

Legal Alert

Banking & Finance

September 2017

Insolvency Update - Trust Assets in Liquidation & Corporations Act Reform

In a Nutshell

There has been significant recent change to the legal landscape in which insolvency practitioners operate.

Insolvency practitioners should be aware of the judgment in *Re Amerind* [2017] VSC 127, which may require liquidators to revisit the basis on which creditors' claims have been dealt with in the liquidation of any corporate trustee.

In addition, the *Treasury Laws (Amendment) 2017 Enterprise Incentives No. 2 Bill 2017* ('**Bill**') will provide company directors with a safe harbour from insolvent trading, and prevent the termination of contracts merely because a party has entered voluntary administration or receivership.

The Bill has now been passed by both houses, and given the nature of these developments, it is timely to briefly consider each.

Trust Assets in Liquidation

There are significant implications for any liquidation of trustee companies following the decision of the Supreme Court of Victoria in *Re Amerind*. The Court held that assets of an insolvent trustee company will not be subject to the priority regime in the Act. This means that employees and the Department for Employment (pursuant to the Fair Entitlements Guarantee Scheme) will not be entitled to any priority from the distribution of the company's property held as trustee, pursuant to sections 433, 556, or 560.

The Court observed that property held by a company as trustee is not "property of the company" for the purposes of those provisions within the Act. Accordingly, that property is not to be distributed to

priority creditors, but is to be distributed in accordance with normal trust principles, and on a proportionate basis as between unsecured trust creditors.

Whilst *Re Amerind* is subject to appeal, it has been followed by the Federal Court of Australia and is based on a previous judgment of the Supreme Court of New South Wales. These decisions, as well as the current uncertain state of the law, leave liquidators in a very vulnerable position. Liquidators may be found to have breached their duties if they incorrectly distribute trust assets to priority creditors under the Act.

We encourage liquidators to seek advice prior to making any priority distribution of trust assets in light of this recent line of authority.

Safe Harbour for Insolvent Trading

The Bill creates a safe harbour to protect company directors from personal liability for insolvent trading. This harbour will apply if the company is undertaking a restructure outside of formal insolvency, and a director develops a course of action reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or a liquidator. If that course of action has been developed, the director will not be liable personally for any debts incurred directly or indirectly in connection with that course of action.

Continued on next page

In assessing whether a director was operating within the safe harbour, the Court may take into account whether advice was obtained from an appropriately qualified entity. This provides an opportunity for insolvency practitioners to work alongside directors in an advisory capacity with a view to advising on the restructure of a company's affairs on an informal basis.

The 'safe harbour' is a carve out from insolvent trading liability. It is not a defence to insolvent trading. Liquidators should carefully consider whether any director might be acting within the safe harbour prior to commencing any proceedings for insolvent trading.

Stay of "Ipsa Facto" Clauses

In addition, the Bill provides for a stay on "ipso facto" clauses, which allow contractual rights to be exercised by a party to a contract if the other party enters voluntary administration, receivership or a scheme of arrangement, or because of the other party's "financial position".

Parties will no longer be able to rely on "ipso facto" clauses in order to exercise rights under contracts entered into after the Act has been amended, such as a right to terminate the contract. This reform is designed to preserve the value of the underlying business, and to allow any formal insolvency process appropriate "breathing space" to allow those processes to succeed, without the risk of key supply ceasing. The legislation will not prevent a party from exercising a right that arises for other reasons, such as a right to terminate for non-performance.

These developments warrant careful consideration by insolvency practitioners.

If you have any queries regarding this alert, please contact:



James Jarvis *Partner*
james.jarvis@finlaysons.com.au
+61 8 8235 7550



Lewis Gentry *Senior Associate*
lewis.gentry@finlaysons.com.au
+61 8 8235 7464