trading, Statutory Forgiveness and Law Reform' (2010) 18 *Insolvency Law Journal* 96; J Harris, ‘Director Liability for Insolvent Trading: Is the Cure Worse than the Disease’ (2009) 23 *Australian Journal of Corporate Law* 266. More recently: J Harris, ‘Reforming Insolvent Trading to Encourage Restructuring: Safe Harbour or Sleepy Hollows? (2016) 27 *JBFLP* 294; A Hargovan, ‘Governance in Financially Troubled Companies: Australian Law Reform Proposals’ (2016) 34 *Company and Securities Law Journal* 483. [↑](#footnote-ref-1)
2. See the ground-breaking reports by leading academics: [Anderson, H, O'Connell, A, Ramsay, I, Welsh, M, and Withers, H, Defining and Profiling Phoenix Activity (December 2014)](http://law.unimelb.edu.au/__data/assets/pdf_file/0003/1730703/Defining-and-Profiling-Phoenix-Activity_Melbourne-Law-School.pdf); [Anderson, H, O'Connell, A, Ramsay, I, Welsh, M, and Withers, H, Quantifying Phoenix Activity: Incidence, Cost, Enforcement (October 2015)](http://law.unimelb.edu.au/__data/assets/pdf_file/0004/2255350/Anderson%2C-Quantifying-Phoenix-Activity_Oct-2015.pdf); and [Anderson, H, Ramsay, I, Welsh, M, and Hedges, J, Phoenix Activity: Recommendations on Detection, Disruption and Enforcement (February 2017)](http://law.unimelb.edu.au/__data/assets/pdf_file/0020/2274131/Phoenix-Activity-Recommendations-on-Detection-Disruption-and-Enforcement.pdf)See further: <http://law.unimelb.edu.au/centres/cclsr/research/major-research-projects/regulating-fraudulent-phoenix-activity> [↑](#footnote-ref-2)
3. As defined in s 588GA (5). [↑](#footnote-ref-3)
4. For discussion on the point that generally there is insufficient appreciation of the fact that different types of creditors have different interests, see Koeck, William and Ramsay, Ian, The Importance of Distinguishing between Different Categories of Creditors for the Purposes of Company Law. *Company and Securities Law Journal*, Vol. 12, No. 2, 1994. Available at SSRN: [https://ssrn.com/abstract=1024879](https://ssrn.com/abstract%3D1024879) [↑](#footnote-ref-4)
5. See collection of judicial authorities in footnote 6. [↑](#footnote-ref-5)
6. *Walker v Wimborne* (1976) 137 CLR 1; *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722; *Spies v R* (2000) 201 CLR 603. For discussion of these seminal cases, see A Hargovan, ‘Directors’ Duties to Creditors in Australia after Spies v The Queen – Is the Development of an Independent Fiduciary Duty Dead or Alive?’(2003) 21 *Company and Securities Law Journal* 390; ‘Geneva finance and the “duty” of directors to creditors: imperfect obligation and critique’ (2004) 12 *Insolvency Law Journal* 134.

More recently, see *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No 3)* (2012) 89 ACSR 1; [2012] WASCA 157 (hereinafter *Bell*). For critical analysis, see A Hargovanand J Harris, ‘For Whom the Bell Tolls: Directors' Duties to Creditors after Bell’(2013) 35(2) *Sydney Law Review* 433. <http://www.austlii.edu.au/au/journals/SydLawRw/2013/16.html> [↑](#footnote-ref-6)