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AUSTRALIA – SAFE HARBOUR BUT HAVE WE MISSED THE BOAT?

In 2015 the Australian Federal Government (**Australian Government**) launched its National Innovation and Science Agenda (**Innovation Agenda**) with a clear focus on encouraging entrepreneurship, innovation and investment across the Australian economy.

As a result of this Innovation Agenda, over the course of 2017 and 2018, Australia saw the first real reforms to corporate insolvency laws for over 20 years. We have seen the implementation of a number of insolvency reforms, including the introduction of a safe harbour for directors from personal liability for insolvent trading and a stay on the enforcement of "ipso facto" clauses. Much has been written about the technical aspects of these reforms – it is not the purpose of this article to go over "old ground". Whilst the reforms implemented have been welcomed, there is a view that these could have gone further if Australia was to truly embrace a restructuring mindset.

There has been much debate over many years in Australia about whether it should simply adopt the Chapter 11 Regime under the US Bankruptcy Code (**Chapter 11**). Whilst there are many that say Chapter 11 is a slow, cumbersome and expensive process, many countries have adopted a similar regime.

The South East Asia experience

In recent years, many South East Asian countries including Malaysia, India and Myanmar have introduced insolvency reforms with a focus on rescuing companies experiencing financial distress. In countries such as Hong Kong and Indonesia, progress has been slower.

Singapore, however, has been the most noteworthy jurisdiction within South East Asia to look at real reform, with its recent significant insolvency law reforms and its adoption of the UNCITRAL Model Law on Cross-Border Insolvency in March 2017. Singapore has unashamedly positioned itself to become the restructuring hub of the Asia Pacific region – and it has proven time and time again that it is a nimble jurisdiction, responding quickly and effectively to a changing economic and legal landscape.

Singapore's legislation with respect to liquidations and schemes of arrangement has historically been modelled on the UK insolvency regime due to the foundation of its constitution and legal system being based on English law. However, its recent insolvency law reforms have seen it adopt characteristics of the US Chapter 11 framework.

There has been much discussion about Singapore "super-charging" schemes of arrangement by adapting parts of Chapter 11[1] including implementing a super priority for rescue financing, facilitating multi-jurisdictional restructurings for foreign debtors through the low threshold for the"substantial connection" test and extending the availability of the judicial management regime to pre-insolvency scenarios. There have been a number of high profile uses of the Singaporean

[1] Paul Apathy and Emmanuel Chua, 'Singapore's new "supercharged" scheme of arrangement', (2017) 5 *Butterworths Journal of International Banking and Financial Law* 272, 272, 283; Kei Jin Chew, 'Singapore's efforts to become an international hub for debt restructuring', Norton Rose Fulbright Knowledge (Publication, January 2019).

system which has put a spotlight on the country as a "restructuring hub" in the global media. The judicial response in Singapore has been very positive and supportive of the reforms.

Chief Justice Menon of Singapore remarked to the then Chief Justice of the High Court of Australia, Robert French AC that "Singapore is a place in which it is possible to have a good idea and to have it realised".[2] The insolvency reform and judicial support for such reform ensures that Singapore will become a contender amongst forums such as London and New York for restructurings of companies in the South East Asia region.

How has Australia missed the boat?

Since its inception, the voluntary administration process in Australia has been considered by many as first class. The view is that the Australian process is more nimble and cost-effective than Chapter 11 and does not get bogged down in the Court system. However, the harsh insolvent trading laws in Australia have often meant that many directors relied on the voluntary administration process when a true restructuring may have worked.

There are however some shortcomings with the voluntary administration process. Unlike the US and Singapore, there is no automatic moratorium or stay for proposed schemes of arrangement for the purpose of restructuring,[3] no provision for the Court to allow "rescue financing" to be given priority[4] and notably, no allowance of "pre-packaged" administrations.[5]

Prior to the announcement of its Innovation Agenda, the Australian Government requested a report by the Productivity Commission in relation to business set-up, transfer and closure which, amongst other things, recommended the steps to facilitate a "genuine restructuring mechanism", including but not limited to:

a) a safe harbour defence to insolvent trading;

b) the introduction of provisions in relation to "pre-positioned" sales whereby in circumstances where a sale was to a non-related party, there should be a presumption of sale if the sale is for market value and would not unduly impinge on the performance of an administrator's duties;

c) ipso facto clauses to be unenforceable;

d) moratorium on creditor enforcement during formal schemes of arrangement; and

e) the Australian Securities and Investment Commission (**ASIC**) should produce a regulatory guide targeted at small and medium enterprises (**SMEs**) facing financial difficulty covering legitimate restructure and liquidation options and responsibilities.

Of the 5 recommendations, only two have been implemented. As a result, the view is that there is a distinct lack of reform for restructuring of SMEs. There is a strong feeling that the new safe harbour provisions may work well for larger enterprises, but not necessarily for SMEs.

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[2] Robert French AC, 'Singapore – Where Common Law and Constitutions Meet' (Speech, Anglo-Australasian Lawyers Society Breakfast Address, 21 October 2013), cited in Noel McCoy, 'Will Singapore become an international centre of debt restructuring? A comparative analysis of Singapore's bold insolvency reforms', (Special Report, INSOL International, November 2018) 19, 19.

[3] *Companies Act* (Singapore, cap 50, 2006 rev ed) s 211B ('*Singapore Companies Act*'); *United States Bankruptcy Code*, 11 USC § 362 (1978)('*Bankruptcy Code*').

[4] *Singapore Companies Act* (n 3) s 211E; *Bankruptcy Code* (n 3) § 364.

[5] *Singapore Companies Act* (n 3) s 211I; *Bankruptcy Code* (n 3) § 1125(g).

The second complaint was the failure to allow "pre-positioned" sales. Australia hesitated on this point. Some have said that Australia's hesitation was due to its voluntary administration regime being substantially a creditor driven process and the notion of a "pre-positioned" sale "flies" in the face of the protections currently afforded to creditors. Added to that, Australians are sceptical about the appearance of any sale occurring if pre-organised by a distressed company's directors.

The UK experience has evidenced that the rise of "pre-pack" sales (although still making up a very small number of sales in the insolvency context) has not come about from specific legislative change. Whilst not enshrined in legislation in the UK, "pre-pack" sales have been accepted because the code of ethics and Statement of Insolvency Practice 16 in the UK specifically contemplate the occurrence of such sales and the consequences for wrongful trading in the UK are more lenient.

There is commentary by a number of people that "pre-positioned" sales would work in the SME space if enough protections were put in place for creditors. The Productivity Commission in fact recommended a cost and time efficient "small liquidation" process which would involve an SME with liabilities to unrelated creditors up to a maximum of AUD$250,000 applying to ASIC for an Insolvency Practitioner facilitating a small pre-positioned sale. This recommendation was not taken up by the Australian Government.

At a very minimum, Australia has missed an opportunity to test whether pre-positioned sales could work by first ascertaining if such sales could work for SMEs.

Conclusion

The political reality is that for all the rhetoric around the Innovation Agenda, unfortunately insolvency reform is not a "vote winner". Some politicians have also tried to "kick Insolvency Practitioners" as a way of gaining voter support. This was evident during the recent Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Royal Commission**) where there were calls for the Royal Commission to be extended to include Insolvency Practitioners.

Unfortunately, with this sort of political landscape, we in Australia can only but watch other countries in the region such as Singapore take the restructuring lead.

It seems clear even with a safe harbour, Australia has "missed the boat"

Ian Dorey

Partner

+61.7.3233.1236

Ian.dorey@klgates.com

Rebecca Dalais

Lawyer

+61.7.3233.1277

Rebecca.dalais@klgates.com