Recent developments in Corporate Insolvency Law

Justice Sifris*

Remarks of the Hon. Justice Sifris at the Restructuring Insolvency and Turnaround Association Conference, Vic/Tas Division, RACV Club, Melbourne.

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I Introduction

1 Much has happened in the last year in the area of corporate insolvency and restructuring. This paper focuses on some of the more important developments:

- Insolvency of corporate trustees (*Commonwealth v Byrnes* (2018) 124 ACSR 246 and *Jones v Matrix Partners Pty Ltd* (2018) 124 ACSR 568);
- Deeds of company arrangement (Holding DOCAs, Bad DOCAs and Future DOCAs);
- Safe harbour from insolvent trading; and
- The stay on ipso facto clauses.

2 Of course, there are many other issues and areas dealt with by the courts. In particular:

- Remuneration assessment (reasonableness and proportionality – *Australian Executor Trustees Ltd v Provident Capital Ltd* [2018] FCA 439 referring with approval to *Templeton*[1] and *Sanderson*[2]);
- Universal distributing-type claims (limits not finally worked out – *Valdii Investments Pty Ltd v Specialist Australian Security Group Pty Ltd (in liq)* [2018] VSC 199);
- Judicial advice and directions (*Re Woodings* [2017] WASC 322; *White, in the matter of Mossgreen Pty Ltd (administrators appointed) v Robertson [2018] FCAFC 63*);

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1 *Templeton v Australian and Securities Investments Commission* [2015] FCAFC 137.

2 *Sanderson as liquidator of Sakr Nominees Pty Ltd (in liquidation) v Sakr* [2017] NSWCA 38.

- Winding up on the just and equitable ground (*Asia Pacific Joint Mining Pty Ltd v Allways Resources Holdings Pty Ltd & Ors* [2018] QCA 48);
- Schemes of arrangement (*Snowside Pty Ltd v Boart Longyear Ltd* [2017] NSWCA 215); and
- Disclaimer of onerous property (*Longley v Chief Executive, Department of Environment and Heritage Protection* [2018] QCA 32).

3 There are also many challenges for the future, including:

- insolvency relating to blockchain technology and crypto currencies;
- revisiting the voluntary administration procedure;
- complex transitional provisions under the *Insolvency Law Reform Act 2016* (Cth);
- cross border insolvency; and
- the extent of the inherent jurisdiction of the Supreme Court, as a gap filling mechanism in corporate insolvency and related cases.

<u>II Insolvency of Corporate Trustee</u>

4 The recent decisions of the Court of Appeal of Victoria in *Commonwealth v Byrnes*[3] ('**Amerind**') and the Full Court of the Federal Court in *Jones v Matrix Partners Pty Ltd*[4] ('**Killarnee**') have clarified certain aspects of the law relating to the insolvency of corporate trustees, particularly in relation to the trustees right of recourse or indemnity – as part of the liquidation – to the assets of the trust and the applicability of the statutory priority regime in relation to the creditors of the trust. The decisions are not entirely consistent and other issues require clarification and further elucidation, either by the High Court or preferably by legislation.

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3 (2018) 124 ACSR 246 (*Amerind*).

4 (2018) 124 ACSR 568 (*Killarnee*).

5 It is of course trite that a trust is not a legal person. Rather it is a relationship that comprises various rights and duties, both personal and proprietary, between the corporate trustee, the trust property and the beneficiaries.[5] The focus is entirely on the corporate trustee. In this capacity it has acquired assets, incurred liabilities, entered into contracts, engaged employees, managed and controlled the business or the assets, often with no reference to the capacity in which it is acting. It has all the power and authority. It is also the legal holder of all assets, but not the beneficial owner thereof. Of course, a corporate trustee may also act in its own right and as trustee of multiple trusts. Difficulties often emerge in this context but these are usually exceptional cases.

6 Specifically, in the event of a corporate trustee's insolvency, can the liquidator exercise a power of sale with respect to trust assets, so as to give effect to the trustee's right of recoupment or exoneration, and if so, on what basis? Is there a need for an order of the Court granting power to sell the trust assets, or can such a power be located elsewhere? Further, in what manner must the proceeds arising from the exercise of the right of recoupment or exoneration be distributed amongst creditors?

Trustee's Right of Indemnity

7 A trustee is personally liable for debts or liabilities incurred in execution of its duties and powers in the business or affairs of the trust.[6] However, the trustee is entitled to be indemnified against debts and liabilities properly incurred in the execution of its duties and powers out of the trust assets.[7] A trustee's right of indemnity may be divided into two distinct rights; the right of recoupment (or reimbursement) and the right of exoneration. If the trustee

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5 See the useful reminder of Leeming JA in *Kelly v Mina* [2014] NSWC 9 and Allsop CJ in *Killarnee* at [31].

6 *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 367 ('*Octavo Investments*'); *Kilarnee* (2018) 124 ACSR 569, 576 [34].

7 *Chief Commissioner of Stamp Duties v Buckle* (1998) 192 CLR 226, [45]; See also *Trustee Act 1958 (Vic),* s36(2).

has paid the amount, the trustee is entitled to *recoupment* from the trust assets. If the trustee has not paid the amount, the trustee is entitled to have recourse to the trust assets by way of *exoneration*. Any recourse to trust assets must relate to trust liabilities.[8]

8 The right of indemnity is secured by a lien over the trust property and enjoys priority over any interest of the beneficiaries in the trust assets.[9]

Sale of Trust Property

9 Difficulties arise with respect to the exercise of the right of exoneration in the event of the corporate trustee's insolvency. The company may have carried on trading in its own right, as well as in its capacity as trustee. The trust deed may, and often does, include a clause removing the trustee from office in the event of its liquidation, rendering the company a bare trustee and more importantly removing power it might have otherwise had under the trust deed to sell the trust assets.

10 Both *Amerind* and *Killarnee* agree that the corporate trustee's (and therefore the liquidator's) right of exoneration secured by a lien over trust property constitutes an equitable proprietary interest in such assets, and more relevantly constitutes 'property of the company' with certain consequences.[10]

11 The question, however, is whether as a bare trustee, the liquidator of the corporate trustee has the power to deal with and dispose of the trust assets secured by the lien, or whether the intervention of the Court is required to grant such power to the liquidator.

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8 The contrary view expressed in *Re Enhill* [1983] 1 VR 561 has been criticised and the better view is that it is wrong in this regard. It was not necessary to deal with this aspect in *Amerind* and the Court of Appeal in *Amerind* considered *Re Enhill* binding until overturned.

9 *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319, 335; *Octavo Investments* (1979) 144 CLR 360, 367.

10 *Amerind* (2018) 124 ACSR 246 [124]; *Killarnee* (2018) 124 ACSR 569 [89].

12 This issue was not directly addressed by the court in *Amerind. Amerind* was primarily concerned with the application of the statutory priority regime to the proceeds arising from the exercise of the right of exoneration (to which I will turn later). Nonetheless, there is no indication in the judgment (or in the *Re Enhill*[11] decision which was extensively referred to) that a companion or ancillary order is required appointing the liquidator (or another insolvency practitioner) as receiver of the assets of the trust in order to facilitate sale or disposal of the trust assets. Of course this was not a matter that required a determination in either *Amerind* or *Kilarnee*.

13 In *Killarnee* the Full Court of the Federal Court *was* required to deal with this issue. The Court held that unless the corporate trustee remained a trustee or the trust deed specifically provided, directions should be sought from the Court in relation to the sale or disposal of the underlying assets of the trust in which the lien subsists.[12] The reason, set out below, relates to the nature and character of the trustee's right.

14 Prior to *Amerind* and *Killarnee* there were broadly two strands of authority on this issue. One strand, exemplified by a range of decisions in New South Wales, held that the trustee's lien did not constitute property of the company and that the appropriate course was to appoint a receiver to the assets of the trust, in order to facilitate any sale or disposal.[13] In many cases receivers were appointed out of an abundance of caution without any consideration of the underlying jurisprudential basis and, in many cases, relying on the provisions of the various trustee acts.[14]

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11 [1983] 1 VR 561

12 *Killarnee* (2018) 124 ACSR 569 [91].

13 *Re Stansfield DIY Wealth Pty Ltd (in liq)* (2014) 103 ACSR 401; *Bastion v Gideon Investments Pty Ltd (in liq)* (2000) 35 ACSR 466; *Re Kerr; Angel's Castle Pre-School Pty Ltd (in liq)* (2010) FCA 786; *Re Gramarker Pty Ltd* [2014] NSWSC 243; *Re Indopal Pty Ltd* (1987) 12 ACLR 54.

14 *Re Starrit Pty Ltd (in liq)* [2012] FCA 803; *Re Suncoast Restoration Pty Ltd (in liq)* (2013) 211

15 The other strand, including the decisions in *Apostolou*[15] and *Re South West Kitchens,*[16] held, it has been suggested, that a liquidator was entitled to sell trust assets by virtue of the power under s 477(2)(c) of the *Corporations Act 2001 (Cth)* ('the Act'), which specifically permits a liquidator to sell or dispose of 'property of the company'. Under this strand of authority the assets of the trust do not cease to be property of the company upon the termination of the company as trustee. However, in *Apostolou* the power of sale remained applicable despite the insolvency of the trustee. It was this power that was critical to that decision.

16 However, according to *Killarnee* as well as the line of New South Wales authority previously referred to,[17] other steps need to be taken before the liquidator of the bare corporate trustee engages in the sale or disposal of trust property, whether as a result of the trust assets or secured right of indemnity not constituting 'property of the company' (the New South Wales authorities) or for the reasons advanced in *Killarnee*. According to Allsop CJ in *Killarnee*, whilst the right of exoneration and supporting lien are 'property of the company' within the meaning of s 477(2)(c) of the Act, the underlying trust assets secured by the lien are not.[18] Consequently, s 477(2)(c) should not be taken to refer to the sale or disposition of property which is not the property of the company, but which is trust property in which the trustee has a proprietary interest.[19]

17 Allsop CJ refers with approval to the decision of the High Court in *Chief Commissioner of Stamp Duties v Buckle*[20] where the Court approved the reasons of McPherson J in *Kemtron*

FCR 203.

15 *Apostolou v VA Corporation of Australia Pty Ltd* (2010) 77 ACSR 84.

16 *Re South West Kitchens (WA) Pty Ltd* (2014) 224 FCR 408.

17 See fn 13.

18 *Killarnee* (2018) 124 ACSR 568, 589.

19 Ibid.

20 (1998) 192 CLR 226.

Industries Pty Ltd v Commissioner of Stamp Duties (Qld).[21] In *Buckle,* the Court, after referring to the priority afforded to the right of exoneration, said:

> [50] … A court of equity may authorise the sale of assets held by the trustee so as to satisfy the right of reimbursement or exoneration. In that sense, there is an equitable charge over the 'trust assets' which may be enforced in the same way as any other equitable charge.

18 In relation to the need for judicial intervention in circumstances where the right of exoneration constitutes property of the company, Allsop CJ said:

> [44] A trustee may exercise its right of indemnity without judicial intervention where property is not required to be sold: *Jennings v Mather* [1902] 1 KB 1 at 6; *Apostolou v VA Corporation of Australia Pty Ltd* (2010) 77 ACSR 84; [2010] FCA 64 at [38]-[39]. But the lien does not confer a power of sale, and if sale be necessary a court order or the appointment of a receiver to sell is required: *Apostolou v Va Corp Aust Pty Ltd* [2011] FCAFC 103 (*Apostolou*) at [45]; and see generally Heydon JD and Leeming MJ, *Jacobs' Law of Trusts in Australia* (8th ed, LexisNexis Butterworths, 2016) at 512-4 [21.04].
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> [69] Once one appreciates that the trustee's right of exoneration is a proprietary interest of the trustee that is held by the trustee in preference or priority to the beneficiaries' interests, it cannot be considered as other than property of the company. Not only is that conclusion required by *Octavo Investments*, but also by *Buckle* at [49]-[51] and *Bruton Holdings Pty Ltd (in liq) v Commissioner of Taxation* (2009) 239 CLR 346; 258 ALR 612; 73 ACSR 241; [2009] HCA 32 (*Bruton*) at [43]. The trust assets are not property of the company, but the trustee's right of exoneration supported by the lien in the character of a proprietary interest is. It is, however, property of a particular character, with its content and shape determined by its origin as trust property, and the purpose for which it came into existence – the payment of creditors the liability to whom was incurred in executing the trust. These circumstances mark out the property (of the company) as limited. It is not trust property, but property of the company, the nature of which limits those who are to be paid from it.
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> [87] Thus, in one sense, what exists can be seen to be an equitable proprietary interest or charge or lien in or over trust assets; but any enforcement by a Court of Equity is not of a security interest or a right created over the interests of the beneficiaries, but rather the

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21 [1984] 1 Qd R 576.

> enforcement by a Court of Equity of a prior proprietary interest in the trust fund to support the right of indemnity: see the words of Sheller JA in the Court of Appeal in *Chief Commissioner of Stamp Duties v Buckle* (1995) 38 NSWLR 574 at 586, specifically approved by the High Court in *Buckle* (see [42] above).

19 Between the decisions in *Killarnee, Amerind, Apostolou* and the New South Wales authorities to which I have referred, the law remains unclear in an area that requires certainty, harmony and consistency.[22]

The Statutory Priority Regime

20 The next question relates to the extent to which the statutory priority regime provided for in the Act applies to the distribution of proceeds arising from the exercise of the right of exoneration.

21 The trial judge in *Amerind* followed the New South Wales decision in *Re Independent Contractor Services (Aust) Pty Ltd (in liq) (No 2)*[23] and held that the statutory priority regime set out in s 556 of the Act is limited to assets beneficially owned by the company. Consequently the claims of trust creditors were to be decided under trust law, and the claims of trust creditors would rank *pari passu*.

22 The Court of Appeal in *Amerind* disagreed. Following a line of authority[24] and having held that the equitable proprietary interest in the trust assets constituted property of the company, the Court unanimously agreed that the statutory priority regime applied.[25]

23 The Full Federal Court in *Killarnee* largely agreed with the position adopted by the Court of Appeal in *Amerind.* Chief Justice Allsop held that the Act should not be restricted in its

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22 Nicholas Mirzai, 'The Commercial Trust in Insolvency' (2018) 45 *Australian Bar Review* 193 at 200-201.

23 (2016) 305 FLR 222.

24 *Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99; *Re Enhill* [1983] VR 561.

25 *Amerind* (2018) 124 ACSR 246, [100].

application to only some types of property, nor should it be construed as intended to change the nature of property of the company.[26] It follows that the property of the company including the right of exoneration and the funds obtained from its exercise are to be distributed in accordance with the statutory priority regime.[27] Chief Justice Allsop went onto observe that, in any event, if the distribution of the funds arising from the exercise of the right of exoneration is to be in accordance with equitable principles, equity would follow the statute by providing for the priority afforded to employees.[28]

24 It was observed that difficulties may arise in more complex cases, where the corporate trustee acts for many trusts or in its own right. In such circumstances, equitable principles may be necessary to supplement the operation of the statutory regime, without contradicting it.[29] It may therefore be necessary to examine each provision in s 556 for its meaning. Chief Justice Allsop referred to the observations of King CJ in *Re Suco Gold,*[30] where His Honour noted:[31]

> … the liquidator is entitled to have recourse to the property of each trust for the purpose of meeting the costs and expenses of winding up, the petitioner's costs and the liquidator's remuneration, so far as they are incurred in relation to each trust. As there are no non-trust assets or liabilities, all the expenses are attributable to one or other of the trusts and must be apportioned between them. The liquidator will be able to make an estimate of the work and expense involved in the liquidation so far as it relates to each trust. Where no apportionment is possible, the maxim that equitability is equity should provide the solution to the problem of apportionment.

25 Justices Siopsis and Farrell agreed with the Chief Justice in relation to the requirement for

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26 *Killarnee,* [101] per Allsop CJ.

27 Ibid [102]. The decision was followed and applied by Markovic J in *Jones*, *in the matter of Maz Platinum Pty Ltd (in liq)* [2018] FCA 1139 (2 August 2018).

28 *Kilarnee,* [111] per Allsop CJ.

29 Ibid [103].

30 *Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99.

31 Ibid, 110.

Court intervention in relation to the sale and disposal of the trust assets, and that the right of exoneration and the equitable lien in its support were indeed 'property of the company.'[32] However, Siopsis J held that the statutory priority regime did not apply. Justice Farrell considered that she was bound to follow *Amerind* but that, in any event, equity (her Honour's preferred course) was bound to follow the law.

III Deeds of Company Arrangement

Holding DOCA

26 The Court of Appeal of Western Australia[33] has unanimously held that a deed of company arrangement ('**DOCA'**) that merely creates a moratorium period in relation to creditors' claims and that does not specify any property that will be available to satisfy creditors' claims (called a '**holding DOCA**') was a valid DOCA under Part 5.3A of the Act. The holding DOCA did not make any provision for a return to creditors and was clearly intended to permit the deed administrators to carry out further investigations for up to six months and then present to the creditors a restructuring proposal.

27 An appeal was heard by the High Court in Perth on 19 June 2018.[34] Shortly after the conclusion of the hearing and on 19 June 2018 the Chief Justice said:

> The Court is, at least by a majority, of the view that the appeals…should be dismissed with costs. The orders of the Court are that…the appeal is dismissed with costs. The Court will publish reasons at a later date.

28 Reasons have not been published. However, a review of the transcript of the hearing confirms that the High Court is in substantial agreement with the decision and reasons of the Court of Appeal of WA. The judgment was delivered on 11 August 2017 and is 126 pages

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32 *Killarnee* at [142] per Siopsis J and [211] per Farrell J.

33 *Mighty River International Ltd v Hughes* [2017] WASCA 152 ('*Mighty River*').

34 *Mighty River International Limited v Hughes & Ors*; *Mighty River International Limited v Mineral Resources Limited & Ors* [2018] HCATrans 120 (19 June 2018).

and 411 paragraphs.

29 In relation to the first question, namely whether s 444A(4)(b) of the Act requires the DOCA to specify at least some property or future property of the company that is available to pay creditors, Buss P held that there was no such requirement. The critical requirement is to specify the property of the company ‘that is to be available to pay creditors’ claims’. There is no requirement that some property be available, but merely that whatever is available be specified. His Honour said:

> [146] The property of the company which must be specified pursuant to s 444A(4)(b) is the property 'that is to be available to pay creditors' claims'. Those words are significant. They indicate that the deed must particularise or address expressly and in detail the extent to which the present or future property of the company is to be available to pay creditors' claims.
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> [147] Section 444A(4)(b) does not require that *all* of the company's present and future property be made available under the deed to pay creditors' claims. Further, the provision does not require that *any* particular part or amount of the company's present or future property be made available under the deed to pay creditors' claims. The deed need not specify property that 'is available' for the payment of creditors' claims. It need only specify the property that 'is to be available' to pay their claims. See *Elliott v Water Wheel Holdings Ltd (subject to deed of company arrangement)* [2004] FCAFC 253; (2004) 209 ALR 682 [58] (Wilcox, Heerey & RD Nicholson JJ).
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> [148] Section 444A(4)(b) merely requires that the deed particularise or address expressly and in detail the extent to which the company's present or further property is to be available to pay creditors' claims. The provision does not require that the deed or the arrangement make property available for distribution to creditors. Section 444A(4)(b) will be complied with if the deed specifies that no property of the company is to be available to pay creditors' claims.

30 President Buss set out several other matters that pointed to this construction, including the following:

(a) If a proposed DOCA does not make available any property to pay creditors’ claims, the administrators must include details to that effect in the statement accompanying the notice convening the creditors meeting(s 439A(4)(c)).[35]

(b) An absurd proposition arises on the rival construction, namely that $1 would be sufficient (as there is 'some' property) but not $0.[36]

(c) There is no justification for reading down the ordinary and natural meaning and adopting a narrow construction, given the text, context and objects of Part 5.3A. In this regard his Honour referred to DOCAs where no property was made available by the company but third parties had agreed to make payments or transfer property to trustees for the benefit of creditors or creditors agreeing to release their claims against the company in exchange for an allotment of shares in the company.[37]

(d) Section 444A(4)(b) operates harmoniously with s 444A(4) as a whole. The textual analysis is set out at [154] to [163].

(e) The absence of the words 'if any' (which appear in many of the other sub-paragraphs) does not, as is made plain from the text, require the DOCA to specify some property. The drafting is not consistent and it is clear that it is property (if any) that is to be made available.[38]

(f) The reference in s 444A(4)(b) to the order of distribution of the proceeds 'is to be understood, in context, as a requirement that, if and to the extent that any present or future property of the company is to be available…then the order of distribution must be specified in the deed.'[39]

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35 *Mighty River* [2017] WASCA 152 [149].

36 Ibid [151].

37 *Mighty River* [2017] WASCA 152 [152].

38 Ibid [166].

39 Ibid [167].

(g) The fact that the eligible employee creditors are entitled to priority under s 444DA(1) does not support the rival contention. Again, the text, context and objectives contemplate a position that, 'if and to the extent that any…property of the company is to be available to pay creditors' claims then the deed must contain a provision conferring the stipulated priority on any eligible employee creditors.'[40]

(h) Section 445FA(1)(c) contemplates that a DOCA may be terminated 'without realisation and application of any assets in payment of the creditors…'[41]

31 Finally, on this first question Buss P considered that:

> [171 (c)] Mighty River's proposed construction of s 444A(4)(b) is inconsistent with the ordinary and natural meaning of s 444A(4)(b), construed in the context of s 444A and the other provisions of pt 5.3A as a whole.

32 The second question raised the contention that a holding DOCA cannot be used to circumvent an application to the Court under s 439A(6) seeking an extension of the convening period. Fundamental to this submission is that the use of the holding DOCA undermines the intent and operation of Part 5.3A which requires a tight time frame and for investigations to be conducted while the company was under voluntary administration. If the investigations are incomplete the only remedy is to apply for an extension. The submission was rejected.

33 According to Buss P the question was whether a '"holding DOCA" complies with and is a valid deed of company arrangement under pt 5.3A with respect to deeds of company arrangement, and not whether, in the judgment of the Court, a "holding DOCA" achieves one

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40 Ibid [168].

41 Ibid [170].

or other of the objects in s 435A.'[42] President Buss said –

> [177] Secondly, as French CJ, Gummow, Hayne and Kiefel JJ observed in *Lehman Brothers*,[43] apart from s 444A(4), s 444A(5), s 444DA and s 444DB, pt 5.3A does not identify what provisions may or may not be contained in a deed of company arrangement [37]. The nature and content of the compromise or arrangement between the company and its creditors that may be made by, and expressed in, a deed of company arrangement is not prescribed by pt 5.3A. Although the subject matter of the compromise or arrangement must be debts or claims against the company, pt 5.3A does not prescribe the terms and conditions on which those debts or claims may be compromised. By pt 5.3A, it is for the majority of creditors to decide, as a matter of commercial judgment, the terms and conditions upon which the debts or claims against the company should be compromised. As their Honours observed in *Lehman Brothers*, neither the fact that a deed of company arrangement must be proposed, agreed to and concluded speedily nor the fact that dissenting creditors are bound by the requisite statutory majority, requires a narrow or confined reading of those provisions of pt 5.3A that govern the making and content of a deed of company arrangement.

34 On this point, Buss P held that a holding DOCA was in substance a compromise or arrangement between the company and its creditors and depending on the circumstances and facts of the case a holding DOCA 'will advance the objects in s 435A' because the moratorium and investigation were 'reasonably capable of…maximising the chances of the company…continuing in existence…'[44]

35 President Buss set out several other matters that pointed to this construction, including the following:

(a) The power of variation (ss 445A and 445F) provide contextual relevance and 'recognises that during the subsistence of the deed the creditors may determine that the deed should be varied to deal differently with their debts or claims.'[45] The point is

42 *Mighty River* [2017] WASCA 152 [176].

43 *Lehman Brothers Holdings Inc v City of Swan* [2010] HCA 11; (2010) 240 CLR 509.

44 *Mighty River* [2017] WASCA 152 [179].

45 Ibid [181].

that an initial moratorium-type DOCA may be varied to provide for further terms (which could be anything) including making available some or all of the company's property.[46]

(b) The administrators may be unable to form an opinion, as required, within the convening period specified in s 439A(5). However, the administrators may form the opinion that it is more desirable that a holding DOCA be executed and that creditors exercise their commercial judgment accordingly. President Buss said:

> [190] It would be for the commercial judgment of the creditors as to whether they should resolve that the company execute a deed of company arrangement of the kind I have mentioned. An important factor in making that judgment would ordinarily be the creditors' assessment as to whether the proposed deed would be likely to result in, or at least have reasonable prospects of resulting in, a better return than would result from an immediate winding up.
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> [193] So, an application to the Court under s 439A(6) for an extension of the convening period is not the sole means (nor, necessarily, the preferable means) by which further investigations in relation to the company or the enhancement of a significant asset of the company may be undertaken, after the convening period specified in s 439A(5).
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> [194] A 'holding DOCA' does not, in any relevant sense, 'side-step or outflank the Court' in relation to the function and power of the Court under s 439A(6).

(c) The word 'holding' has the potential to mislead. The DOCA complies with Part 5.3A and may be varied or terminated.[47]

(d) There is nothing in Part 5.3A that prohibits further investigation during the subsistence of the DOCA and there is nothing that precludes an administrator 'from

46 Ibid [181]-[184].

47 *Mighty River* [2017] WASCA 152 [195].

formulating an additional proposal or a varied proposal, as a result of further investigations or otherwise, during the subsistence of the deed for submission to the creditors.'[48]

36 Finally, in upholding the validity of the DOCA, Buss P said:

> [203] I am satisfied, on the basis of my reasoning in relation to the first and second questions, that the Mesa DOCA is not invalid. More specifically, the Mesa DOCA is not invalid on the ground that it does not specify some present or future property of Mesa that is to be available to pay creditors' claims, and the Mesa DOCA is not invalid on the ground that it is not consistent with the objects of pt 5.3A as set out in s 435A.
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> [204] In my opinion, for the reasons I have given in considering the first and second questions, the Mesa DOCA is a valid deed of company arrangement within pt 5.3A. In particular, the Mesa DOCA complies with the provisions of pt 5.3A with respect to deeds of company arrangement. Also, the Mesa DOCA, evaluated objectively, creates a framework that is reasonably capable of securing a better return for Mesa's creditors and members than would result from an immediate winding up of the company. I agree with the observations of Murphy JA at [232] - [237] below and those of Beech JA at [389] - [391] below in relation to the Mesa DOCA.

37 Justices of Appeal Murphy and Beech were in substantial agreement with the President.[49]

Bad DOCAs

38 In *Eco Heat (Vic) Pty Ltd v The Syndicate Forty Four Pty Ltd (subject to deed of company arrangement)* ('**Eco Heat**')[50] a pooled DOCA of 38 companies ('**the Syndicate Companies**') was terminated by Sifris J on the basis of public interest and commercial morality considerations, pursuant to ss 445D(1)(f) and (g) of the Act.

39 *Eco Heat* is a most peculiar case. Despite 'a clear recommendation in the Report that

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48 Ibid [198].

49 On the first question see Murphy JA at [221] to [225] and Beech JA at [349] to [369]. On the second question see Murphy JA at [244] to [252] and Beech JA at [370] to [386].

50 [2018] VSC 156 ('*Eco Heat*').

"creditors resolve to wind up the Companies" and that "it would not be in the interests of creditors for the Companies to execute the proposed DOCA…"', the creditors voted overwhelmingly, at a meeting held on 2 December 2016, to accept the DOCA.'[51] Eco Heat voted against acceptance of the DOCA and sought to set it aside.

40 The administrators' s 439A Report ('**the Report**') attached a comparison of the returns under the proposed DOCA, with a Low, Mid and High range and the returns in a liquidation in the same ranges. The liquidation ranges were all (and the Low range under the DOCA was) $0.00 in the dollar. The Mid-range under the DOCA was $0.25c and the High-range was $0.48.[52]

41 The evidence demonstrated very clearly that the figures, provided by the director, were not only unsubstantiated but entirely misleading and deceptive. The High-range under the DOCA was utter nonsense and the Mid-range extravagant and fanciful, and in any event, payable over four years and contemplating the continuation of the Syndicate Companies.

42 The Syndicate Companies provided credit finance, primarily to fund the purchase of used motor vehicles in Queensland. The Syndicate Companies were first registered around 2001 and continued in operation through numerous and successive Syndicate Companies until the appointment of David Michael Stimpson and Michael Carrafa as administrators ('**the Administrators'**) on 28 October 2016.

43 The Syndicate Companies sourced the funds for the loans from a range of investors, who were primarily clients of an accounting firm of the director, Allan Walker ('**Walker'**). A standard 'Letter of Offer and Explanation' ('**LOE'**) provided to the investors of a particular Syndicate Company at the time (e.g. The Syndicate Eleven Pty Ltd) stated that funds

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51 *Eco Heat* [2018] VSC 156 [3].

52 The figures are approximate.

totalling approximately $250,000 would be pooled to bank roll the loans. Approximately 80% of funding was to be provided by the investors and the remaining 20% was to be provided by Peter Barratt Pty Ltd. In return for investing in a Syndicate Company, the investor was allocated shares in the relevant Syndicate Company.

44 Once the Syndicate Company had received the required investment amount, it would be closed and a new Syndicate Company was established to receive further amounts in order to fund the next tranche of car loans. The LOE stated that the investors were to receive their capital investment back within 66 to 78 weeks of the last car loan, which was to be paid by the Syndicate Company when it had enough money from collecting the repayments of the car loan debtors. The LOE indicates that the Syndicate Companies operated high interest loans with interest rates of over 40%. Based on the books and records, it appeared the Syndicate Companies' policy was to return 100% of the amount contributed by investors plus interest equal to the original amount invested.

45 Needless to say, as a result of bad debts and loan defaults the promised returns to investors were unsubstantiated and unrealistic.

46 In their Report, which recommended a winding up, the Administrators formed the view that 'there are grounds to maintain that attributes of a Ponzi type scheme are present.' In addition, the Administrators formed the view that the later schemes 'should have been registered with ASIC as registered managed investment schemes'.[53] These matters were reported to ASIC, however, ASIC declined to investigate.

47 The Syndicate Companies argued that, in effect, creditor democracy must prevail. Further, it was submitted, that the return under the DOCA was greater and there was no evidence of any prospects of recovery (or cause of action) available in a winding up against the director

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53 [2018] VSC 156 [19].

or others, matters that Eco Heat was required to establish. ASIC declined to investigate and although small, the dividend was better than nothing. Of course, the creditors, mostly clients and friends of the director, were told of the High-range. The evidence suggested that they would support the directors come what may.

48 Eco Heat pointed to all the peculiarities and the powerful need for an investigation.

49 After referring to the relevant authorities dealing with the termination of DOCAs under the public interest and commercial morality grounds,[54] Sifris J said:

> [56] As the authorities clearly demonstrate each case must be decided according to its own peculiar facts and circumstances. This is particularly so in relation to the public interest and commercial morality issues. The identification and weight to be attached to these issues and how and to what extent they interrelate with the best interests of creditors, particularly where the DOCA offers a greater return than a liquidation, is often a difficult balancing exercise. Ultimately all relevant factors need to be considered and a judgment made.
>
> [57] As a general proposition if the return under the DOCA is not insubstantial or token and the public interest and commercial morality issues are unlikely to translate into a cause of action realistically worth investigating and pursuing, the scale may tip in favour of retaining the DOCA. However and by contrast if the return under the DOCA is nominal or token or not much more than on a liquidation, and there are or may be available causes of action which could result in a greater return or otherwise ought be investigated, the scale may tip in favour of setting aside the DOCA. Of course in this event, as the authorities demonstrate proper consideration needs to be given to the basis and

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54 See *Re Recycling Holdings Pty Ltd* [2015] NSWSC 1016; *Mediterranean Olives Financial Pty Ltd v Loaders Traders Pty Ltd (ACN 069 549 042) (subject to deed of company arrangement)* (No 2) [2011] FCA 178; *TiVo Inc v Vivo International Corporation Pty Ltd* [2014] FCA 789; *Emanuele v Australian Securities Commission* (1995) 19 ASCR 1; *Bidald Consulting Pty Ltd v Miles Special Builders Pty Ltd* (2005) 226 ALR 510; *Britax Childcare Pty Ltd v Infa Products Pty Ltd* [2016] FCA 848; *Deputy Commissioner of Taxation v Portinex Pty Ltd (subject to deed of company arrangement)* (2000) 34 ACSR 391*; Joseph Khoury & Sons v Zambena Pty Ltd* (1999) 217 ALR 527; *Australian Securities and Investments Commission v Midland Highway Pty Ltd* [2015] FCA; *Fleet Broadband Holdings Pty Ltd v Paradox Digital Pty Ltd (subject to a deed of company arrangement)* (2005) 8 ALR 598; *Re Hester* (1889) 22 QBD 632; *Re Flatau* [1893] 2 QB 219; *In the Matter of ACN 138 535 832 Pty Ltd (Subject to a Deed of Company Arrangement)* [2014] FCA 783; *Public Trustee (Qld) v Octaviar Ltd (subject to a deed of company arrangement) (recs and mgrs apptd) (No 8)* (2009) 73 ACSR 139; *Promoseven Pty Ltd v Prime Project Development (Cairns) Pty Ltd* [2015] 2 Qd R 317.

nature of any cause of action and satisfaction that any such cause of action is not fanciful or speculative or without foundation. In addition funding issues and prospects of recovery may also be relevant. However, it should also be emphasised that in suitable cases it may not only be about the return to creditors.

[58] In my opinion the DOCA should be set aside. I consider that the anticipated return to creditors under the DOCA is overstated, and in the case of the anticipated mid to high range is not only overstated but extravagant, unsubstantiated and entirely misleading. The possible small return, in respect of which I have little confidence, is outweighed by the benefits that a liquidation may bring. I do not consider that these benefits, which are not only financial, are illusory, speculative or fanciful. They have a sufficient basis to conclude that liquidation is desirable. I am not attracted by the submission that the suggested financial benefits are simply expectation damages arising out of very high promised returns, which creditors (other than Eco Heat) have, by voting for the DOCA, elected in essence to forego. Again, it must be emphasised that there are also non-financial benefits. Finally by way of overview there are two related matters that cannot be ignored. First, and unlike most cases the Administrators clearly and unequivocally recommended against accepting the DOCA and have not changed their position. Secondly, the obvious relationship between Walker and the investors cannot be ignored.

…

[66] I will deal with the second point first. It seems to me that there does need to be an investigation and examination of the Syndicate Companies. Liquidation of the Syndicate Companies would provide such an opportunity, given the unwillingness on the part of ASIC to investigate the matter. There are serious issues as to whether the Syndicate Companies were MISs and/or involved the operation of a Ponzi scheme. It is unnecessary and undesirable to make such findings at this stage. It is sufficient to say that the Administrators are and remain74 of the view that 'there are grounds to maintain that attributes of a Ponzi type scheme are present' and 'it is our opinion that the Companies were operating a MIS'.75 In my opinion there is a sufficient basis for the opinion of the Administrators. Whatever the return to creditors and shareholders these matters and others require investigation. The loss of this right is itself a serious matter.

…

[68] Finally, and in any event I am not satisfied that they will be worse off financially. The Administrators have identified causes of action against Walker which have a sufficient basis or foundation.76 Again it is unnecessary and undesirable to undertake an assessment of the strength of any such claim. There is no evidence to suggest that in the event of a successful proceeding against Walker less than $0.02 cents in the dollar would be recoverable. Even if it was this case is not only about the derisory and paltry return to creditors. It is also about

commercial morality and ultimately the public interest. Of course the return may well be greater. Walker was an accountant with his own practice for many years.

[69] Ultimately the evidence relating to any return in the event of a winding up is speculative but not entirely without foundation. However as stated above it does not matter. In my opinion even if it were demonstrated conclusively that there would be a nil return I would still find that an investigation is, in the peculiar circumstances of this case, more important than a negligible return over a period of four years, notwithstanding the desire of the creditors, who for the most part are friends, acquaintances or supporters of Walker.

…

[73] The critical matter and finding is that even assuming the genuineness of the vote (against the recommendation of the Administrators) and the suggested effect of setting aside the DOCA (which I very much doubt), the interests of justice in this case clearly must prevail. There are in my view serious commercial morality issues that require investigation in the public interest and in the interests of the creditors despite their position. As pointed out these considerations far outweigh what I have found to be the negligible returns under the DOCA. Of course there are other matters that have not been raised or discussed. One is the desirability of investigating why it was simply assumed that pooling of the investors in each of the Syndicate Companies was desirable.

…

[75] The operation of a Ponzi scheme and/or an unregistered MIS are serious matters. They require investigation. As pointed out there is a sufficient basis for such investigation. The existence of this basis is in my view sufficient given the very small return. If the returns were much higher, the position may be different when the required balancing act is undertaken. However this is not the case.

Future DOCAs

50 Although the Act does not specifically contemplate 'holding DOCA',[55] it does not exclude one either. Overall it is, in my opinion, a positive development. Although it achieves at least that which an application to Court usually achieves, without the costs of such an application, 'it

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55 A point made by Professor Symes in 'The path that makes sense: Using holding DOCAs' (2017) 32 *Australian Journal of Corporate Law* 386. (The article was written before the High Court decision.)

empowers the creditors to continue to have the “control” of the process …’.[56] The moratorium continues and the deed administrator is not burdened by time restraints.[57]

51 Whether Australia should move beyond its focus on having an independent insolvency practitioner appointed, towards a process where, like the United States Chapter 11 process, the debtor remains in possession is a matter that requires more serious consideration. The suggestion that the debtor in possession concept will be costly and leave control in the wrong hands needs to be revisited and reassessed. This avoids the cost of external administrators, reduces the overall cost of reconstructions and could potentially change the Australian insolvency landscape by shifting a liquidation-centric culture towards one truly and primarily focussed on reconstruction and rescue, by reducing the stigma of failure that follows from the directors being relieved by external administrators.

52 Further consideration needs to be given to extending the moratorium imposed in voluntary administration and through a DOCA so that it does not carve out the ability of a secured creditor to take enforcement action during the decision period under s 441A. The stay on ipso facto clauses assists but does not go this far.[58] Whether the Court, where just and equitable, should have the power to 'cram down' the votes of dissenting secured creditors, and enforce a restructuring proposal despite objection is also an issue worthy of consideration. These matters are hardly new or revolutionary.

53 The nature and extent of the Court's role, which should, in any event, be minimal needs to be considered further. Specifically, whether it is more beneficial for the Court's supervisory role

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56 Symes, ibid at [386].

57 This kind of DOCA called a ‘Transaction Support DOCA’ was used in the Arrium administration in 2016 to great effect. (See Symes, ibid at [389].).

58 This right is not stayed, but in fact preserved by the ipso facto reforms. The Note to s 451E (the stay on rights against a company under administration) states that ‘Subsection (1) also does not apply to certain secured creditors (see Subdivision B of Division 7)’, being the Subdivision within which s 441A appears.

to consist of approving a reconstruction plan (as in a scheme or arrangement or Chapter 11), or reviewing and terminating where it has been executed but is undesirable (as under ss 445D and 445G in relation to DOCAs).

IV Safe Harbour

The Carve-Out

54 Section 588GA of the Act provides a carve out from insolvent trading. The provisions came into operation on 19 September 2017. A director is exempt from liability for debts of the company incurred whilst insolvent if:[59]

(a) at a time after the director begins to suspect that the company is insolvent;

(b) they start developing one or more '*courses of action';*

(c) which course(s) of action is/are '*reasonably likely to lead to a better outcome*' for the company than the than the immediate appointment of an administrator, or liquidator;

(d) the debt the subject of the insolvent trading claim was incurred '*directly or indirectly*' with any such course of action; and

(e) the debt was incurred during the period commencing when the course of action starts being developed and ending the earliest of the times, being:

(i) the end of a reasonable period after the director fails to take any such course of action;

(ii) when the director ceases to take any such course of action;

(iii) when the course of action is no longer reasonably likely to lead to a better

59 *Corporations Act 2001* (Cth) s 588GA(1).

outcome; and

(iv) upon the appointment of an administrator or liquidator.

Suspecting Insolvency

55 Murray and Harris state that:[60]

> Insolvent trading liability can apply even where the individual director has no suspicion of insolvency, because it applies where the company is insolvent and a reasonable person would be aware of grounds to suspect insolvency (or where the director is aware of such grounds)…The safe harbour will only apply once the director "starts to suspect" the company is or may become insolvent. This is a flexible test that should not be too onerous to establish, but it will require that the director be at least aware of the company's financial position.

56 Although the director's suspicion of insolvency is the first-in-sequence event of the safe harbour timeline, it is worth noting that the director can only rely on the carve out for debts which have been incurred once they have begun developing a course of action. This is because s 588GA(2) requires the debt to be incurred in this period and be related to such course(s) of action. Put another way, the director cannot rely on safe harbour for debts incurred in the period *between* the point at which they began to suspect insolvency and the point at which they began developing a course of action.

Course of Action

57 The Explanatory Memorandum states that directors must take an active approach:[61]

> …Directors who merely take a passive approach to the business's position or allow a company to continue trading as usual during severe financial difficulty, or whose recovery plans are fanciful, will fall outside the bounds of the safe harbour.

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60 Michael Murray and Andrew Harris, 'Keay's Insolvency: Personal and Corporate Law and Practice' (2018, Law Book Co.), 899.

61 Explanatory Memorandum, Treasury Amendment (2017 Enterprise Incentives No. 2) Bill 2017 ('Explanatory Memorandum) at [1.19].

58 Under subs 588GA(2) factors that may be considered in determining whether '*a course of action is reasonably likely to lead to a better outcome*', include whether the director:

(a) is properly informing themselves of the company's financial position;

(b) is taking steps to prevent misconduct of officers/employees that might adversely affect the company's ability to pay its debts;

(c) is taking steps to ensure appropriate financial records consistent with the size and nature of the company are kept;

(d) is obtaining advice from an 'appropriately qualified entity' who was given 'sufficient information to give appropriate advice'; or

(e) is developing or implementing a restructuring plan to improve the company's financial position.

59 The Explanatory Memorandum states that the 'indicia are not prescriptive', are non-exhaustive and 'it is not necessary for all of these factors to apply for directors to have the protection of safe harbour.'[62]

60 Subsection 588GA(2)(d) states that regard may be had to whether the director is obtaining advice from an '*appropriately qualified entity'*. This term is not defined by the Act, and rather the Explanatory Memorandum states that the term 'is used in the sense of "fit for purpose" and is not limited merely to the possession of particular qualifications.'[63] It is for directors to consider whether the particular adviser is appropriate in the context, having regard to:[64]

- the nature, size, complexity and financial position of the business to be

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62 Ibid [1.63] to [1.64].

63 Explanatory Memorandum [1.69].

64 Ibid [1.69].

restructured;

- the adviser's independence, professional qualifications, good standing and membership of appropriate professional bodies (or in the case of an advising entity, those of its people);

- the adviser's experience; and

- whether the adviser has adequate levels of professional indemnity insurance to cover the advice being given.

61 The Explanatory Memorandum states that '[b]eyond smaller business or those with relatively simple structures…one would expect an advisor with the customary attributes of a true "professional", such as:[65]

- possession of minimum educational qualifications as a condition of eligibility to practise or give that advice (and who is subject to Continuing Professional Development obligations whether by law or by membership of a professional association);

- possession of appropriate levels of professional indemnity insurance to cover their advice; and

- being bound by an enforced code of conduct or similar professional standards (whether under the law or by membership of a professional body).

62 As Renfrey and Wicks observe, the examples contained in the Explanatory Memorandum contemplate 'that an "appropriately qualified entity" may not even need to be an accountant',[66] and may in the case of Example 1.4 to the Explanatory Memorandum, be an 'experienced logistics manager'.[67] In each case where a director has obtained advice, the Court will be required to determine the type of advice that the director should have obtained and whether the entity engaged was appropriately qualified to give that advice. [68]

63 This raises a separate but related question of whether the director can rely on having

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65 Ibid [1.74].

66 Ben Renfrey and Lloyd Wicks, 'Reaching the Safe Harbour - an Easy Voyage for Directors?' (2018) 22(1) IHC 13, 14.

67 Explanatory Memorandum at Example 1.4.

68 Renfrey and Wicks, above n 66, 14.

obtained advice from an entity who was appropriately qualified but gave advice that was incorrect, negligent or did not ultimately lead to a better outcome for the company. Subsection s 588GA(2)(d) states that the entity must be '*given sufficient information to give appropriate advice'*. That subsection however, focuses on *whether* the information provided was sufficient to give appropriate advice and not the quality on the advice itself, that is, it focuses on the conduct of the director and not the entity.[69] In considering whether a director can have the benefit of having obtained advice (even though it is subsequently found to have been incorrect), for the purpose of establishing that the course of action was '*reasonably likely to lead to a better outcome'*, it may be necessary to find:

(a) the entity was appropriately qualified;

(b) the director provided them with information that was sufficient to give appropriate advice; and

(c) it was reasonable in the circumstances for the director to believe that the information, if followed at the time it was given, was reasonably likely to lead to a better outcome for the company.[70]

64 As noted, safe harbour commences at the point the director '*starts developing one or more courses of action*'.[71] This is likely to raise issues with respect to timing, and specifically, *when* it can be said that a director has begun 'developing' such a course of action. The

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69 Similarly, if looking at subs 588GA(2)(b), it would be unfair if a director, having taken appropriate steps to '*prevent misconduct of officers/employees that might adversely affect the company's ability to pay its debts'* could lose the benefit of safe harbour by virtue of having been the victim of fraud by one of its officers/employees that was neither foreseeable nor preventable.

70 See Murray and Harris, above n 60, at 900: 'The mere fact that the course(s) of action taken by the directors did not succeed…. does not mean that the safe harbour is inapplicable. The safe harbour is to be judged at the time that the conduct is undertaken, not by consequences of that conduct.'

71 *Corporations Act 2001 (Cth)* s 588GA(1)(a).

Explanatory Memorandum states that this element 'includes the deliberative and decision making period which informs the course of action and any period required to garner initial advice.'[72] For example, if the directors seek to rely on the fact that they had obtained advice from a *'properly qualified entity'*,[73] it would be the point at which the directors discussed obtaining such advice (whether informally or in meetings), and not when the directors resolved to engage the entity or the company actually engaged the entity. Other situations will be more difficult to pinpoint.[74]

65 It is worth noting that this element is separate and distinct from that under subs 588GA(1)(b) which requires the debt to be incurred '*directly or indirectly*'. This question of timing, however, is likely to be superseded by argument of characterisation, and specifically whether a debt is sufficiently related to a course of action. Logically speaking, if a debt is found to be related to a course of action, it has to have been incurred at a point in time after the course of action had commenced.

Reasonably Likely to Lead to a Better Outcome

66 Section 588GA(1) requires that the course(s) of action are reasonably likely to lead to a '*better outcome for the company',* which is defined by subs 588GA(7) to mean *'an outcome that is better for the company than the immediate appointment of an administrator, or liquidator, of the company.'*

67 The Explanatory Memorandum refrains from describing the term, '*reasonably likely'* as a '50 per cent chance' of a better outcome, but rather:[75]

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72 Explanatory Memorandum at [1.39].

73 *Corporations Act 2001 (Cth*) s 588GA(2).

74 Such as determining the point at which the director began '*properly informing himself or herself of the company's financial position'* under s 588GA(2)(a).

75 Explanatory Memorandum at [1.52].

> "Reasonably likely" here requires that there is a chance of achieving a better outcome that is not fanciful or remote, but is "fair", "sufficient" or "worth noting".

68 Murray and Harris state that the analysis should take place at the time the conduct was undertaken, and without the benefit of hindsight:[76]

> It is important to note however that the focus here is on the course of action likely to lead to a better outcome for the company. The mere fact that the course(s) of action taken by the directors did not succeed in saving the business (because it ended up in liquidation),[77] or that the conduct resulted in a worse outcome for the company (due to unforeseen circumstances, such as changes in trading conditions) does not mean that the safe harbour is inapplicable. The safe harbour is to be judged at the time that the conduct is undertaken, not by consequences of that conduct.

Debt is Incurred Directly or Indirectly to the Course of Action

69 Noting that the Explanatory Memorandum provides little guidance as to the meaning of this element, Murray and Harris state:[78]

> On a purposive interpretation it is likely to mean that debts which are not conducive to the course of action likely to lead to a better outcome are not covered by the safe harbour.

70 The Explanatory Memorandum does provide a number of examples of debts which would fall within the scope of safe harbour, including:

(a) 'ordinary trade debts incurred in the usual course of business';[79]

(b) 'debts taken on for the specific purpose of affecting a restructure', such as 'paying a professional turnaround adviser to provide advice';[80] and

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76 Murray and Harris, above n 60, 900.

77 Given that directors may rely on safe harbour as an exception to insolvent trading, which in turn is brought by the liquidator of the company, it could never be said that the course of action did, in fact, save the business.

78 Murray and Harris, above n 60, 900.

79 Explanatory Memorandum at [1.48].

80 Ibid [1.48].

(c) some loss-making trade may be accepted in trying a secure a better outcome, for instance 'debts associated with the sale of assets' which would help the overall financial position.[81]

Curiously, the Explanatory Memorandum gives an example of debts which are neither directly nor indirectly connected to the course of action, being 'debts incurred where they are not for a proper purpose.'[82] It is unclear whether this 'proper purpose' is the purpose of carrying out the course of action, or whether it refers to a proper purpose under s 181 of the Act. Given the context in which it arises it is presumably the former.

Mandatory Requirements

71 Under subs 588GA(4) a director cannot rely on safe harbour if the company is not meeting its employee entitlements (including superannuation contributions)[83] when they fall due, nor giving returns, notices, statements, applications or other documents as required by taxation laws.[84] The failure of each must amount to '*less than substantial compliance*' or form one of two or more failures by the company to do those things during the 12 month period ending when the debt was incurred.

72 Under subs 588GA(5) a director cannot rely on safe harbour if the director failed to complete the Report as to the Affairs of the company, or failed to assist a liquidator and the failure amounts to '*less than substantial compliance*'.

73 Under subs 588GA(6), a director affected by subs 588GA(4) or (5) may apply to the Court for an order that those subsections do not apply, and that safe harbour does apply, if the Court is satisfied that the failures '*were due to exceptional circumstances'* or that '*it is otherwise in*

81 Ibid [1.49].

82 Ibid [1.51].

83 *Corporations Act 2001* (Cth) s 596AA(2).

84 Within the meaning of the *Income Tax Assessment Act 1997* (Cth).

the interests of justice to make the order'.

Evidentiary Burden

74 Because safe-harbour is a 'carve-out' and not a legal defence the liquidator holds the burden of proof on the balance of probabilities. Directors possess only the lower evidentiary burden of s 588GA, and once met, the legal burden of proof remains on the liquidator to prove that, on the balance of probabilities, the elements of s 588G are met, and that the director has not met the requirements of s 588GA.[85]

Reliance on Books of the Company

75 Under s 588GB(1) the books of the company cannot be used as evidence that a reasonable course of action was taken if the director previously failed to provide these materials as required under the Act (primarily being when requested by liquidator or administrator), or where a warrant has been issued by the Court, the Court is satisfied that the director has, or is about to, conceal, destroy of remove the books of the company.

76 Under s 588GB(2) information about the company cannot be used as evidence that a reasonable course of action was taken if the director previously failed to provide this information as required under the Act.

77 The exclusions do not apply where:

(a) the director can show that they did not possess the materials at the time of the request and there were no reasonable steps they could have taken to obtain them;[86]

(b) the Court is satisfied that the failures were due to '*exceptional circumstances'* or it is

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85 *Corporations Act 2001* (Cth) s 588GA(3).

86 *Corporations Act 2001* (Cth) s 588GA(3).

otherwise '*in the interests of justice to make the order*'; and[87]

(c) the entity that requested the information or books of the company, and seeks to rely on s 588G(1) or (2), did not also given notice of the effect of s 588GB.[88]

Safe Harbour of Holding Companies

78 Section 588WA extends the safe harbour carve out to a holding company's liability for insolvent trading under s 588V if the requirements of s 588GA(1) are satisfied by *each* of the directors of the holding company and the debt.

V Ipso Facto Clauses

79 An '*ipso facto'* clause allows a party to a contract to terminate or alter the terms of the contract upon the occurrence of certain events relating to the solvency or creditworthiness of the counterparty, such as the appointment of a receiver or administrator.

80 The provisions staying the operation of ipso facto clauses commenced on 1 July 2018. A separate set of provisions exist for receivership, voluntary administration and schemes of arrangement.

The Stay

81 Under ss 415D(1), 434J(1) and 451E(1) an express '*right*' in a contract is not enforceable against a body/company for the reason:

(a) that an administrator has been appointed to it;

(b) that a receiver has been appointed over the whole or substantially the whole of its assets;

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87 Ibid s 588GB(4).

88 Ibid s 588GB(5).

(c) that it is subject to a scheme of arrangement (or is the subject of an application for a scheme of arrangement, or it has publically announced that it will make such an application);

(d) of its '*financial position',* if the body/company is experiencing any of the above insolvency events; or

(e) that it is '*in substance'* contrary to one of the above reasons.

82 Under ss 415(2), 434J(2) and 451E(2), the length of the stay is dependent upon the insolvency process:

(a) for a voluntary administration the stay commences upon the company's entry to administration and ends when it concludes or when the company is wound up;

(b) for a receivership the stay begins when the receiver is appointed and ends when the receiver no longer maintains control of the company's property; and

(c) for a scheme of arrangement the stay begins when the announcement or application for the scheme is made and ends three months after the announcement, when the application is unsuccessful or dismissed, or when the body is wound up.

83 Some rights may be rendered unenforceable indefinitely, that is after the insolvency process concludes and stay period lapses, if the right is exercised by reason of the company's financial position before the insolvency process, or because it was previously subject to the insolvency process.[89]

Rights

84 The legislation does not define the '*rights*' stayed. It is expected to cover rights to terminate

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89 *Corporations Act 2001* (Cth) s 415D(4), 434J (4), 451E(4).

and call upon the acceleration and payment of the debt. The stay applies regardless of whether the right is self-executing (under ss 415FA, 434LA and 451GA) or exercised by one of the parties to the contract.

85 Sections 415D(6), 434J(5) and 451E(5) carve out rights which are not stayed. These include:

(a) ipso facto clauses contained in contracts entered into before 1 July 2018 (even if the contract was amended after that date);

(b) rights contained in contracts entered into after the appointment of the receiver or administrator or the day the scheme of arrangement was approved.

(c) swaps, arrangements for managing financial risk, and certain other arrangements governed by the *Payment Systems and Netting Act 1998* (Cth) and the *International Interests in Mobile Equipment (Cape Town Convention) Act 201*3 (Cth) where the provisions of these Acts are inconsistent with the ipso facto reforms;

(d) other types of contracts to be specified in regulations by the Commonwealth Government;

(e) the right of a counterparty to terminate or amend a contract for another reason; and

(f) the right of a secured creditor holding security over all (or substantially all) of the assets of a company to enforce that security before or during the decision period (13 business days) following the appointment of an administrator.[90]

86 The *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations* 2018 (‘**Regulations’**) were published on 24 June 2018 and commenced on 1 July 2018. The Regulations set out, at length, types of agreements which are carved out. Some of the more

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90 Explanatory Memorandum at [2.22]; *Corporations Act 2001* (Cth) s 441A(3).

commonplace exclusions include:

(a) licences, permits or approvals issued by the Commonwealth or a State or Territory government (r 5.3A.50(2)(b));

(b) derivatives or transactions directly connected with derivatives (r 5.3A.50(2)(g));

(c) securities financing transactions or transactions directly connected with securities financing transactions (r 5.3A.50(2)(h));

(d) agreements for the underwriting of an issue or sale, subscription, or which is or governs securities, financial products, bonds, promissory notes, or syndicated loans (r 5.3A.50(2)(i)-(k));

(e) the offer of securities under a rights issue (r 5.3A.50(2)(l));

(f) the sale of all or part of a business, including by way of the sale of securities or financial products (r 5.3A.50(2)(m));

(g) margin lending facilities (within the meaning of Chapter 7 of the Act) (r 5.3A.50(2)(o));

(h) covered bonds (r 5.3A.50(2)(p));

(i) agreements for the management of financial investments (r 5.3A.50(2)(q));

(j) an agreement under which the priority of security interests in particular property is changed or can change (r 5.3A.50(2)(v)); and

(k) an agreement which novates or assigns rights under a pre-1 July 2018 arrangement, provided the novation, assignment or variation occurs before 1 July 2023 (r 5.3A.50(2)(zn)).

87 The *Corporations (Stay on Enforcing Certain Rights) Declaration 2018* ('**Declaration**')

outlines rights carved-out from the stay. Some of those more commonly arising include rights:

(a) rights to change the basis or rate on which an amount (i.e default interest) is charged under a financing arrangement, or guarantee, indemnity or security related to a financing arrangement (s 5(4)(a));

(b) to indemnity payments for costs, expenses, losses or liabilities arising from the preservation or enforcement of rights (s 5(4)(b));

(c) of termination in a standstill or forbearance arrangement (s 5(4)(c));

(d) to change the priority or order of priorities in which amounts are to be paid, distributed or received under an agreement (s 5(4)(d));

(e) of set-off and of combination of accounts (s 5(4)(e));

(f) to net balances or other amounts (s 5(4)(f));

(g) to assign, transfer or novate rights or obligations (s 5(4)(h));

(h) to step-in to certain rights and obligations (s 5(4)(j)); and

(i) for a secured creditor holding a security interest over the whole, or substantially the whole of the property of the company, to appoint a receiver or controller, in circumstances where a receiver or controller has been appointed by another secured creditor (s 6).

88 Relief is also given to credit providers under ss 415D(9), 434J(8)and 451E(8) who are not required (where obliged under the contract) to provide further money or credit to the body/company subject to the stay period if one or more of their rights exercisable against that body/company are stayed by virtue of these provisions.

89 The legislation also does not prevent parties from enforcing rights to terminate for unrelated reasons. For instance, for reasons of convenience, non-performance or non-payment.[91]

Court Powers

90 Under ss 415E, 434K and 451F the Court may order that the stay does not apply to '*one or more*' rights:

(a) in the case of a scheme of arrangement (s 415E), if the compromise or arrangement was not sought for the purpose of avoiding that the body be wound up, or if satisfied that it is appropriate in the interests of justice; and

(b) in the case of receivership (s 434K) and administration (s 451F), if satisfied that it is appropriate in the interests of justice.

91 The Court also has power to extend the scope of the stay. Under ss 415F, 434L and 451G the Court may order that any rights (including rights which do not fall under the automatic stay, such as a right to terminate on convenience, but excluding rights specifically carved out as exempt from the stay) are only enforceable against the body/corporation with leave of the Court and subject to any terms the Court might impose. The Court may make such an order if:

(a) the insolvency event (being the appointment of a receiver, administrator, announcement or application of a scheme of arrangement) has occurred; and

(b) the rights are being exercised, likely to be exercised, or there is a threat to exercise them because of the insolvency event.

The order must specify the period for which the stay applies which cannot exceed the period

91 Explanatory Memorandum at [2.11].

that the automatic stay would be under subs 415D(2), 434J(2) or 451E(2).

The Court may also make interim orders prior to deciding an application under ss 415F, 434L and 451G and the Court must not require that an undertaking as to damages be given as a condition of granting the interim order.