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Australia

RESTRUCTURING & INSOLVENCY

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This country-specific Q&A provides an overview of restructuring & insolvency laws and regulations applicable in Australia.

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AUSTRALIA
RESTRUCTURING & INSOLVENCY

1. What forms of security can be granted over immovable and movable property? What formalities are required and what is the impact if such formalities are not complied with?

Immovable property

In Australia, the principal type of security that is taken on 'immoveable property', (i.e. interests in land or fixtures and buildings attached to land), is a real property mortgage, for which a registration system exists (referred to as the Torrens Title system). Under this system, a mortgagor who has registered a mortgage with the relevant state or territory land titles register grants a legal charge over the land as opposed to transferring legal title to the mortgagee. This transfer is subject to the 'equity of redemption', that is, the mortgagor's right to redeem the title to the property once it has satisfied its debt obligations. The mortgagor and the mortgagee thereafter both possess a legal interest in the land. The mortgagor is free to deal with the land (subject to any restrictions in the terms of the mortgage itself) and retains the beneficial and legal interest in the land. The mortgagee holds a legal charge that will confer actionable rights in the event of default by the mortgagor.

It is also possible under the Australian system for an equitable mortgage over land to exist. This arises in circumstances where the mortgage is not yet registered but the parties have an expressed an intention (often by way of a written agreement) to enter into a mortgage or, the mortgagor deposits the title deeds with the mortgagee. An equitable mortgage can arise by design or the failure to perfect the requirements to effect a legal mortgage.

Movable property

Since its inception in 2012, the *Personal Property Securities Act 2012* (**PPSA**) has established a uniform concept of a 'security interest' in Australia. This concept covers all forms of security interests, including mortgages, charges, pledges and liens. It applies primarily to security interests under which an interest in personal property is granted pursuant to a consensual transaction that, in substance, secures payment or performance of an obligation. It also applies to certain deemed security interests such as certain types of lease arrangements for certain terms, retention of title arrangements and transfers of debts, regardless of whether the relevant arrangement secures payment or performance of an obligation. 'Personal property' (or moveable property) is broadly defined and essentially includes all property other than land, fixtures and buildings attached to land, water rights and certain statutory licences.

The PPSA has introduced a new lexicon relating to security in Australia. For instance, the traditional concept of a fixed and floating charge has been replaced by a 'general security agreement' and the concept of a floating charge has now become a 'circulating asset security agreement'. The concept of crystallisation and the distinction between fixed and floating charges under the PPSA have become irrelevant.

The concept of 'security interest' is broad enough to capture pre-existing forms of security and the documentation creating security has not changed significantly (i.e. charges, debentures, mortgages and pledges may still be used with certain amendments).

Generally, attachment and perfection of a security interest occurs when the grantor and the secured party execute a security agreement (although the parties can defer attachment) and the security interest is registered on a register known as the Personal Property Securities Register (**PPSR**) within the prescribed statutory timeframes. However, security interests over certain assets can be perfected other than by way of registration, for example, by the security holder controlling the relevant assets in the manner prescribed by the PPSA.

The rights of a secured creditor to enforce a security interest are subject to a requirement that the security interest be perfected. Unregistered or unperfected security interests vest with the grantor upon insolvency. If a security interest is not perfected in accordance with the PPSA the security interest will, on the appointment of an administrator or liquidator to the grantor, vest in the grantor. This has created a paradigm shift for retention of title arrangements since failure to perfect such arrangements (by registration on the PPSR) will vest title in the relevant goods to the recipient of the goods (that is, the grantor), despite an agreement between supplier and recipient whereby the supplier would otherwise retain title to those goods until they are paid for.

Further, registration of a security interest has an important bearing on its priority position with respect to competing security interests. It is therefore essential to register a security interest as soon as possible and within the prescribed statutory timeframes so as to ensure the secured party has the best possible claim against the grantor or third parties vis-à-vis competing security interests.

2. What practical issues do secured creditors face in enforcing their security package (e.g. timing issues, requirement for court involvement) in out-of-court and/or insolvency proceedings?

In a voluntary administration, a statutory moratorium under section 440B of the Corporations Act 2001 (Cth) (Corporations Act) prevents a security interest from being enforced against the company's assets without the administrator's consent or leave of the court.

There are exceptions to this general rule, the primary one being where a secured creditor has security over the whole or substantially the whole of the company's property. Where this occurs, the secured creditor may enforce its security and appoint a receiver within 13 business days' following the date the administrator gave notice of his or her appointment (known as the "decision period"). If a secured creditor does not enforce its security within the decision period, the section 440B moratorium will operate thereafter preventing enforcement during the period of administration. Notwithstanding this short window available to secured creditors to enforce their security, there are often practical difficulties associated with being satisfied that the secured creditor's security is 'over the whole or substantially the whole' of the company's assets.

A similar moratorium on enforcement operates in a liquidation (under section 471B of the Corporations Act), however the rights of secured creditors are not impacted in circumstances where their security is valid, they remain entitled to realise their security despite the appointment of the liquidators.

3. What restructuring and rescue procedures are available in the jurisdiction, what are the entry requirements and how is a restructuring plan approved and implemented? Does management continue to operate the business and / or is the debtor subject to supervision? What roles do the court and other stakeholders play?

Restructurings and other informal work outs can be pursued in Australia provided adequate attention is paid to the prohibitions on insolvent trading under Australia's stringent insolvent trading laws. One way to alleviate directors' concerns about their insolvent trading obligations is for the company to enter into forbearance or standstill arrangements with its creditors pursuant to which creditors might agree not to enforce any rights that might otherwise arise during the restructuring or work out period. In doing so, the company will have an opportunity to restructure what might otherwise be current debt obligations.

Outside a fully consensual debt restructuring, there are three ways to effect a restructure of a company's debts under Australian law:

- through a deed of company arrangement (**DOCA**);
- through a scheme of arrangement; and
- through a small business debt restructuring process (available to companies with less than $1 million of liabilities (excluding employee liabilities)).

DOCA

A DOCA is a flexible restructuring tool in terms of outcomes that it can deliver. These include debt-for equity swaps, a transfer of equity, moratorium of debt repayments, a reduction in outstanding debt and the forgiveness of all, or a portion of, outstanding debt. DOCAs also have the benefit of being fast and subject to low voting thresholds (50% in number and value).

A DOCA takes place in the context of a voluntary administration (i.e. a formal insolvency appointment). It is a creditor approved arrangement governing how a company's affairs will be restructured. As a voluntary administrator is formally appointed, they take over the management and control of the company's business and affairs for the term of the appointment. A DOCA is effectively a contract or compromise between the company and its creditors. Whilst it is a feature of voluntary administration, it should in fact be viewed as a distinct regime, where the rights and obligations of the creditors and the company differ to those under voluntary administration.

Once a company is in voluntary administration, a DOCA can be proposed by anyone with an interest in the company (i.e. a director, creditor or third-party purchaser). Creditors are required to vote to resolve that the company should execute the DOCA. Once the terms of the DOCA are approved (by the relevant threshold majorities), the instrument must be executed within 15 business days of such a resolution. A DOCA can be varied by either a subsequent resolution of creditors or by the court.

A DOCA binds not only creditors (other than secured creditors) but also the company, directors and shareholders. Whilst binding on shareholders, it is recognised in scenarios where a shareholder has limited interest in the company under administration and is not entitled to vote in the DOCA in its capacity as shareholder. The statutory priority afforded to employees in a liquidation scenario must be the equivalent in a DOCA (unless the employees vote otherwise). In this way, employees are afforded a level of protection under a DOCA.

Upon the execution of the DOCA the voluntary administration ends. The outcome of the DOCA is generally dictated by the terms of the DOCA itself. Typically, however, once a DOCA has achieved its goal it will terminate. The recourse of the court is available to creditors to set aside the DOCA if it does not achieve its goal or is challenged by creditors on grounds that they are unfairly prejudiced in a relative sense.

Schemes of arrangement

A scheme of arrangement is a court approved process binding the creditors and/or members to some form of rearrangement or compromise of pre-existing rights and obligations. Schemes may involve the deleveraging of a business or the reduction of outstanding debt in exchange for the issuing of equity. There are two types of schemes of arrangement:

- a members' scheme of arrangement (between the company and its members); and
- a creditors' scheme of arrangement (between the company and its creditors).

Schemes of arrangement can be implemented without the commencement of a formal insolvency process. As such, the company and its directors can remain in control of the business during the proposal and approval phase (and, depending on the terms of the scheme, after its implementation).

The approval process is heavily regulated and involves a number of steps, including the preparation of explanatory statements and scheme booklets, notification to the corporate regulator, the Australian Securities & Investments Commission (ASIC), an application to court to convene scheme meetings, the holding of those meetings, court approval of the scheme and finally, the filing with ASIC of the court approved scheme. The timeline for scheme approval is typically between 3 months (but can often take between 4 to 6 months) from the commencement phase through to the final approval and implementation phase.

Schemes of arrangement must be approved by a majority of 50% in number and 75% in value of the voting class (of affected members and/or creditors) at the scheme meeting. Classes are determined by reference to commonality of legal rights and only those whose rights will be compromised or affected by the scheme need be included. Unlike a DOCA, a scheme can bind secured creditors who vote against it and release third party claims.

The key element to the success of a scheme of arrangement is the willingness of creditors (most commonly financial creditors, as opposed to trade and operational creditors) to work with the management of the distressed company as well as other stakeholders. The starting point for the negotiation will often involve an agreement or undertaking on a standstill or forbearance period, during which the company will look to refinance its current debt structure (often through the injection of new capital and/or equity).

Small business debt restructuring process

From 1 January 2021, a simplified debt restructuring process was introduced into the Australian restructuring landscape whereby financially distressed small companies with liabilities of less than $1 million (excluding employee entitlements) are able to appoint a "small business restructuring practitioner" to oversee the restructuring of existing debts whilst the directors remain in control of the company. The company must put a restructuring plan to creditors within 20 business days of entering the process (or as extended by up to 10 business days by the small business restructuring practitioner). Once the plan is put to creditors, they have 15 business days to vote to accept or reject the plan. The plan is accepted if more than 50% by value of voting creditors accept the plan.

4. Can a debtor in restructuring proceedings obtain new financing and are any special priorities afforded to such financing (if available)?

A debtor can obtain financing and otherwise use its assets as security in a scheme of arrangement and informal voluntary reorganisations. This is solely a matter for agreement between the company and its creditors. There are no special priorities given to new debt as of right and such priorities have to be negotiated and agreed with any existing creditors who already hold some form of priority.

5. Can a restructuring proceeding release claims against non-debtor parties (e.g. guarantees granted by parent entities, claims against directors of the debtor), and, if so, in what circumstances?

DOCA and small business restructuring process

A DOCA and the small business restructuring process cannot be used to extinguish claims against non-debtor parties. A DOCA only releases creditor claims against the company the subject of the administration.

Scheme of arrangement

Schemes can be used to effect releases of claims against non-debtor parties and are a flexible mechanism for implementing a broad settlement between creditors and third parties. Schemes of arrangement can be used to extinguish subordinated claims without requiring the holders of those claims to consider or agree to the scheme (assuming it can be shown that they are out of the money). This means that schemes of arrangement can be used to eliminate the risk that a company might be exposed to shareholder claims, including class actions.

6. How do creditors organize themselves in these proceedings? Are advisory fees covered by the debtor and to what extent?

There are no set requirements as to how creditors must organise themselves under a DOCA. Creditors that form a committee of inspection throughout the course of a voluntary administration (i.e., prior to a DOCA coming into effect) may continue to organise themselves through such a committee if provision is made to do so under the terms of the DOCA. As noted in paragraph 3 above, creditors under a scheme of arrangement are organised into voting classes determined by reference to commonality of legal rights.

Separately, it should be noted that creditors can informally band together to form what is often termed an ‘ad hoc’ advisory committee through which they can communicate with the company, deed administrator or scheme administrator or agree to vote in a certain way.

Whether or not advisor fees are covered by the debtor will depend on the terms of the proceeding.

7. What is the test for insolvency? Is there any obligation on directors or officers of the debtor to open insolvency proceedings upon the debtor becoming distressed or insolvent? Are there any consequences for failure to do so?

In Australia, the definition of insolvency is set out in section 95A of the Corporations Act, which states:

1. A company is solvent if, and only if, the company is able to pay all the company’s debts, as and when they become due and payable.
2. A company that is not solvent is insolvent.

Case law in Australia has indicated that the focus of the insolvency test for companies approaching financial distress is the ‘cash flow’ position of the business, rather than its balance sheet.

Company directors are burdened by a positive statutory duty to prevent insolvent trading. This duty prevents directors from incurring any debt on behalf of the company if the company is insolvent or the director has reasonable grounds for suspecting that it is likely to become insolvent when the company incurs the debt. Directors can be held personally liable for debts that are incurred thereafter in these circumstances.

With effect from September 2017, new section 588GA was incorporated into the Corporations Act and introduced a new concept of a ‘safe harbour’ protection for directors who might otherwise be exposed to insolvent trading. The safe harbour protection could, in certain circumstances, enable a company to delay a formal insolvency process where it seeks to pursue a turnaround plan that has a ‘better outcome’ for the company. If such a plan is being developed, the company must ensure it meets the relevant criteria to enliven the protection, because as a matter of practice, if the turnaround plan is unsuccessful and a formal insolvency follows, the safe harbour protection will only operate as a defence to an insolvent trading claim rather than a positive exception to liability. Relevantly, the safe harbor protection does not extend protection for directions against more general breach of duty claims. The operation of the safe harbour provisions is discussed further in paragraph 25.

8. What insolvency proceedings are available in the jurisdiction? Does management continue to operate the business and / or is the debtor subject to supervision? What roles do the court and other stakeholders play? How long does the process usually take to complete?

There are 3 formal insolvency procedures that operate in Australia:

1. Voluntary administration;
2. Liquidation; and
3. Receivership.

Each of the formal processes, other than receivership, has a moratorium in place to prevent unsecured creditors (including shareholders) from enforcing their rights. Whilst no such moratorium exists in receivership, to the extent an unsecured creditor takes action to enforce its rights, it has no recourse to the assets which are secured and in the control of the receivers.

Voluntary administration

Voluntary administration is a creditor driven process, and whilst designed to be short and temporary, can last for months, if not years in more complex situations. There is no strict requirement for Court involvement or approval – it is not unusual for less complex administrations to proceed without any Court involvement. It is open to an administrator or creditor to seek judicial directions from the Court, or prescribed orders, at any stage during the course of the administration.

Upon appointment, the administrator takes control of the company's business, affairs and property. The administrator has extensive powers and is entitled to perform any function and exercise any power the company or its officers would otherwise perform. A director's powers to manage the affairs of the company are immediately suspended (although they are not moved from their position). In performing this function, the administrator will be acting as the company's agent.

Administrators are granted a right of indemnity out of the company's property (other than property the subject of retention of title arrangements that are subject to a perfected PPSA security interest), which is secured by a lien.

The purpose of the voluntary administration process (outlined in Part 5.3A of the Corporations Act) is to either:

1. maximise the chances of the company, or as much as possible of its business, continuing into existence; or
2. result in a better return for the company's creditors and members than would result from an immediate winding up, if it is not possible for the company or its business to continue to exist.

In practice, administrators tend to recommend or adopt one of three strategies; a simple sale of business and assets, a move to liquidation or a recapitalisation plan (effected through a deed of company arrangement). The latter two strategies require the approval of creditors (by 50% of those creditors voting in number and value).

Liquidation

In Australia, a company may be wound up:

- if solvent, voluntarily by its members (members' voluntary liquidation); or
- if insolvent, by its creditors (creditors' voluntary liquidation); or
- compulsory order of the court.

Upon appointment, a liquidator will assume control of the company's affairs and has the power to realise and distribute assets to the exclusion of the directors and shareholders. Similar to the position in voluntary administration, upon the appointment of a liquidator, the directors, while they will remain in office, their powers to manage the affairs of the company are immediately suspended. A provisional liquidator will also control the affairs of the company to the exclusion of the directors and shareholders.

Court involvement is required in a compulsory winding up, where the Court will enter orders appointing the liquidator. It will also consider applications by the liquidator, pursuant to section 480 of the Corporations Act, for an order that the liquidator be released and that the company be deregistered after the liquidator has realised all of the property of the company or so much of that property as can, in his or her opinion, be realised without needlessly protracting the winding up, has distributed a final dividend (if any) to the creditors, has adjusted the rights of the contributories among themselves and made a final return (if any) to the contributories. The Court must be satisfied that no creditor will be adversely affected by the order.

The length of a liquidation process will vary depending on the company and how complex the business and affairs of the company are. Other factors that will affect the length of the liquidation include whether litigation is necessary to recover funds/assets belonging to the company. For a small company, with uncomplicated affairs, the winding up can be usually completed between 12 to 18 months. Where the company has more complicated affairs and is the subject of litigation, the winding up can take some time.

On 1 January 2021, a simplified liquidation process was introduced which allows a streamlined creditors' voluntary winding up for companies that have liabilities less than $1 million (excluding employee liabilities). Compared with a creditors' voluntary winding up, a simplified liquidation process has reduced investigation and reporting requirements, no obligations for liquidators to convene meetings of creditors, no committees of inspection, fewer voidable transactions and a simplified dividend process.

Receivership

Receivership is an option available to secured creditors. A receiver and manager may be appointed pursuant to the relevant security document granted in favour of the secured creditor, where a company has defaulted and the security is enforceable. Far less common is a court appointed receiver, where the appointment is made to preserve the company's assets where it may not otherwise be possible to trigger a formal insolvency process.

A receiver's primary role is to take control of the relevant assets subject to the security pursuant to which they are appointed and realise those assets for the benefit of the secured creditors. Despite being appointed by the secured creditors, a receiver is not obliged to act on the instructions of the secured creditors. A receiver must, however, act in their best interests, and this will invariably lead a receiver to seek the views of secured creditors on issues that are material to the receivership (particularly given that a receiver cannot effectively undertake a transaction involving the secured property without a release by, or the consent of, the secured creditor).

It is common for the appointment of a receiver to the whole or substantially the whole of the company's assets to closely follow, the appointment of an administrator by the directors. Both processes will proceed in tandem. There is no prescribed time period for a receivership. Generally, the receivership ends where the receiver has sold sufficient collateral to repay the secured creditor.

9. What form of stay or moratorium applies in insolvency proceedings against the continuation of legal proceedings or the enforcement of creditors' claims? Does that stay or moratorium have extraterritorial effect? In what circumstances may creditors benefit from any exceptions to such stay or moratorium?

Receivership

There is no moratorium in receivership and creditors may take action against the company including initiating Court proceedings, but such actions are treated as unsecured claims (subordinated to the claims of the secured creditors who appointed the receiver). The receiver will be in control of the company's material assets and is permitted to realise such assets for the benefit of the secured creditor only (with any surplus being provided to the company capable of being distributed to unsecured creditors).

Voluntary administration and liquidation

An automatic moratorium operates following the appointment of a voluntary administrator or upon the winding up of a company. Consequently, civil legal proceedings cannot be commenced except, in the case of a voluntary administration, with the administrators consent or leave of the court and in the case of liquidation, with the leave of the court.

Under the *Cross-Border Insolvency Act 2008* (Cth), foreign creditors, save for tax and penal debts, have the same rights regarding the commencement of, and participation in, insolvency proceedings as an Australian creditor. All foreign claims must be converted into Australian currency for the purposes of the insolvency process.

10. How do the creditors, and more generally any affected parties, proceed in such proceedings? What are the requirements and forms governing the adoption of any reorgnisation plan (if any)?

There are two creditors' meetings prescribed under the Act during a voluntary administration.

The first meeting of creditors must be convened by an administrator within eight business days of their appointment whereby creditors vote on whether to replace the administrator, approve their fees and decide whether to appoint a committee of inspection.

The second creditors' meeting is usually convened 20 business days following the commencement of the administration (this may be extended by court application). At this meeting, the administrator must provide creditors with a report on the affairs of the company and recommend the best option available to maximise a return to creditors. There are three possible outcomes of the second creditors' meeting:

- the company enters into a DOCA;
- the company is placed into liquidation; or
- the administration is terminated, and the company is returned to the control of the directors.

It should also be noted that the Court may make any orders it thinks fit in respect of an external administration, including in respect of the adoption of a DOCA.

In a liquidation, creditors are required to lodge proofs of debt with the liquidator in order to receive a *pari passu* distribution from any assets made available to the unsecured creditors.

Where a receiver is appointed, the receiver will take control of the secured assets to the exclusion of all other parties. Therefore, the extent to which a creditor can proceed against a company in receivership will depend on the scope of the receivers' appointment.

11. How do creditors and other stakeholders rank on an insolvency of a debtor? Do any stakeholders enjoy particular priority (e.g. employees, pension liabilities, DIP financing)? Could the claims of any class of creditor be subordinated (e.g. recognition of subordination agreement)?

When a company is wound up, the statutory distribution waterfall in Australia generally provides that secured creditors are paid first in priority to unsecured creditors. There is an exception to this for employee entitlement claims and other priority payments as prescribed in the Corporations Act. During a receivership, winding up (or under a deed of company arrangement), the entitlements of employees have priority over the proceeds available from a realisation of assets subject to a circulating security interest (formerly a floating charge). The remuneration, costs and expenses of insolvency practitioners appointed will also be afforded priority over all creditors' claims, including employees.

There is no concept of equitable subordination under Australian law and shareholder loans generally rank equally with unsecured claims. The only shareholder claims that are subordinated to unsecured claims are:

1. claims for a debt owed to a shareholder in that person's capacity as a shareholder; and
2. claims arising from the buying, holding, selling or other dealing in shares of the company.

Otherwise, the relationship between creditor groups is very much a feature of contract and Australian courts will generally give effect to whatever contractual arrangement and/or structural subordination arrangements a company and its creditors have agreed to, even where doing so leaves whole creditor groups out of the money.

12. Can a debtor's pre-insolvency transactions be challenged? If so, by whom, when and on what grounds? What is the effect of a successful challenge and how are the rights of third parties impacted?

Under Australian law, antecedent transactions will only be vulnerable to challenge where a company is in liquidation. A liquidator has the power to bring an application to the Court to declare the following types of transactions void:

- insolvent transactions (which includes both unfair preferences and uncommercial transactions) if entered into, in the case of unfair preferences, during the 6 month period ending on the relation-back day (the relation back day is generally the date of the application to wind up the company or the date of the appointment of a liquidator, or if the company had previously been in administration, the date of the appointment of the administrator) or in the case of uncommercial transactions, during the two year period ending on the relation-back day;
- unfair loans, which are voidable if entered into any time before the winding up began;
- unreasonable director-related transactions, which are voidable if entered into during the 4 years ending on the relation-back day; and
- transactions entered into for the purpose of defeating, delaying or interfering with creditors' rights on a company's winding up, which are voidable if entered into during the 10 years ending on the relation-back day.

Uncommercial transactions and unfair preferences are voidable if the company was insolvent at the time of the transaction or at a time when an act was done to give effect to the transaction. Australian courts have held that a transaction is 'uncommercial' if a reasonable person in the company's circumstances would not have entered into it. An unfair preference is one where a creditor receives more for an unsecured debt than would have been received if the creditor had to prove for it in the winding up. The other party to the transaction or preference may prevent it being held void if it can be shown that they became a party in good faith, they lacked reasonable grounds for suspecting that the company was insolvent and they provided valuable consideration for, or changed position in reliance on, the transaction.

Australian Courts have also determined that loans to a company will be 'unfair' and thus voidable if the interest or charges in relation to the loan were, or are, not commercially reasonable. This is to be distinguished from the loan simply being a bad bargain. Any 'unreasonable' payments made to a director or a close associate of a director are also voidable, regardless of whether the payment occurred when the company was insolvent.

Upon a finding of a voidable transaction, a court may make a number of orders impacting the rights of third parties to those transactions. Those orders include directions that the offending person pay an amount equal to some or all of the impugned transaction; direct a person to transfer the property back to the company or direct an individual to pay an amount equal to the benefit obtained.

Further to the above, the Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020 introduced to the Act an ability for liquidators to apply to set aside 'creditor-defeating' transactions entered into on or after 18 February 2020. Section 588FE(6B) of the Act enables liquidators to apply to set aside dispositions of property where the relevant transaction (or an act done to effect the transaction) was entered into while the debtor company was insolvent, caused the debtor company to become insolvent or, directly or indirectly, resulted in the debtor company entering into external administration. Section 588FDB of the Act defines 'creditor-defeating dispositions' as dispositions where the consideration payable for the disposition was less than either the market value or the best price reasonably obtainable in the circumstances, and where the disposition has the effect of preventing, hindering or significantly delaying the process for the property becoming available for the benefit of creditors in the winding up.

The Supreme Court of Victoria recently applied these reforms in what it termed a "blatant example of phoenixing". In the decision of IntelliComms Pty Ltd (in liq) [2022] VSC 228, the Court held that a sale agreement of business assets entered into immediately prior to the winding up of a company (and for substantially less than what the company's creditor was willing to pay for the business assets) was a creditor-defeating disposition within the meaning of section 588FDB of the Act and constituted a voidable transaction pursuant to section 588FE(6B) of the Act.

13. How existing contracts are treated in restructuring and insolvency processes? Are the parties obliged to continue to perform their obligations? Will termination, retention of title and set-off provisions in these contracts remain enforceable? Is there any ability for either party to disclaim the contract?

There is no formal insolvency procedure that results in the automatic termination of contracts between the debtor and third parties. Following appointment, administrators, receivers and liquidators can choose not to continue to perform a contract. Any damages flowing to the counterparty from the non-performance of a contract will rank unsecured against the company. However, any contract that an insolvency practitioner continues with may result in the practitioner being held personally liable under the Corporations Act.

Contractual and mandatory set-off will apply in formal insolvency processes, with certain exceptions. Section 533C of the Corporations Act provides for a statutory set-off in a liquidation where there have been mutual dealings between the distressed company and the relevant creditor. In such circumstances an automatic account is taken of the sum due from one party to the other in respect of those mutual dealings, and the sum due from one is set-off against the sum due from the other. Retention of title provisions will remain enforceable so long as the creditor has a perfected registered security interest in the property.

Under the current landscape, contracts may contain *ipso facto* clauses allowing a counterparty to terminate or renegotiate a contract on the occurrence of any insolvency event (which can be defined to include any form of restructure). From 1 July 2018 new provisions were inserted into the Corporations Act imposing an automatic stay on the enforcement of *ipso facto* termination rights that are triggered simply because a company enters a formal or informal insolvency or restructuring process. The stay will operate during a "stay period", the length of which is determined by reference to the length of the relevant insolvency or restructuring process. There are also circumstances in which the stay period will be indefinite. A court will have the power to lift the automatic stay where it considers it is in the interests of justice to do so.

The automatic stay does not apply retrospectively, that is, the new provisions only apply to contracts entered into after 1 July 2018. There are also certain agreements/ contract set out in regulations where the operation of the automatic stay provisions will not apply. Certain contractual rights as prescribed in ministerial declarations are also excluded from the operation of the automatic stay provisions.

14. What conditions apply to the sale of assets / the entire business in a restructuring or insolvency process? Does the purchaser acquire the assets "free and clear" of claims and liabilities? Can security be released without creditor consent? Is credit bidding permitted? Are pre-packaged sales possible?

Voluntary administration

A voluntary administrator may sell assets of the company, noting, however, it is not permitted to sell assets subject to a security interest, without consent of the secured party (it is not unusual in the Australian market for a receiver to also be appointed and have control over such assets). Administrators can apply to the Court if such consent is not given and the court may make an order if it is satisfied that the secured creditor is adequately protected.

Liquidation

Liquidators appointed in the context of either voluntary or compulsory liquidations can sell or otherwise dispose of unencumbered property of the company without needing to seek approval from the court or other parties to the liquidation. The purchaser will acquire the assets unencumbered unless there are debts or liabilities passing to the purchaser as provided for in the sale documentation. If assets are encumbered, consent of the secured party will be required unless a Court directs otherwise. A liquidator owes fiduciary duties to the company. In realising company property, a liquidator (or administrator) has a duty to obtain the highest possible prices for the assets of the company, keeping in mind that the winding up should not be unnecessarily protracted. Property may be sold in any way the liquidator deems fit, including private contract and, usually, public auction. While creditors may purchase assets of the company, the purchase price will not be able to be set off against the debt owed to the creditor by the company. Instead any funds raised by the sale of company property will be for the benefit for the creditors as a whole, to be distributed according to the relevant distribution rules.

Receivership

A receiver is under a statutory obligation to obtain market value or, in the absence of a market, the best price obtainable in the circumstances pursuant to section 420A of the Corporations Act. Upon a sale, the receiver will transfer the asset free of security interests (a release will be provided by the appointing secured creditor) and often the terms of any intercreditor arrangements will provide for the automatic release of subordinated security. In circumstances where an automatic release mechanism is not provided for, director negotiations will need to take place with the subordinated secured creditors.

Schemes of arrangement

The terms of the scheme itself can provide for the disposal of assets and any associated release of security provided. Such releases will not be automatic (unless specifically provided for in an approved scheme) and will need either agreement from the creditors or the provision of such release in associated finance and security documents.

Informal reorganisations

In an informal reorganisation of a company the conditions of the reorganisation and sale or use of assets are as negotiated with the relevant creditors/stakeholders.

Credit bids

Credit bids are permissible under Australian law and generally are a means of pursuing loan to own strategies, but are rare given the need for a sales process to be conducted by the appointed insolvency practitioner.

Pre-packaged sales

The "pre-pack sale" in the traditional English and US tradition has had limited application in the Australian restructuring environment due to the stringent obligations placed on insolvency practitioners and the protections afforded to creditors under both statute and common law. However, the use of pre-packs may increase following the introduction of the safe harbour protection.

Attempts to effect a "pre-pack" transaction are also restricted by the specific obligations on receivers vis-à-vis the disposal of assets. As noted above, section 420A of the Corporations Act requires a receiver to, upon the sale of an asset, either achieve a price not less than market value (if a market exists for the asset), or alternatively the best price reasonably obtainable. Australian Courts have identified certain steps that a receiver should take in order to comply with the second limb of the obligation, which includes a market or auction sale process and marketing campaign – each making "pre-pack" sales difficult for receivers to achieve. Accordingly, pre-packs tend only to be used in circumstances where:

1. there are limited alternative sale options available to the insolvency practitioner appointed and there is evidence to support the assumption that any delay in sale may be fatal to the underlying business; or
2. a market testing sale process has already been undertaken prior to the appointment of the receiver or administrator.

Notwithstanding the above, the market may well evolve such that we see more pre-packs transactions if it can be demonstrated clearly that junior creditors and shareholders are out of the money.

15. What duties and liabilities should directors and officers be mindful of when managing a distressed debtor? What are the consequences of breach of duty? Is there any scope for other parties (e.g. director, partner, shareholder, lender) to incur liability for the debts of an insolvent debtor and if so can they be covered by insurances?

Directors' duties in Australia arise from contract, under common law and under statute. The principal general law and statutory duties imposed on a director of an Australian company include:

- duties of good faith, care and diligence;
- to not improperly use the position, or information obtained by virtue of the position, to gain personal advantage or cause detriment to the company;
- to keep adequate financial records;
- to take into account the interests of creditors; and
- to prevent insolvent trading.

A director or officer of a company may be liable under the Corporations Act for civil and criminal penalties or to compensate the company if the company incurs a debt while insolvent (insolvent trading). Directors and officers may also attract liability for breaching their statutory duties of reasonable care and diligence in the exercise of their powers and to act in good faith and for a proper purpose. Statutory liability may also be imposed where directors or officers improperly use their position to gain an advantage for themselves or cause detriment to the company. Other stakeholders, such as creditors and shareholders may also be implicated and made to account where a liquidator pursues them for voidable transactions (i.e. unfair loans, uncommercial transaction, unfair preferences).

Liability for breaches of directors' duties and insolvent trading is often covered by director and officer insurance policies. However, this coverage will depend on the particular terms of the policy.

In some situations directors may become personally liable for unremitted amounts of income tax or GST. The Commissioner of Taxation must give 14 days' notice to the directors setting out the details of the unpaid amount and the penalty. Directors may avoid a penalty if the company pays the unremitted amount, the company enters into an agreement relating to the unremitted amount, an administrator is appointed or the company goes into liquidation. The courts maintain a general discretion under the Corporations Act to excuse directors from liability in some circumstances if they can be shown to have acted honestly and reasonably.

16. Do restructuring or insolvency proceedings have the effect of releasing directors and other stakeholders from liability for previous actions and decisions? In which context could the liability of the directors be sought?

The terms of a scheme of arrangement and a DOCA can incorporate releases from liability for directors and other stakeholders, however, such releases will need to be specifically included in any compromise arrangement.

Schemes of arrangement may provide for a release of third parties.

In a DOCA only claims between the company and its creditors and not those of third parties can be extinguished. The terms of DOCA may also provide that certain claims are excluded, therefore allowing those excluded creditors to enforce rights which may otherwise be released or extinguished under the terms of the DOCA.

While the particular terms of a DOCA will govern the timing of any release, releases will often come into effect only after the effectuation of the DOCA.

17. Will a local court recognise foreign restructuring or insolvency proceedings over a local debtor? What is the process and test for achieving such recognition? Does recognition depend on the COMI of the debtor and/or the governing law of the debt to be compromised? Has the UNCITRAL Model Law on Cross Border Insolvency or the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments been adopted or is it under consideration in your country?

Australian Courts act cooperatively with foreign courts and insolvency practitioners and will recognise the jurisdiction of the relevant court where the 'centre of main interests' (COMI) is located. This approach follows the UNCITRAL 'Model Laws' on insolvency which were codified into Australian law through the Cross-Border Insolvency Act 2008 (Cth).

Recognition of foreign restructuring or insolvency proceedings is not automatic. To receive recognition, evidence of the existence of the foreign proceedings must be tendered. A court has power to grant both provisional relief pending the determination of a recognition application and, if a finding of recognition is made, a broad power to grant 'any appropriate relief' requested by the foreign representative. The types of relief that can be granted include:

1. staying the commencement or continuation of individual actions or individual proceedings concern the debtor's assets, rights, liabilities or obligations;
2. staying execution against the debtor's assets to the extent it has not been stayed; and
3. providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities.

Whilst conceivable that an Australian company's COMI could be recognised as being outside Australia, a foreign restructuring that purported not to comply with the Australian Corporations Act and the Australian regulatory regime (imposed by ASIC and the ASX) would unlikely be recognised.

In addition, the Foreign Judgments Act 1991 (Cth) creates a general system of registration of judgments obtained in certain foreign countries. This legislation only extends to judgments pronounced by courts in countries where, in the opinion of the Governor-General, substantial reciprocity of treatment will be accorded by that country in respect of the enforcement in that country of judgments of Australian courts.

The application to register a foreign judgment must be made by a judgment creditor to the appropriate court (usually the State or Territory Supreme Court) within six years of the date of judgment or, if an appeal has been taken, within six years of the last judgment in the appeal proceedings.

18. For EU countries only: Have there been any challenges to the recognition of English proceedings in your jurisdiction following the Brexit implementation date? If yes, please provide details.

N/A

19. Can debtors incorporated elsewhere enter into restructuring or insolvency proceedings in the jurisdiction? What are the eligibility requirements? Are there any restrictions? Which country does your jurisdiction have the most cross-border problems with?

It is possible for a foreign company to have its affairs in Australia wound up in liquidation if:

- it is unable to pay its debts, has been dissolved or deregistered, has ceased to carry on business in Australia or has a place of business in Australia only for the purpose of winding up its affairs;
- if the Court is of the opinion that it is just and equitable that the foreign company should be wound up; and
- ASIC has reported that in its opinion the foreign company cannot pay its debts and should be wounder up or it is in the interest of the public, of the members, or of the creditors that it be wound up.

The party applying to wind up a foreign company's affairs in Australia must have standing to bring such an application, which is determined by reference to the general standing provisions in the Act. Ordinarily, a company itself and contributories have standing to bring such applications.

Putting aside any orders made in cross-border applications (see our comments above), the Act does not provide for a foreign company to be able to appoint voluntary administrators to its Australian operations.

We are not aware of any foreign corporations having initiated a scheme of arrangement.

20. How are groups of companies treated on the restructuring or insolvency of one or more members of that group? Is there scope for cooperation between office holders? For EU countries only: Have there been any changes in the consideration granted to groups of companies following the transposition of Directive 2019/1023?

In insolvency proceedings involving corporate groups, a consolidated group is not considered as a single entity. Where companies operate as a consolidated group, the starting legal position is that the 'separate legal personality' principle prevents creditors of an insolvent company from gaining access to the funds of other companies for payment of their debts. Having said that, wholly-owned subsidiaries in large corporate groups often enter into a deed of cross guarantee to afford themselves the benefit of consolidated financial reporting. That deed commits the companies a party to it to pay the liabilities of all the other companies party to it in a liquidation, until such time as the deed is revoked.

The Corporations Act does provide that a holding company will be liable for the debts of its insolvent subsidiaries in certain circumstances. These provisions enable the subsidiary's liquidator to recover amounts from the parent company equal to the amount of the new debt incurred by the subsidiary after the subsidiary becomes insolvent, but only where the parent company failed to prevent the subsidiary from incurring the debts and where there were reasonable grounds to suspect that the subsidiary was cash flow insolvent.

The corporate veil may also be lifted in circumstances where an insolvent subsidiary is deemed to be acting as a mere agent, conduit or partner of its parent company. However, Australian courts have displayed some reluctance to lifting the corporate veil in these circumstances. Pooling of group funds may occur in limited circumstances, as prescribed by Division 8 and Part 5.6 of the Corporations Act, being section 571 to 579L. Generally, those circumstances are where there is a substantial joint business operation between members of the same corporate group and external parties; such members of the group are jointly liable to creditors. The liquidator of the corporate group entity being wound up makes what is called a pooling determination, after which separate meetings of the unsecured creditors of each company must be called to approve or reject the determination. The court may vary or terminate any approved pooling determination. A liquidator may also apply to court seeking an order that a group of companies be treated as a pooled group.

Finally, in group insolvencies, office holders tend to be appointed from the same firm. If material conflicts arise, special purpose officeholders tend to be appointed.

21. Is your country considering adoption of the UNCITRAL Model Law on Enterprise Group Insolvency?

As at the date of this publication, the Australian Government has not publicly made its position on the UNCITRAL Model Law on Enterprise Group Insolvency known.

22. Are there any proposed or upcoming changes to the restructuring / insolvency regime in your country?

In recent years, there has been significant development to Australia's insolvency landscape. The reforms discussed above, being the simplified liquidation process and small business restructuring process took effect on 1 January 2021. These permanent processes were introduced by the Australian Government in response to the COVID-19 pandemic and a call from the industry to provide better opportunities for small businesses to restructure their affairs or enter liquidation, without the costs and time which often accompany voluntary administration and liquidation.

On 28 September 2022, the Federal Government commenced an inquiry into the effectiveness of Australia's corporate insolvency laws in protecting and maximising value for the benefit of all interest parties and the economy following calls from industry bodies and stakeholders for a wide-scale and comprehensive review. The inquiry will involve a broad scope review into the operation of the existing insolvency legislation, recent and emerging trends, management of financial distress including by access to corporate turnaround capabilities and potential areas for reform (including unfair preferences, corporate trustees, safe harbour and insolvent trading) among other areas of interest.

It remains to be seen what recommendations will come out of this review and stakeholders continue to await the release of the Federal Government's findings which at the time of writing is scheduled for 12 July 2023.

23. Is your jurisdiction debtor or creditor friendly and was it always the case?

Australia is widely considered to emphasise the rights of creditors over debtors and as such is recognised as a creditor-friendly jurisdiction. Whilst there are some limitations on the options that might otherwise be available to distressed companies and some inflexibility in certain of the tools available to insolvency practitioners, Australia's insolvency regime is, for the most part, primarily focused towards protecting the rights and interests of creditors over the interests of debtors. For example, Australia's voluntary administration regime is controlled by creditors to the exclusion of management and members and its purpose is designed to maximise creditor returns. Further, unlike the United Kingdom for instance, receivership is alive and well in Australia.

Creditors are active participants in all insolvency processes in Australia. They can enforce their rights in each process and, whilst there are some timing limitations placed on their enforcement rights in a voluntary administration scenario, enforcement rights over secured assets are otherwise unfettered.

Secured creditors and employees enjoy a statutory priority in a distribution of assets and, in some circumstances, unsecured creditors can also place themselves in a position of protection. Unlike secured creditors, unsecured creditors are given no legal right to priority, yet due to a particular relationship that may exist with a debtor (for example, as a supplier of essential materials), they can exercise that power to obtain payment and ensure future payments as a practical necessity to maximise value and keep the debtor business running.

24. Do sociopolitical factors give additional influence to certain stakeholders in restructurings or insolvencies in the jurisdiction (e.g. pressure around employees or pensions)? What role does the State play in relation to a distressed business (e.g. availability of state support)?

There is very little state involvement or government intervention for distressed businesses in Australia. However, there are certain circumstances where the government has stepped in to guarantee some financial support in formal insolvency proceedings, in particular, in relation to employee entitlements. Whilst employee entitlements (including wages, superannuation, leave entitlements and redundancy payments) are given statutory priority over the payment of other unsecured debts in a distribution of assets, it is sometimes not possible for those debts to be met out of the recoverable assets of the company in a timely manner or indeed, at all.

Pursuant to the Federal Government's Fair Entitlement Guarantee (FEG), when a company is placed into liquidation leaving employee entitlements unpaid, the Federal government, through FEG, can make payment to employees of certain levels of unpaid entitlements. The government then becomes the creditor and is afforded the same priority in the distribution as the employee claims it paid. Importantly, the position of directors and management is different, and the priority afforded to them is capped substantially.

25. What are the greatest barriers to efficient and effective restructurings and insolvencies in the jurisdiction? Are there any proposals for reform to counter any such barriers?

Commentators of the Australian insolvency regime often note that the greatest barriers to efficient and effective restructuring and insolvencies in Australia include:

- The prohibition on directors from incurring a debt where the company is (there are reasonable grounds to suspect the company is) insolvent, as it shifts the focus of company directors from trying to manage business distress to managing their own risk and exposure to personal liability; and
- The statutory duties on receivers and liquidators in relation to administering a 'prepack sale', as the consequences that may flow from implementing such a transaction (including personal liability) renders them unattractive.

However, this landscape has changed somewhat in recent years, particularly in relation to the introduction of the automatic stay provisions for *ipso facto* clauses and the safe harbor provisions to deal with Australia's stringent the insolvent trading regime. In addition, recent legislative changes have looked to simplify and streamline insolvency laws so that viable businesses that do encounter economic challenges have the opportunity to restructure and continue trading.

Safe harbor

The concept of a safe harbor has been introduced to the Corporations Act via a new section 588GA which provides that section 588G(2), being the provision which makes directors personally liable for insolvent trading, will not apply if, after starting to suspect the company is, or may become, insolvent, the director takes steps to develop one or more courses of action that is "*reasonably likely to lead to a better outcome for the company*" than the immediate appointment of an insolvency practitioner. There are a number of criteria that will be used to assess whether the test has been satisfied so as to enliven the protection, including the engagement of appropriately qualified advisors to provide advice on the restructuring plan. The Explanatory Memorandum accompanying the legislation states that "reasonably likely" requires that there is a chance of achieving a better outcome that is not "fanciful or remote", but is "fair", "sufficient" or "worth noting".

The safe harbor rule does not provide protection in respect of all debts and only covers debts that are incurred:

- in connection with the relevant course of action being pursued; and
- during the period commencing at the time the course of action is being developed ending at the earliest of a "reasonable period" following the course of action not being pursued, when the director ceases to take such course of action, when the course of action ceases to be 'reasonably likely' to lead to a better outcome or following the appointment of an insolvency practitioner.

Care should be taken when relying on the safe harbor principle as it will not operate to automatically exempt a director from exposure to personal liability; rather it will be relevant to a director seeking to defend an insolvent trading claim.

To date there has been no case law providing judicial interpretation of s588GA as a defence to insolvent trading, including how the safe harbor provisions should be applied.

Ipso facto clauses
The legislative reform introducing the automatic provisions into Australian law was seen as a positive development in the Australia's restructuring and insolvency landscape. Ipso facto provisions are seen to potentially limit a company's ability to successfully restructure and recover from financial hardship. Together with the operation of the statutory moratoriums in administration and liquidation, the relatively recent reforms to the application of ipso facto clauses will, it is hoped, allow companies to continue to trade with exiting contractual arrangement remaining in place, therefore preserving value and facilitating restructures.

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