BRI Ferrier

INDUSTRY INSIGHTS

By Moira Carter

Safe Harbour and Ipso Facto Clause reforms in corporate insolvency laws: a Safe Harbour or Pirate Cove?

The Government's release of draft legislation to addressing the Safe Harbour and Ipso Facto Clause reforms mooted in last year's Innovation Statement prompts us to ask: will the legislation go beyond what is necessary to protect directors from prosecution while they are restructuring a business to provide an opportunity for unqualified advisors to take unfair advantage of creditors?

The goals of the proposed legislation are the promotion of a culture of entrepreneurship and a reduction in the stigma around company failure. By reducing the perceived "penalties" associated with formal appointments it is hoped a better outcome will result for all participants, including creditors and employees.

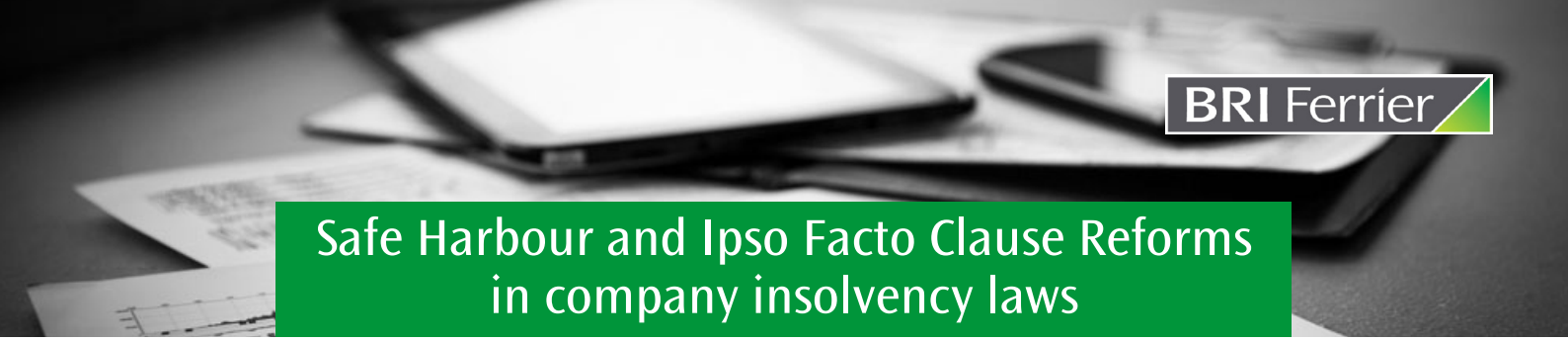
When will the new law apply?

The proposed "Safe Harbour" will apply to directors of companies in the process of a restructure. It will protect them from personal liability for insolvent trading while facilitating informal restructuring efforts. This protection will last as long as the course of action taken is reasonably likely to lead to a better outcome compared to a formal insolvency appointment (i.e. voluntary administration or liquidation). There will be no change to other duties owed by directors to, for example, act in the best interest of their companies, exercise their powers honestly, to keep accurate accounts and report the company's tax and superannuation position to the ATO.

The protection will take effect as soon as the director starts to take a course of action to avoid the company becoming insolvent. The protection will stop if:

1. the course of action is no longer reasonably likely to lead to a better outcome, or
2. the company goes into formal administration (including receivership).

According to the legislation, the definition of a "better outcome" is "an outcome that is better for both the company and its creditors as a whole than if the company entered some form of external administration".



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So how do you tell whether the proposed course of action is reasonably likely to lead to a better outcome for a company and its creditors?

A key factor is whether the director has obtained the appropriate advice from a suitably qualified advisor, assuming the advisor has been given sufficient information to provide solid advice.

The safe harbour will not apply to those directors who have not made adequate provisions for employee entitlements or whose company tax affairs are not up to date.

Suspending "Ipso Facto" clauses: how does it work?

"Ipso Facto" clauses can be found in many contracts. Ipso Facto (Latin for "by the fact itself") clauses either require or allow a supplier, lessor or customer to terminate, suspend or modify a contract (such as a lease or supply agreement) because of an event such as a formal external administration appointment like Voluntary Administration or Receivership even if the company can prove that it can meet the contractual payments or performance obligations.

These clauses have stopped companies from restructuring or trading out of financial difficulties in the past after a formal appointment, as a restructure proposal has not been able to be implemented due to the termination of vital contracts.

The bottom line: what are the key reforms?

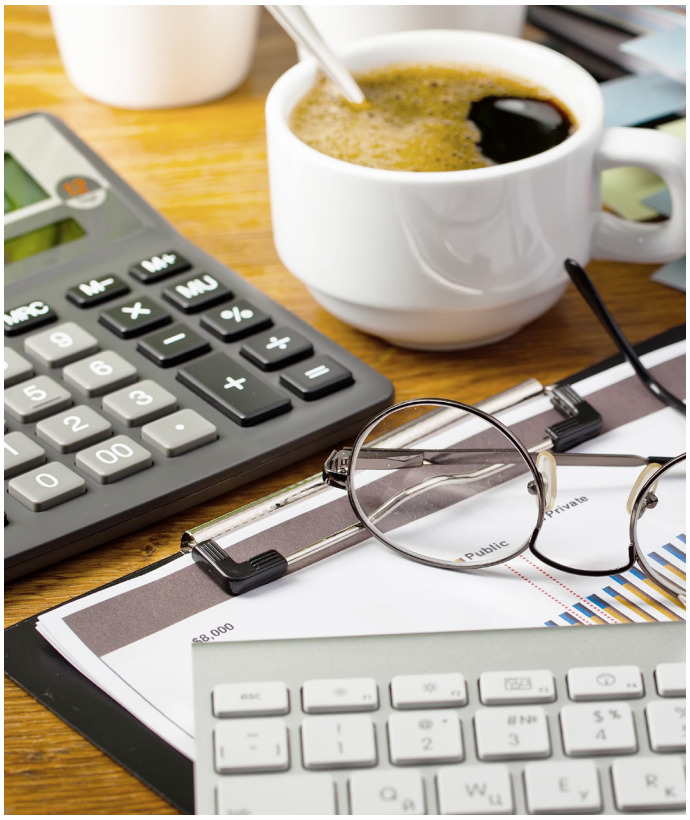
1. There will be a "stay", or suspension of the operation of Ipso Facto clauses in most (but not all) contracts when a company enters into a scheme of arrangement or a voluntary administration. The court will have the power to override the stay. There are certain conditions where the stay will not apply. All the details are found in the regulations.
2. Importantly, even though a stay on enforcement of an Ipso Facto clause may be in place, a party to a contract will not be obliged to provide additional credit. This means that if the contract is with a party whose continued support is crucial to the ongoing trade of the company, and their position cannot be renegotiated, a restructure may still not be able to proceed.

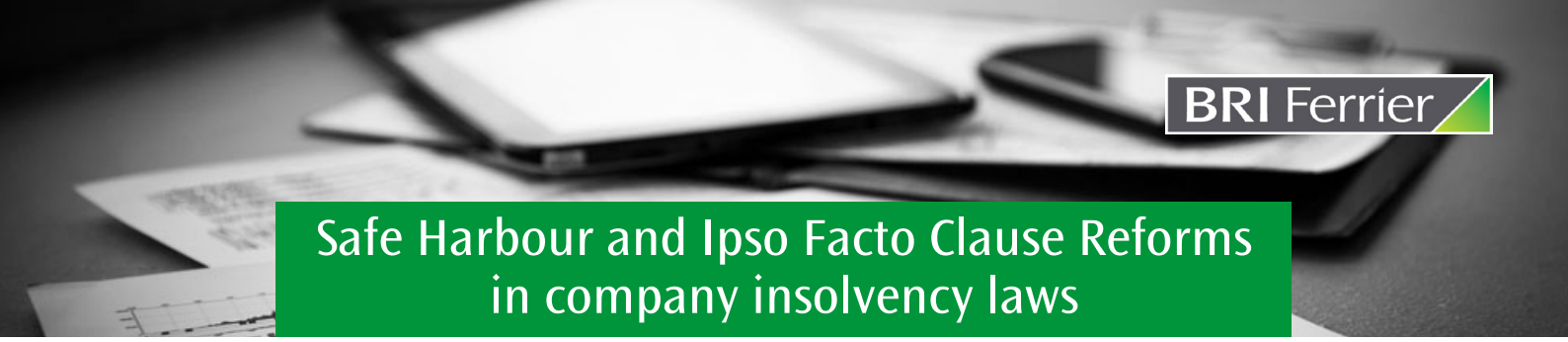
The concerns for accountants and lawyers advising their clients are clear

The reforms are significant as they remove a restriction on taking early action by directors facing possible insolvency, and provide a mechanism for directors to work towards the company's recovery and continued success. They are designed to do so in ways that provide creditors with some protection, although those protections will inevitably be weaker than the existing law.

However, as they now stand, the reforms do not address a secured creditor's right to enforce their security. To be successful, any restructure will require skilful negotiation with those secured creditors. The directors, their advisors and secured creditors will need up-to-date financial information, and would be concerned if that information could not be supplied in a timely manner.

For the reforms to be effective, directors will need to form a strong and healthy relationship with their accountant and ensure that they maintain good bookkeeping records and are informed about their company's financial position.





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The proposed legislation does not clarify what is an "appropriately qualified entity". It appears that it is not a requirement for the specialist to be a qualified restructuring professional.

This could lead to many directors being taken advantage of by those who profess to be specialists in restructuring but have no real qualifications or experience in these matters. There is a risk that the less reputable advisors who haunt the "pre insolvency" market may take advantage of this loophole. Accountants and lawyers will need to advise their clients to be wary of relying on unprincipled and unqualified "advisors".

For the latest information on how the proposed legislation may affect your company or your clients, please contact Moira Carter to find out how we can support you.

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About BRI Ferrier

BRI Ferrier is a unique affiliation of expert business recovery, insolvency, forensic accounting and advisory firms. We provide practical, innovative services that help financially distressed businesses to recover or at least minimise the negative impacts of insolvency.

With over 160 staff and eleven practices in Australia, New Zealand, Hong Kong and the United Kingdom, we work with clients of all types – from individuals, sole traders and small businesses to public corporations and government entities.

We also work with financiers, solicitors, accountants and creditors to address the needs of all stakeholders when businesses face financial challenges.

BRI Ferrier's team has the expertise and resources to meet any client challenge. By combining our skills and enthusiasm, we achieve the best possible outcomes in all cases where a business experiences financial distress.

How BRI Ferrier can help

BRI Ferrier can assess your current situation and advise on a path forward to minimise further risk.

Early intervention is often the key for a successful restructure of your business. If you or your client is experiencing financial challenges then don't delay, contact us today.