Article Information

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What? You're Insolvent? That's fine, just keep working.

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From 1 July 2018, reforms to the *Corporations Act 2001* (Cth) (**the Act**) will become effective including the addition of safe harbour laws and protections against ipso facto clauses.

The introduction of the new provisions in the *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017* (Cth) provides some safeguards to directors who attempt to 'trade out' of financial trouble without the threat of being personally liable for insolvent trading arising from debts incurred in attempting to do so or its trading contracts being terminated because an insolvency event has been triggered.

Megan Calder, Partner and **Jeremy Chan**, **Lawyer** discuss below.

Safe harbour provisions

Under these highly-anticipated provisions, directors will not be personally liable for debts incurred when they have been actively developing or taking one or more courses of action that are reasonably likely to lead to a better outcome for the company than appointing an administrator or liquidator. The safe harbour provision is not a defence to insolvent trading, rather it creates an exception in respect of those debts incurred directly or indirectly in in connection with the course of action. Where there is the risk of insolvency, the new provisions are focused on assisting directors and companies to restructure without the need to undergo formal insolvency processes.

In determining whether a course of action is reasonably likely to lead to a better outcome, the court may consider whether the person is:

- properly informing themselves of the company's financial position;
- taking appropriate steps to prevent any misconduct by employees of the company that could adversely affect the company's ability to pay its debts;
- taking appropriate steps to ensure that the company is keeping appropriate financial records;
- obtaining advice from a qualified entity who has been given sufficient information to give appropriate advice; and
- developing or implementing a plan for restructuring the company to improve its financial position.

To maintain the protections of the safe harbour provisions, directors must ensure that the company continues to comply with its obligations, such as paying its employees and tax liabilities, as well as ensuring that it is fulfilling its directors' duties.

Ipso facto clauses

Ipso facto clauses are included in most construction contracts and allow a party to the contract to take works out of the other party's hands or terminate the contract upon an insolvency event being realised, without the need for default. The definition of an insolvency event in the standard form contracts is broad and it is not unusual to see these clauses further amended to be even broader. For example, clause 39.11 of the standard form AS4000-1997 allows a party to exercise its rights if the other party gives notice of a meeting of creditors with a view to the company entering into a deed of company arrangement, a deed of company arrangement is entered into, a controller or administrator is appointed. It has in recent

years also become more common for contracts to provide an automatic entitlement to recourse to security in the event of insolvency.

In respect of contracts entered into after 1 July 2018, the new protections afforded by the amendments, mean that a mandatory stay will be imposed over a party's rights to take works out of the other party's hands or terminate the contract insofar as the rights are triggered by the following events occurring:

- the other party makes an application under s 411 of the Act and the application states that it is being made for the purpose of avoiding being wound up, or the other party is subject to such an application or subsequent compromise or arrangement (s 415D);
- a managing controller is appointed over the whole or substantially the whole of the other party's property (s 434J); and
- the other party is placed under administration, or the other party's financial position if the company is already under administration (s 451E).

Each provision ends with a broad protection against the rights being exercised for any reason that, in substance, is contrary to each of the subsections. For example, if the triggering event is one that will lead to the other party appointing an administrator or liquidator, then that will likely be caught by the stay as well.

The aim of the reform is to '*allow breathing space for a company to continue to trade during a formal restructure*' and to '*recover from an insolvency event instead of these clauses preventing their successful rehabilitation*'[1]. Importantly however contractual clauses that allow a party to exercise its rights by reason of the other party's financial position being irretrievable such as where the company is actually in liquidation are not caught by the reforms.

What to focus on

Key takeaways from the legislation:

- the new provisions will only apply to contracts entered into after 1 July 2018;
- a party can seek the written consent of the administrator, liquidator or receiver to consent to the enforcement of the right, or make an application to the court to lift the stay if it is in the interests of justice to do so;
- the protections do not prohibit the enforcement of rights for other contractual breaches, such as failing to fulfil an obligation in the contract but the show cause procedure will need to be enlivened; and
- parties cannot contract out of the ipso facto protections.

Construction contracts should be reviewed to ensure that provisions relating to insolvency take into account the protections against ipso facto clauses.

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[1] Explanatory Memorandum, *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*