

## ■ Insolvency law reform welcomed

AICD has welcomed the package of insolvency law reforms announced last week by Minister for Corporate Law Chris Bowen, noting that they address some significant concerns of business and the director community.

The measures include amendments to the *Corporations Act*, which would reverse the effects of the High Court's decision in the *Sons of Gwalia* case.

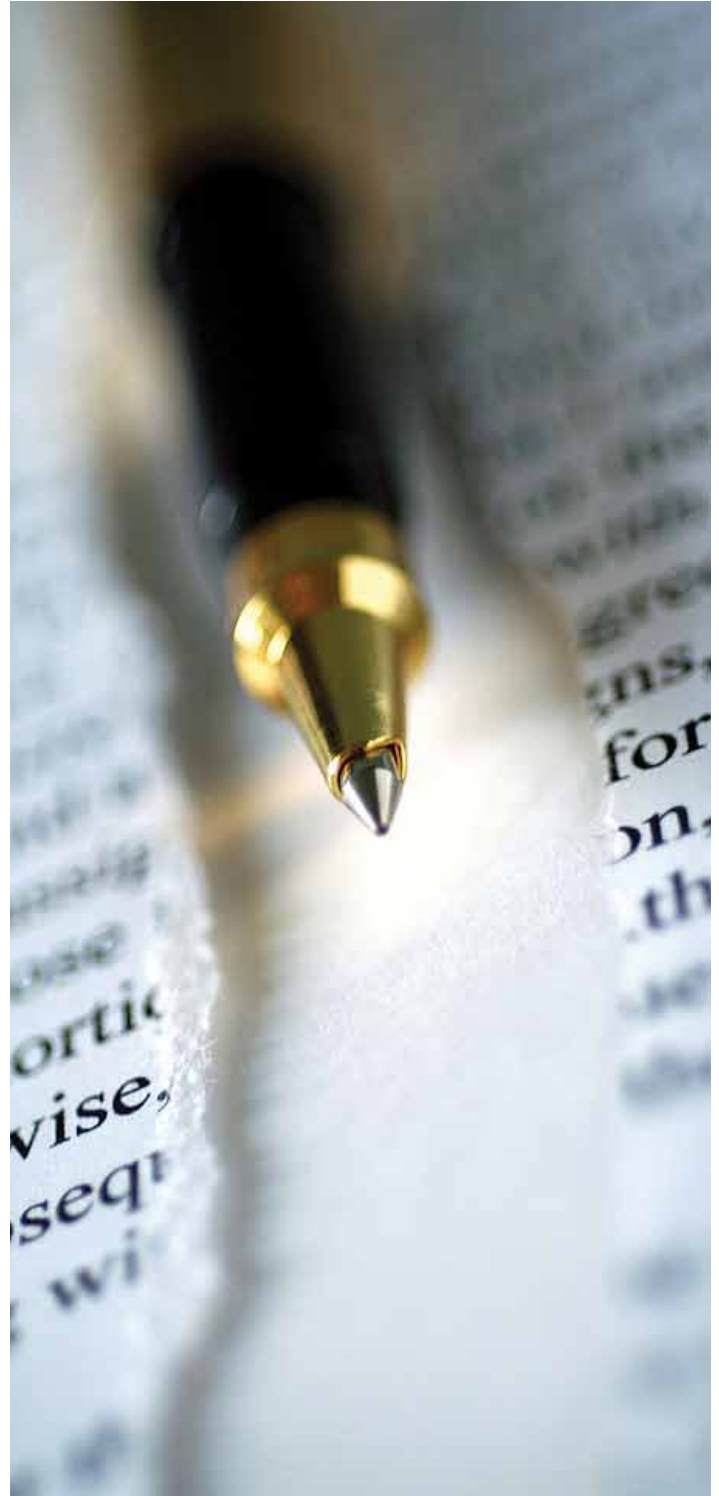
AICD CEO John Colvin says this reversal of the *Sons of Gwalia* decision is sensible and important. "It will create certainty and address some adverse consequences flowing from that decision, both for the cost and availability of credit to Australian business and for the cost and complexity of external insolvency administration.

"The High Court decision had the effect of ranking shareholders equally with unsecured creditors. This drove up the cost of credit for business. It created major practical problems for insolvency administrations, meant added delays and costs and reduced the pool of assets available to ordinary creditors. It also gave litigation funders added impetus to bring class actions against insolvent companies. This move by the Government restores the long-standing principle that lenders to companies rank ahead of the owners of companies."

AICD also welcomed Bowen's release of a discussion paper canvassing options for improvements to the operation of Australia's insolvency laws to provide a "safe harbour" for directors who are attempting to reorganise companies outside formal external administration.

AICD has made a submission to the Australian Securities and Investments Commission, which recently published a consultation paper 124, *Duty to prevent insolvent trading: Guide for directors*. AICD now believes these two initiatives should inform one another.

"In particular, the option to allow the application of a modified business judgement rule under section 180 of the *Corporations Act*, in respect of a director's duty to avoid insolvent trading while attempting to restructure a company without resorting to external administration, appears to be a good step forward and could address many of the problems created by the current insolvency laws," says Colvin. "AICD has long been concerned that the personal liability of directors for insolvent trading under the current law has discouraged attempts to rescue businesses



which might otherwise have been saved. The results of the December 2008 joint AICD/Federal Treasury ASX 200 *Survey of Company Director* demonstrates that personal liability has led to overly-cautious decision-making by directors.

“Allowing companies that might have survived to go into administration without the directors being properly empowered to salvage the company has often been to the ultimate disadvantage of shareholders, creditors and employees. The modified business judgement rule being proposed would help avoid that situation. However, the Government could go further in this area.

“AICD strongly believes there is a need more generally for a broad-based business judgement rule defence, or safe harbour, for directors, consistent across Commonwealth, state and territory laws. The defence would be available when directors make commercial decisions in good faith, having informed themselves about the subject matter and having acted in the best interests of the company. This business judgement rule could apply more generally in the area of insolvency, not just in the case of work-outs.”

AICD made this point in its 2007 submission to Treasury in response to their *Review of Sanctions in Corporate Law* discussion paper.

AICD will also examine closely the proposed option in the discussion paper of allowing directors to invoke a moratorium from the duty not to trade while insolvent, for a limited period and subject to termination by creditors, as work-outs are attempted.

AICD will make a submission on the discussion paper as part of the consultation process announced by Bowen.

## ■ Clipping the Phoenix's wings

A Treasury proposal to address the significant rise in corporate Phoenix activity during the global financial crisis (GFC) could have a major effect on the personal liability of company directors, warns Vantage Performance managing director, Michael Fingland.

Phoenix companies are commercial entities that have emerged from the collapse of another company. The new company, with a similar name, is set up to undertake the same activities as the previous company, thereby presenting the appearance of "business as usual" to its customers.

"The primary objective in engaging in Phoenix activities is to evade taxation and other liabilities (often employee entitlements). The liabilities evaded through Phoenix activities can be considerable, and therefore provide significant incentives for the creation of sophisticated avoidance strategies. The Australian Taxation Office estimates that the suspected Phoenix cases currently under review equate to approximately \$600 million in unremitted taxes, with the Australian Securities and Investments Commission estimating annual costs to be around \$670 million to \$1.3 billion," says Fingland.

Despite existing taxation legislation and the *Corporations Act* containing a number of deterrents, Treasury believes that Phoenix activities are increasing, particularly due to liquidity constraints associated with the GFC, and recently issued its *Action Against Fraudulent Phoenix Activity* proposals paper for public comment.

But Fingland says the impact of the proposed changes on directors is substantial and believes particular attention should be given to the following elements:

- Replacement of the Director Penalty Notice (DPN) with an automatic penalty and personal attachment of the liability to the directors upon the expiration of three months following the due date for payment of the statutory liabilities.
- Directors will also be personally liable for outstanding superannuation, GST, excise and income tax, and not just PAYG which is currently the case.
- Reinstatement of the "failure to remit" offence. This will empower the Commissioner of Taxation to take action against directors for outstanding income tax, and may go so far as enabling the Commissioner to seize assets of directors. Treasury

is also considering introducing similar provisions in relation to superannuation guarantee and other tax liabilities.

- The current taxation legislation enables Commissioner Michael D'Ascenzo to seek a bond against anticipated income tax liabilities from a director where he considers there is a risk of Phoenix activity. Treasury proposes to expand this provision to include other liabilities, and to significantly increase the penalty for failing to provide a bond.

Fingland says some players believe the changes will result in an increase in voluntary administrations and creditors' voluntary liquidations as directors choose to protect their personal asset position rather than push on in an attempt to turn their business around, because if the turnaround does not succeed they may have a substantially higher level of personally guaranteed creditors to deal with.

Others, however, believe the changes will stimulate early intervention to address the underlying causes of underperformance, fostering turnaround activity and reducing the number of insolvencies in the longer term. "We subscribe to this view, as many directors have existing personal guarantees and the introduction of these provisions will incentivise those directors to seek professional advice sooner," says Fingland.

"Either way, Treasury will need to balance the severity of the additional deterrents with the need to ensure that innocent directors and companies are not captured through honest mistakes. Treasury will also need to undertake an education program to ensure businesses are not destroyed by being placed into insolvency administration through fear of personal asset seizure. If this is not done, it will be more difficult to find experienced individuals to act as directors."

AICD made a submission to Treasury on its *Action Against Fraudulent Phoenix Activity* proposals paper, which can be found on its website, [here](#).

## ■ Director share trading improves

Directors continue to clean up their act when it comes to share trading during “blackout” periods, new figures from the Australian Securities Exchange (ASX) show.

An ASX review on securities trading by directors during the September 2009 quarter “blackout” period shows that only 0.7 per cent of all active on-market trades by directors were confirmed as contraventions of the trading policies of the companies concerned and where permission from the relevant chairman of the board had not been granted.

The contraventions involved five trades by four directors in the shares of four different entities, a tiny proportion of the approximately 7,000 directors of publicly listed companies in Australia.

The figure was down on the 0.8 per cent of trades in the March 2009 quarter “blackout” period, when eight confirmed contraventions by six directors occurred, and compares with 1.1 per cent of trades in the September 2008 quarter.

The ASX review also showed that 31 per cent of total active trades by directors in the quarter occurred during the “blackout” period, involving 151 directors. This was a fall on the 33 per cent of trades recorded in the March quarter of last year, involving 219 individual directors, and the 50.1 per cent figure for the September quarter 2008.

AICD has welcomed the continued improvement in director share trading behaviour. “Greater scrutiny and focus on this issue appears to be having an effect in terms of directors adhering to good governance standards in this area,” notes AICD CEO John Colvin.

“However, the message is still not getting through to a very small number of directors that they can only trade when their company’s trading policy permits them to do so, or when they receive approval from their board or chairman. This is disappointing for that vast majority of directors who are doing the right thing.”

ASX has proposed new listing rules on share trading by directors and key management personnel. While AICD supports these, Colvin observes: “AICD would have preferred a less prescriptive “if not, why not” approach, with guidelines enshrined in the *ASX Corporate Governance Principles* rather than in the ASX Listing Rules.”

The ASX’s new listing requirements include a requirement for listed companies to adopt, and disclose to the market, a policy which sets out periods of the year when trading by directors and key management is prohibited, with companies given the flexibility to determine policies appropriate to their own circumstances.

“They will help address adverse investor perceptions about share trading by directors, which can negatively impact on the reputation of listed companies and potentially undermine the integrity of the market,” says Colvin.

## ■ Are you ready for the new IR laws?

As we swing into the New Year, many businesses are realising that they have not done all that is necessary to comply with the new workplace laws which took effect on 1 January 2010, warns Lisa Honeychurch, a principal of Honeychurch Workplace Lawyers.

“Failure to take immediate steps to comply could open your business up to employee claims and prosecutions for breaches of Awards and the National Employment Standards (‘NES’).”

Honeychurch says directors should check whether their organisations have taken the following minimum steps to ensure compliance with the new laws:

### **1. Update and re-issue employment contracts to comply with the new NES.**

NES came into effect on 1 January 2010. It is a set of 10 minimum employment obligations that apply to all National System employers. These prescribe a number of new obligations on all employers, including a general redundancy pay obligation for all employees, regardless of Award coverage and changes to the way that employers must accrue leave for employees.

### **2. Update policies to deal with the new Flexible Work Arrangements.**

The new laws require employers to give due consideration to requests for part-time work for parents with school age children. Adopting a blanket approach of saying “no” can result in businesses being dragged before Fair Work Australia to explain why they have denied requests. Policies and procedures should be reviewed to ensure that they are fair and

reasonable and managers should be trained in how to respond to these types of requests. Employers will need to implement new Flexible Work Arrangements policies which are in line with the new laws.

### **3. Consider which Modern Awards now apply to a business.**

On 1 January 2010, the new Modern Awards system came into operation and will now apply to your business. Modern Awards operate on the basis of “industry” or “occupational” lines, instead of the old system where employers needed to be named as a respondent to a Federal Award. As a result, many employees and businesses not previously covered by an Award may now be covered. Businesses, therefore, need to budget for pay rises which will take effect under the new Awards over the coming 18 months. Transitional provisions will apply under the modern awards, which will effectively phase in pay rates and other entitlements over a period of time.

### **4. Consider whether the organisation needs to implement “High Income Guarantees” or “Individual Flexibility Agreements” to limit the application of the Award.**

Both of these types of arrangements need to be in writing. Therefore, their use should be considered at the same time as new employment contracts are prepared and issued.

## ■ Protecting confidential information

Australian Securities and Investments Commission (ASIC) Commissioner Belinda Gibson has reminded listed company directors of the importance of properly handling their confidential information.

“Company directors would be well aware that the leakage of confidential information about a possible corporate transaction poses a number of serious risks to the company conducting the transaction and can cause significant disruption to the market in the company’s securities,” she says.

Late last year, ASIC released proposed best practice guidelines to help improve market practices related to the handling of confidential information by companies, advisers and other service providers. The guidelines are part of ASIC’s efforts to promote confidence and efficiency in Australia’s capital markets.

The guidelines were developed in response to ASIC’s concerns about the leakage of price-sensitive information on transactions prior to their announcement to the market.

“The guidelines are a set of principles for companies to consider when they have a significant transaction. They will need to be adapted for the scale and complexity of both the company and the transaction,” says Gibson.

“They are intended to assist companies and their advisers who are in receipt of confidential, price-sensitive information to benchmark themselves against best practice with a view to strengthening their internal controls and adopting procedures appropriate for the scale and context of their business.

“The statement of best practice should also facilitate companies insisting on equivalent standards from others in the market.”

The best practice guidelines for handling of confidential information cover three key areas:

- Internal corporate procedures, which describe a range of policies for companies and their staff covering:
  - The ‘need-to-know’ principle;
  - Information barriers, information technology controls and physical document management;

- Maintenance of “insider lists” for sensitive transactions;
- Staff share dealing and controls;
- Staff confidentiality obligations, staff training and exiting employees; and
- Leak investigation.

- Guidance on conditions before releasing confidential information to advisers, covering terms of engagement, undertakings about who will access information within a firm and how the transaction may be promoted by the firm.

- Principles that companies should have their advisers commit to in terms of protecting the companies’ information, including:
  - Insider lists;
  - Confidentiality agreements;
  - Personal account dealing by staff; and
  - Leak investigations.

“ASIC has developed the guidelines after extensive discussion with the market about common practices and existing controls. The standards we are proposing have already been adopted by some market participants and should bring Australia into line with practices in the US and UK,” says Gibson.

“Ultimately, ASIC is looking to promote a system of best practice within the industry, not just a minimum level of compliance with law.”

The proposed best practice guidelines are contained in consultation paper 128 *Handling confidential information*, available from ASIC’s website at: [www.asic.gov.au](http://www.asic.gov.au). Submissions can be made until 21 February 2010.