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Surviving *the storm*

K&L Gates' **Zina Edwards** gives the low down on major insolvency law reforms.

THE GOVERNMENT HAS introduced major law reforms to Australia's insolvency laws which will come into effect next year. With news of established local and international fashion brands facing financial difficulty and entering formal insolvency processes becoming more common, these law reforms will impact on the fashion industry.

In this article, we explain how the new laws will operate and the opportunities that they may create both for fashion start-ups and established businesses.

A 'safe harbour' for directors of a struggling business

Currently directors of Australian companies can face large personal fines and even criminal liability if they continue trading whilst the business is insolvent

(or approaching insolvency). This means that directors of a struggling business have a legal obligation to appoint a voluntary administrator, rather than try to find an alternative solution, as voluntary administration gives the directors protection from liability. It also means that businesses in their early stages that do not yet have sufficient capital or that are 'risky' find it difficult to attract experienced directors to their boards, as those directors do not want to take the personal risk that comes with accepting such an appointment.

The new laws will introduce a 'safe harbour' that allows directors of a struggling business to continue trading without facing liability when those directors commence developing one or more courses of action that are reasonably likely to lead to a better outcome for the business. This 'safe harbour' will give directors breathing room to assess the situation, obtain appropriate professional advice and negotiate with their stakeholders to see if a solution outside of formal insolvency can be found.

From a practical perspective, once the new laws come into effect, a director of a fashion business that is facing financial difficulty will need to take quick and prudent action in order to qualify for the 'safe harbour' protection.

The director will need to make sure they keep themselves informed of the company's financial position, ensure that the company and its employees are complying with all laws and work on developing and implementing a plan to turn the business around. The exact steps for developing such a plan will differ in each situation but may include renegotiating terms with suppliers or financiers, approaching new financiers or investors and engaging competent advisers (such as brand and media advisers, lawyers, accountants or other turnaround professionals).

'Ipso facto' clauses

The other big change is aimed at preventing parties to a contract from terminating that contract because the counterparty has gone into (or has taken preparatory steps towards) a formal insolvency process. Similarly, a contract cannot be terminated merely due to a counterparty's financial position. Such termination rights are known as 'ipso facto' clauses. Under the current laws when a business enters into administration it often faces immediate value destruction as suppliers and large customers terminate contracts thereby sealing the fate of that business. The new laws will put a stay on exercising 'ipso facto' clauses so that businesses in financial difficulty will get a chance to return back to solvent trading or, if they are approaching insolvency, to undertake a restructuring or turnaround.

While this may be good news for struggling fashion businesses, it is also something to be cautious about when you sit on the other side of a contract. For example, if your business supplies goods to a business that goes into administration it may no longer be able to terminate the supply contract.

Opportunities

If these new laws have their intended impact, it will be easier for businesses in the start-up phase to not only attract more experienced directors to their boards but also to entice angel investors, as the insolvency risks faced by start-ups should be reduced.

More established businesses that experience difficult trading conditions will also have more time to consider their options. It could also mean that there are more investment opportunities as struggling businesses look for new sources of capital or consolidate with compatible brands. ■

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