How the new insolvency laws will help directors

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The proposed changes to the insolvency laws are likely to be fast-tracked by Treasury. But how do they actually help directors?

The draft legislation, introduced as part of the Federal Government's National Innovation and Science agenda, wants to introduce:

- a "safe harbour" carve out to a director's personal liability for insolvent trading, and
- stay provisions affecting the enforceability of certain "ipso facto" and other clauses during administration or a scheme of arrangement.

Jirsch Sutherland Partner Andrew Spring says it's likely Treasury will first pass the safe-harbour provisions, with the ipso facto changes following by the end of the year. [Submissions for the existing draft laws closed in May 2017].[/vc_column_text][/vc_column][/vc_row][vc_row][vc_column][vc_column_text css=".vc_custom_1496621462655{padding-bottom: 1em !important;}"]

Pros and cons of the safe-harbour changes

Under the safe harbour changes, directors won't be liable for certain debts incurred while insolvent if they start taking a course of action that is reasonably likely to lead to a better outcome for both the company and its creditors.

"By being granted additional breathing space, directors can improve the position for creditors," Andrew says. "Rather than opting to liquidate, which could devalue the business if they choose to sell, opting for safe harbour lets them restructure it or explore the possibility of a sale. This could lead to more of the company's value being preserved."[/vc_column_text][/vc_column][/vc_row][vc_row][vc_column width="5/12?][vc_single_image image="1912? img_size="full"][/vc_column][vc_column width="7/12?][vc_column_text css=".vc_custom_1496621673948{padding-bottom: 1em !important;}"]Andrew adds that every situation is different and whether a director's course of action is reasonable will vary on a case-by-case basis.

"Directors who carry on with a 'business as usual' approach to trading will not be able to rely on the safe harbour legislation," he says. "Only directors who act honestly and diligently will be afforded protection."

Andrew says directors need to be aware that the rules don't cover all debts and that the safe harbour changes have a number of pros and cons.[/vc_column_text][/vc_column][/vc_row][vc_row][vc_column][vc_column_text css=".vc_custom_1496625853553{padding-bottom: 1em !important;}"]"I'm also concerned there is not enough clarity as to what boards have to do to trigger safe harbour," he says. "But I

think safe harbour is a good option as boards should be encouraged to explore all options outside liquidation."

Andrew adds safe harbour also enables boards to seek advice earlier rather than wait until it's too late. "Seeking advice, such as from a restructuring officer is likely to be more comfortable for boards with the advent of this legislative reform," he says. ***[See: Role of restructuring officer needs clarifying]***

Pros and cons of the ipso facto changes

The new insolvency legislation also seeks to prevent contractors terminating supply and other contracts with a struggling business during the restructuring period, under what are called "ipso facto" clauses.

An automatic stay on the enforceability of certain ipso facto clauses will be introduced to prevent contracts being terminated just because a company has entered into a scheme of arrangement, administration, receivership or managing controllership.[/vc_column_text][/vc_column][/vc_row][vc_row][vc_column width="1/2?][vc_column_text css=".vc_custom_1496621640773{padding-bottom: 1em !important;}"]Andrew says that directors need to be aware that the automatic stay will not apply to all contracts. "The ipso facto legislation eliminates the immediacy of insolvency clauses in certain contracts, such as within the construction industry," he says.

For example, Andrew says he recently handled an earth-crushing business, which was prepared to work through a voluntary administration. However, the principal terminated the contract, which had an impact on the voluntary administration and was detrimental for the debtors.[/vc_column_text][/vc_column][vc_column width="1/2?][vc_single_image image="6302? img_size="full"][/vc_column][/vc_row][vc_row][vc_column][vc_column_text]"The contractor lost confidence the business could complete the works, which ultimately was a bad decision," Andrew says. "But under the proposed ipso facto clause, the contractor would not have been able to immediately terminate the contract. The change gives administrators the ability to say 'we are ready and able to complete the works'."

Andrew adds while a company is in administration, contracts cannot be terminated.

"It gives the voluntary administration process a greater chance of assessing the viability of a business and provides a greater opportunity to preserve the company's value," he says. "It enables the insolvency industry to change mindsets, so rather than 'terminate first and think later', it means 'thinking first about working together'."[/vc_column_text][/vc_column][/vc_row]