

LegalTalk Alert

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Proposed Australian corporate insolvency law reforms

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On 19 January 2010, the Government announced a number of reforms to Australia's corporate insolvency laws. The proposed reforms are outlined in the discussion paper, *Insolvent Trading: A safe harbour for reorganisation attempts outside of external administration* (the Paper), and purport to improve the balance between discouraging undesirable conduct while promoting responsible risk taking and economic development. The Paper raises three potential options for insolvency law reform:

- 1) **Maintain the status quo:** the current law would remain and directors would continue to be required to ensure that their company maintains solvency while attempts to reorganise outside the bounds of external administration were undertaken. Retaining the existing law may avoid the abuse of any safe harbour or relief provided to directors, which may have otherwise resulted from a weakened prohibition against insolvent trading.
- 2) **Modified business judgement rule:** a modified business judgement rule would operate and directors would be relieved of the duty not to trade whilst insolvent, subject to compliance with conditions set out in the Paper. This option would provide a safe harbour from the risk of personal liability for insolvent trading for directors making bona fide efforts at an informal work-out outside of the bounds of external administration.
- 3) **Moratorium:** directors would be permitted to expressly and openly invoke a moratorium from the insolvent trading prohibitions for the purpose of attempting an informal corporate reorganisation outside of external administration. Under this option, companies would be required to inform the market of their insolvency and intention to pursue a work-out outside of external administration. Existing creditors

would have the right to bring the moratorium to an end if the company's insolvent trading was collectively considered to be against the creditors' interests. This final option would enable directors to continue to trade while additionally providing a level of protection and control to existing and potential creditors.

The proposed insolvency reforms will additionally amend the *Corporations Act 2001* (Cth) to reverse the effect of the High Court's decision in *Sons of Gwalia v Margaretic* (2007) 231 CLR 160.

Conclusion

While there are some concerns that the proposed reforms could result in an increase in insolvencies and an expansion of the red tape already impeding business development, the changes would effectively better align Australia's insolvency laws with other western countries and assist in combating the continuing effects of the global financial crisis.

The Government has affirmed that it will not reach a position on any of the proposed reforms until it has reviewed public submissions. These comments should be emailed to insolventtrading@treasury.gov.au and must be received by 2 March 2010.

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