The Restructuring Review

Fifteenth Edition

Editor
Peter K Newman

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THE RESTRUCTURING REVIEW

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PREFACE

I am very pleased to present this 15th edition of *The Restructuring Review*. Our intention is to help general counsel, government agencies and private practice lawyers, as well as other professionals, investors and market participants, to understand the prevailing conditions in the global restructuring market in 2021 and the first half of 2022. This edition seeks to highlight some of the most significant legal and commercial developments and trends during this period.

Two common themes pervade the contributions to this edition by leading practitioners from jurisdictions around the globe. First, the historic economic downturn experienced around the world in 2020 due to the covid-19 pandemic was met with significant state intervention, which cushioned some of the immediate impact of the pandemic. Indeed, many jurisdictions witnessed a bounceback during 2021 as the world eased out of the covid-19 pandemic. Widespread access to covid-19 vaccines allowed many countries to ease or lift entirely the lockdowns and travel restrictions that had been imposed in 2020. The opening of economies and continuation of government support measures allowed for rapid growth during this time. But the upward trajectory seems to have been short-lived, as a number of geopolitical and other factors have already started to slow growth and bring uncertainty to the next phase of post-pandemic life. The second theme is the continued development of restructuring tools to ameliorate and resolve insolvency and financial distress, with numerous jurisdictions introducing additional legislative reforms to facilitate restructurings or even beginning to 'road-test' tools introduced in recent years.

Following the initial onset of the pandemic in 2020, many jurisdictions witnessed only limited restructuring and insolvency activity throughout 2021. Temporary support measures implemented by governments to provide financial support and breathing space for companies to recover from the pandemic were successful in this regard. These measures seem to have offset (at least temporarily) much of the damage wrought by the pandemic for businesses, although most government support programmes have ended or are in the process of being phased out, and economies around the globe now face other challenges to economic recovery. These challenges include massive disruptions in global supply chains and historic levels of inflation in many jurisdictions. In addition, the war in Ukraine, which commenced with the Russian invasion in February 2022 and continues at the time of writing, has ushered in soaring energy costs, has exacerbated supply chain issues, and has been met with punishing economic sanctions from the EU, UK and US. An increased focus on environmental, social and governance concerns and metrics is also leading to changes in the corporate and investment landscape – changes to which businesses must adapt. Although 2021 was a record-breaking year for mergers and acquisitions deals activity, this began to slow in the first half of 2022. Companies are facing uncertain times on many fronts.

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Although levels of insolvency and restructuring activity have remained suppressed, many jurisdictions have in recent years put in place new or updated laws, rules and practices relating to business restructuring and insolvency, both in reaction to the covid-19 pandemic but also as part of a broader trend of reform. As you will see in the coming chapters, many of these new laws have already been tested over the past year and have helped businesses to restructure in an exceptionally challenging period. This continued development means that corporate debtors and their advisers will have increasingly robust toolkits to deal with financial distress and insolvency arising in the turbulent post-pandemic environment.

I hope that this edition of *The Restructuring Review* will continueedia to serve as a useful guide at a crucial moment in the evolution of restructuring and insolvency law and practice internationally. I would like to extend my gratitude to all the contributors for the support and cooperation they have provided in the preparation of this work, and to our publishers, without whom it would not have been possible.

Peter K Newman
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Chapter 1

AUSTRALIA

Peter Bowden and Peter Hession[1]

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

Despite facing a seemingly dire combination of headwinds, the Australian economy proved remarkably resilient in 2021. The stringent quarantine policies of the Australian federal and state governments in response to the covid-19 pandemic continued in the second half of 2021 as the economic stimulus provided by the federal government throughout 2020 was wound back. Despite this, there was not a significant increase in the number of insolvency appointments in Australia, and consumer sentiment remained relatively strong at the close of 2021.[2]

The strength of the Australian economy is being tested by further challenges in the first half of 2022 as the effects of global inflation and supply chain disruptions caused by the conflict in Ukraine compound with the significant debt incurred by the federal and state governments during the covid-19 pandemic. In May 2022, the Reserve Bank of Australia delivered an increase to the cash rate of 0.25 per cent – the first increase in over a decade.[3] Insolvency practitioners in Australia are now watching closely whether these macroeconomic factors will lead to an increase in insolvency appointments, especially for struggling companies that have managed to 'tread water' throughout the covid-19 pandemic.

As with previous years, the authors anticipate that schemes of arrangement will continue to be a popular mechanism for effecting larger and more complex restructuring. Although formal appointments (i.e., of liquidators and administrators) might be increasingly less common, they are often used as leverage against debtors in restructuring negotiations. Voluntary administration and deeds of company arrangement (DOCA) continue to be used frequently in debt-for-equity swaps, particularly at the small to mid-market level. The main driver for restructurings of this type is the power given to deed administrators to compulsorily transfer shares with court approval pursuant to Section 444GA of the Corporations Act 2001 (Cth) (the Act) (if the shares have no economic value).

The insolvency and restructuring market will continue to develop and be shaped by the post-pandemic Australian and global economy. The authors anticipate that the sustained

1 Peter Bowden is a partner and Peter Hession is a lawyer at Gilbert + Tobin.

2 Australian Securities and Investments Commission, 'Insolvency Statistics', https://download.asic.gov.au/media/hktlwqno/asic-insolvency-statistics-series-1a-published-2-may-2022.pdf (Accessed 29 May 2022); Westpac Banking Corporation, 'Consumer optimism holds in positive territory' (bulletin, 15 December 2021), https://www.westpac.com.au/content/dam/public/wbc/documents/pdf/aw/economics-research/er20211215BullConsumerSentiment.pdf (Accessed 29 May 2022).

3 Reserve Bank of Australia, 'Statement by Philip Lowe, Governor: Monetary Policy Decision' (media release, 3 May 2022).

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consequences of the pandemic, rapid inflation, and disruptions caused by the conflict in Ukraine will define the coming years and will provide novel challenges for all insolvency and restructuring practitioners in Australia.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

i Formal procedures

The formal procedures available under Australian law are:

a receivership (both private and court appointed);
b voluntary administration;
c DOCA;
d debt restructuring for small and medium-sized enterprises (SMEs) (i.e., companies with liabilities of under A$1 million);
e provisional liquidation;
f liquidation (both solvent (members' voluntary liquidation) and insolvent, as well as the new, 'simplified' process for SMEs with liabilities of under A$1 million); and
g court-sanctioned schemes of arrangement between creditors and the company.

For receivership, voluntary administration, DOCA, liquidation and the SME restructuring process, the individual appointed must be an independent registered liquidator, except in the case of a members' voluntary liquidation.

ii Receivership

The main role of a receiver 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. One or more individuals may be appointed as a receiver or a receiver and manager of the assets. Despite some historical differences, in practice, if the security is over all the assets of the grantor, it is difficult to distinguish between the two roles, and most security interests will allow for the appointment of either.[4] Receivers are not under an active obligation to unsecured creditors on appointment, although they do have a range of duties under statute and common law. Despite being appointed by secured creditors, receivers are 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).

There are two ways in which a receiver may be appointed to a debtor company. The most common manner is pursuant to the relevant security document granted in favour of the secured creditor when a company has defaulted and the security has become enforceable. Far less common in practice is the appointment of a receiver pursuant to an application made to the court. Court appointments normally take place to preserve the assets of the company

4 For the purposes of this chapter, the terms 'receiver' and 'receiver and manager' will be used interchangeably.

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in circumstances in which it might not be possible to otherwise trigger a formal insolvency process. Given the infrequency of court-appointed receivers, however, this chapter focuses on privately appointed receivers.

For a privately appointed receiver, the security document itself will entitle a secured party to appoint a receiver and will also outline the powers available (supplemented by the statutory powers set out in Section 420 of the Act). Generally, a receiver has wide-ranging powers, including the ability to operate the business and to borrow against or sell the secured assets. The appointment is normally effected contractually through a deed of appointment and indemnity. The underlying security document will normally provide that the receiver will be the agent of the debtor company, not the appointing secured party (although this agency relationship will change if a liquidator is appointed to the debtor company, whereby the receiver will become the agent of the secured party).

The Act imposes an automatic stay on the ability of contractual counterparties to enforce *ipso facto* provisions that allow the contract to be terminated or altered by reason of an appointment of a receiver to all (or substantially the whole) of the company's property.[5]

On appointment, a receiver will immediately take possession of the assets subject to the security. Once in control of the assets, the receiver may elect to run the business (if relevant) if they are appointed to oversee all or substantially all of the assets of a company. Alternatively, and depending on financial circumstances, a receiver may engage in a sale process immediately. While engaging in a sale process, a receiver is under a statutory obligation to obtain market value or, in the absence of a market, the best price reasonably obtainable in the circumstances. This obligation is enshrined in Section 420A of the Act. It is this duty that has posed the most significant stumbling block to the adoption of pre-packaged restructuring processes through external administration[6] that have been seen in, for example, the UK market. This is because of the inherent concern that a pre-packaged restructure that involves a sale of any asset without testing against the market could be seen as a breach of the duty under Section 420A.[7] Once a receiver has realised the secured assets and distributed any net proceeds to the secured creditors (returning any surplus to the company or later ranking security holders), they will retire in the ordinary course.

iii Voluntary administration

The concept of voluntary administration was introduced into Australian law in 1993. Voluntary administration, unlike receivership, is entirely a creature of statute, and its purpose and practice are outlined in Part 5.3A of the Act. Voluntary administration has often been compared with the Chapter 11 process in the United States, but, unlike Chapter 11, voluntary administration is not a debtor-friendly process. In a voluntary administration, the creditors control the final outcome to the exclusion of management and members. The creditors ultimately decide on the outcome of the company, and it rarely involves returning management responsibilities to the former directors.

5 This stay does not affect contracts originally entered into prior to 1 July 2018 or (among others) certain derivatives or underwriting contracts.

6 Often referred to as a 'pre-pack', this is when a restructuring is developed by the secured lenders prior to the appointment of a receiver and is implemented immediately or very shortly after the appointment is made.

7 The regulation of pre-packs in Australia was flagged in the Productivity Commission's 'Report on Business Set-up, Transfer and Closure', which was released to the public on 7 December 2015, although no further steps have been taken.

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The purpose of Part 5.3A is to either:

a maximise the chances of the company, or as much as possible of its business, to continue in existence; or

b if the first option is not possible, achieve a better return for the company's creditors and members than would result from an immediate winding up of the company.[8]

There are three ways an administrator may be appointed under the Act:

a by resolution of the board of directors that, in their opinion, the company is, or is likely to become, insolvent;

b a liquidator or provisional liquidator of a company may, in writing, appoint an administrator of the company if they are of the opinion that the company is, or is likely to become, insolvent;[9] and

c a secured creditor who is entitled to enforce security over the whole or substantially the whole of a company's property may, in writing, appoint an administrator if the security interest is over the property and is enforceable.[10]

The Act imposes an automatic stay on the ability of contractual counterparties to enforce *ipso facto* provisions that allow the contract to be terminated or altered by reason of an appointment of a voluntary administrator.[11]

An administrator has wide powers and will manage the company to the exclusion of the existing board of directors. Once an administrator is appointed, a statutory moratorium is activated, which restricts the exercise of rights by third parties under leases and security interests.[12] In respect of litigation claims, the moratorium is designed to give the administrator the opportunity to investigate the affairs of the company and either implement change or be in a position to realise value, with protection from certain claims against the company. In respect of leases, in addition to the moratorium on enforcement, an administrator can apply to court to extend the rent-free period prescribed in the Act, ranging from a week to a month, with the effect of the administrator further limiting any personal liability for rent for the relevant period.[13] Further, although the Act does not permit an administrator to dispose of property that is subject to a security interest or is owned by another party, an administrator may make such a disposition after obtaining a court order to that effect.[14]

8 Section 435A of the Act.

9 Section 436B of the Act.

10 Section 436C of the Act.

11 This stay does not affect contracts originally entered into prior to 1 July 2018 or (among others) certain derivatives or underwriting contracts.

12 There is, however, an exception to the moratorium on the exercise of rights under security interests in the case of a secured creditor that has security over all or predominantly the whole of the assets of the company and such rights are exercised within the decision period (being 13 business days after the appointment of the administrator).

13 See, e.g., *Strawbridge (Administrator), in the matter of CBCH Group Pty Ltd (Administrators Appointed) (No. 2)* [2020] FCA 555 and *Strawbridge, in the matter of Virgin Australia Holdings Ltd (Administrators Appointed)* [2020] FCA 571.

14 For example, the administrators of the Sargon Group obtained a Section 442C order and were therefore able to complete a sale of its business and assets despite various unsecured creditors claiming ownership or security rights, or both, over the subject of the sale. See *McCallum, in the Matter of Re Holdco Pty Ltd (Administrators Appointed)* [2020] FCA 666.

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There are two meetings over the course of an administration that are critical to the outcome of the administration. Once appointed, an administrator must convene the first meeting of creditors within eight business days. At this meeting, the identity of the voluntary administrator is confirmed, the remuneration of the administrator is approved and a committee of creditors may be established. The second creditors' meeting is normally convened 20 business days after the commencement of the administration (referred to as the convening period). The convening period may be extended by application to the court, which is likely to be granted if the administration is particularly large or complex. At the second creditors' meeting, the administrator provides a report on the affairs of the company to the creditors and outlines the administrator's views as to the best option available to maximise returns. There are three possible outcomes that can be put to the meeting: entering into a DOCA with creditors (discussed further below), winding up the company, or terminating the administration and returning control to the directors.[15]

The administration will end according to the outcome of the second meeting (i.e., by progressing to liquidation, entry into a DOCA or returning the business to the directors to operate as a going concern (although this is rare)). When the voluntary administration terminates, a secured creditor that was prevented from enforcing a security interest due to the statutory moratorium becomes entitled to commence steps to enforce that security interest unless the termination is due to the implementation of a DOCA approved by that secured creditor.

iv Deed of company arrangement

A DOCA is effectively a contract or compromise between the company and its creditors. Although closely related to voluntary administration (and, indeed, the administrators often become the deed administrators), it should, in fact, be viewed as a distinct regime, as the rights and obligations of the creditors and company differ from those under a voluntary administration.

The terms of a DOCA may provide for, inter alia, a moratorium of debt repayments, a reduction in outstanding debt, and the forgiveness of all or a portion of the outstanding debt. It may also involve the issuance of shares and can be used as a way to achieve a debt-for-equity swap through the transfer of shares either by consent or with leave of the court (as noted above).[16] This mechanism has been utilised numerous times to effect debt-for-equity restructures, including, for example, for Mirabela, Nexus Energy, Channel 10 and Paladin.

Entering into a DOCA requires the approval of a bare majority of creditors both by value and by number voting at the second creditors' meeting. In order to resolve a voting deadlock – for example, when there is a majority in number but not in value, or vice versa – under Rule 75-115(3) of the Insolvency Practice Rules (Corporations) 2016 (Cth), an administrator may exercise a casting vote to pass, or not pass, a resolution. The right to exercise a casting vote is not mandatory. A DOCA will bind the company, its shareholders, its directors and its unsecured creditors. Secured creditors can, but do not need to, vote at the second creditors' meetings, and typically only those who voted in favour of the DOCA at the

15 Section 439C of the Act.

16 Section 444GA of the Act.

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second creditors' meeting are bound by its terms.[17] Unlike a scheme of arrangement, court approval is not usually required for a DOCA to be implemented, provided that it is approved by the requisite majority of creditors.

Upon execution of a DOCA, the voluntary administration terminates. The outcome of a DOCA is generally dictated by the terms of the DOCA itself. Typically, however, once a DOCA has achieved its stated aims, it will terminate. If a DOCA does not achieve its objectives or is challenged by creditors, it may be terminated by the court.

A DOCA may also be utilised if the convening period has not been extended and the administrators require more time to sell the business or its assets than provided for in the legislation; for example, an administrator might wish to postpone a sale until market conditions improve to generate a better return for creditors and might use a DOCA to push out the timeline. Such arrangements are known as holding DOCAs and do not generally contain any specific provisions as to the future of the company or, on their face, any benefit for creditors. Their primary purpose is to provide more time for forming and agreeing a restructuring proposal. Holding DOCAs also confer other benefits, including an extension of the moratorium on all creditors bound by the DOCA, time and cost savings on applying for an extension of the convening period, and greater flexibility for the administrator. Although the use of holding DOCAs has at times been controversial, the court has generally supported their use as a means of facilitating a better result for creditors.

v SME restructuring

In 2021, an entirely new debt restructuring framework was added to the Act that enables a company with liabilities of up to A$1 million to appoint a small business restructuring practitioner (SBRP) if the directors of the company believe that it is, or is likely to become, insolvent.[18]

The SBRP's role is to provide advice to the company, assist the company in preparing a restructuring plan (see below) and make a declaration to creditors regarding the restructuring plan.

In addition, the SBRP may dispose of company property to make payments to creditors in accordance with the restructuring plan, though this right does not extend to any property subject to a security interest or property that is used by, or in possession of, the company but where someone else is the owner or lessor.

A key distinction between this restructuring process and other restructuring processes currently in place (i.e., voluntary administration) is that, to an extent, the company's directors retain some control of the company: the directors can enter into a transaction or dealing affecting the property of the company if doing so is in the 'ordinary course' of the company's

17 There have been two cases challenging the validity of the widely held view that secured creditors are not bound by a DOCA unless they vote in favour of it. In *Australian Gypsum Industries Pty Ltd v. Dalesun Holdings Pty Ltd* [2015] WASCA 95 and *Re Bluenergy Group Limited* [2015] NSWSC 977, it was held that a DOCA can (if so expressed) have the effect of extinguishing the debt of a secured creditor that did not vote in favour of the DOCA pursuant to Section 444D(1) of the Act. However, this extinguishment is subject to the preservation of the secured creditor's ability (by virtue of Section 444D(2) of the Act) to realise or deal with its security in respect of its proprietary interest in the secured property and to the extent that its debt was provable and secured assets were available at the date that debt would otherwise be released under the DOCA, without requiring that that debt be preserved into the future or for other purposes.

18 The new provisions form the new Part 5.3B of the Act.

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business. In this sense, the new restructuring process provides for a debtor-in-possession model that bears some similarity to the Chapter 11 process in the United States or Part 26A of the UK Companies Act 2006.

When a company is under the restructuring process, property rights cannot be exercised by third parties in relation to property of the company used, occupied or in the possession of the company (without consent of the SBRP or leave of the court).

A secured party that has security over the whole or substantially the whole of the company's property will be able to enforce during a 13-business-day decision period.

Despite its recent enactment, there has already been judicial consideration as to the operation of the SBRP process in recent decisions of the Supreme Court of Victoria and the Supreme Court of New South Wales.[19] These decisions suggest that the new SME restructuring process is being utilised by Australian small businesses.

vi Provisional liquidation

A provisional liquidator may be appointed by the court in a number of circumstances. The most commonly used grounds include:

a insolvency;

b when an irreconcilable dispute at a board or shareholder level has arisen that affects the management of the company; and

c if the court is of the opinion that it is just and equitable to do so.

A creditor, a shareholder or the company itself has standing to apply for the appointment of a provisional liquidator, although in most cases a creditor will be the applicant. A provisional liquidator will normally be appointed by the court only if there is a risk to the assets of a company prior to a company formally entering liquidation. As such, a provisional liquidator is normally given only very limited powers (e.g., the power to take possession of the assets), and the main role of the provisional liquidator is to preserve the status quo.

A court determines the outcome of a provisional liquidation. It may order either that the company move to a winding up, with the appointment of a liquidator, or that the appointment of the provisional liquidator is terminated.

vii Liquidation

Liquidation is the process whereby the affairs of a company are wound up and its business and assets are realised for value. A company may be wound up voluntarily by its members if solvent or, alternatively, if it is insolvent, by its creditors or compulsorily by order of the court.

viii Voluntary liquidation (members and creditors)

The members of a solvent company may resolve that a company be wound up if the board of directors is able to give a 12-month forecast of solvency (i.e., an ability to meet all its debts within the following 12 months). If not, or if the company is later found to be insolvent, the creditors take control of the process. Creditors may resolve at a meeting of creditors to

19 *Re Dessco Pty Ltd* [2021] VSC 94 and *Re DST Project Management and Construction Pty Ltd* (ACN 623 076 031) [2021] VSC 108; *Re ENA Development Pty Ltd* [2022] NSWSC 54.

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wind up the company and appoint a liquidator. This may take place at the second meeting of creditors during an administration. If the requisite approvals are obtained in either a members' voluntary winding up or a creditors' voluntary winding up, a liquidator is appointed.

ix Compulsory liquidation

The most common ground for a winding-up application made to the court is insolvency, usually indicated by the company's failure to comply with a statutory demand for payment of a debt. Following a successful application by a creditor, a court will order the appointment of a liquidator.

In both a voluntary and compulsory winding up, the liquidator will have wide-ranging powers, including the ability to challenge voidable transactions and take control of assets. Generally, a liquidator will not run the business as a going concern, unless it will ultimately result in a greater return to stakeholders. During the course of the winding up, the liquidator will realise the assets of the company for the benefit of its creditors and, to the extent of any surplus, its members. At the end of a winding up, the company will be deregistered and cease to exist as a corporate entity.

x Simplified liquidation

In 2021, a new and 'simplified' liquidation framework was added to the Act. The simplified liquidation process allows the liquidator to avoid the requirement to prepare a report to creditors under Section 533 of the Act, which may otherwise be required if a person involved with the company might have committed an offence or breached a duty, or if the company is unable to pay its unsecured creditors more than 50 cents on the dollar.

With regard to voidable transactions, the simplified liquidation process specifies that:

a for transactions that occurred more than three months before the relation-back day, an unfair preference is voidable only if a creditor under the transaction was a related entity of the company; and

b for transactions that occurred in the three months before the relation-back day (or after that day but before winding up commenced), an unfair preference is voidable only if a creditor under the transaction was a related entity of the company and the value of the transaction was more than A$30,000.

A company is eligible for simplified liquidation if (among other things):

a it has resolved to be wound up;

b the directors give to the liquidator a declaration stating their belief that the company meets the eligibility criteria; and

c the company's total liabilities are under A$1 million.

A company may enter into the simplified liquidation process when the company's directors give the liquidator of a company a declaration to the effect that the company is eligible within five business days of the liquidator being appointed.

The liquidator may adopt the simplified liquidation process if the liquidator reasonably believes that the company satisfies the eligibility criteria, but it must not adopt the process if (relevantly):

a more than 20 business days have passed since the day on which the triggering event that brought the company into liquidation occurred; or

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b at least 25 per cent in value of the creditors' request that the liquidator not follow the simplified liquidation process in relation to the company.

The liquidator must not continue to engage with the simplified liquidation process if at any point the criteria (including the liability threshold) are no longer met, or if the liquidator has reasonable grounds to believe that the company or a director of the company has engaged in fraud or dishonest conduct that is likely to have a material adverse effect on the interests of creditors.

To date, there has been no detailed judicial consideration of the simplified liquidation process.

xi Scheme of arrangement

A scheme of arrangement is a restructuring tool that sits outside formal insolvency; that is, the company may become subject to a scheme of arrangement whether it is solvent or insolvent.

A scheme of arrangement is a proposal put forward (with input from management, the company or its creditors) to restructure the company in a manner that includes a compromise of rights by any or all stakeholders. The process is overseen by the courts and requires approval by all classes of creditors. In recent times, schemes of arrangement have become more common, in particular for complex restructurings involving debt-for-equity swaps, in circumstances in which the number of creditors within creditor stakeholder groups may make a contractual and consensual restructure difficult.

A scheme of arrangement must be approved by at least 50 per cent in number and 75 per cent in value of creditors in each class of creditors. It must also be approved by the court to become effective. The test for identifying classes of creditors for the purposes of a scheme is that a class should include those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a common interest. Despite this long-standing proposition, recent case law has suggested that courts might be willing to stretch the boundaries of what would ordinarily be considered to be the composition of a class and, in doing so, might agree to put creditors in classes even when such creditors within the class appear to have objectively distinct interests.[20] Thus, the basis upon which parties have previously grouped creditors into classes is now a less certain benchmark for class composition in the future.

The Act imposes an automatic stay on the ability of contractual counterparties to enforce *ipso facto* provisions that allow the contract to be terminated or altered by reason of a company proposing a scheme of arrangement.[21]

The outcome of a scheme of arrangement is dependent on the terms of the arrangement or compromise agreed with the creditors. Most commonly, a company is returned to its normal state upon implementation as a going concern but with the relevant compromises having taken effect.

The scheme of arrangement process does, however, have a number of limiting factors associated with it, including cost, complexity of arrangements, uncertainty of implementation, timing issues (because it must be approved by the court, it is subject to the court timetable and cannot be expedited) and the overriding issue of court approval (a court may exercise its

20 See *First Pacific Advisors LLC v. Boart Longyear Ltd* [2017] NSWCA 116; (2017) 320 FLR 78.

21 This stay does not affect contracts originally entered into prior to 1 July 2018 or (among others) certain derivatives or underwriting contracts.

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discretion to not approve a scheme of arrangement, despite a successful vote, if it is of the view that the scheme of arrangement is not equitable). These factors explain why schemes of arrangement tend to be undertaken only in large corporate restructurings and in scenarios in which timing is not fatal to a restructuring.

xii Rights of enforcement

Secured creditors may enforce their rights in every form of external administration. During a voluntary administration, a secured creditor with security over the whole or substantially the whole of the company's property may enforce its security, provided that it does so within 13 business days of receiving notice of appointment of the voluntary administration, or with leave of the court or consent of the administrator. In addition, if a secured creditor takes steps to enforce its security before the voluntary administration commences, it may continue to enforce its security in the ordinary course of business.

If a company pursues a DOCA, a secured creditor who did not vote in favour of such a proposal will have the ability to enforce its security interests once the DOCA becomes effective.[22] If a voluntary administration otherwise terminates, a secured creditor may also commence steps to enforce its security interest upon termination.

xiii Directors' duties in distressed situations

Case law in Australia, particularly *Westpac Banking Corporation v. Bell Group Ltd (in liq) (No. 3) (Bell)*,[23] has reaffirmed the position that a director must be increasingly mindful of the interests of creditors as a company approaches insolvency. A director's duty to creditors arises by operation of the well-established fiduciary duty owed by a director to the company more generally. When a company is solvent, the interests of the shareholders are paramount, and, conversely, when a company is near insolvency or of doubtful solvency, the interests of the creditors become increasingly relevant. It is important to emphasise that the duty to take into account creditors' interests is owed to the company, not to the individual creditors per se.[24]

The extent of this duty continues to be an evolving area of the law. It is, however, now well established under Australian law that directors must at the very least have regard to the interests of creditors when a company is in financial distress or insolvent. As noted by Lee AJA in *Bell*:

> *At the point of insolvency, or the pending manifestation of insolvency, the duty to act in the best interests of each company was of central importance for the companies to comply with statutory obligations and the obligation of the companies not [to] prejudice the interests of creditors.*[25]

Further, it has been suggested that when the solvency of a company is doubtful or marginal, it would be a misfeasance to enter into a transaction that the directors ought to know is likely to lessen the company's value if to do so will cause a loss to creditors. Directors should not, for instance, allow the company to enter into commitments that it clearly will not be in a position to meet or that might prejudice the interests of creditors generally.

22 ibid.
23 [2012] WASCA 157; (2012) 270 FLR 1.
24 *Spies v. the Queen* [2000] HCA 43.
25 *Westpac Banking Corporation v. The Bell Group Limited (In Liq) (No. 3)* [2012] WASCA 157; (2017) 270 FLR 1 at [920].

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xiv Clawback

Under Australian law, transactions will be vulnerable to challenge only when a company enters liquidation. Only a liquidator has the ability to bring an application to the court to declare certain transactions void. In the report to creditors at the second creditors' meeting, a voluntary administrator may identify potentially voidable transactions, but they are not empowered to pursue a claim in respect of such a transaction. Any such claim must be brought by a subsequently appointed liquidator.

There are several types of transactions that can be found to be voidable, including:

a unreasonable director-related transactions;
b unfair preferences;
c uncommercial transactions;
d transactions entered into to defeat, delay, or interfere with the rights of any or all creditors on a winding up; and
e unfair loans.

Transactions in categories (b), (c) and (d) will be voidable only when they are also found to be insolvent transactions (i.e., transactions that occurred while the company was cash flow insolvent) or contributed to the company becoming cash flow insolvent. Each type of voidable transaction has a different criterion and must have occurred during certain time periods in the lead-up to administration or liquidation. The relevant time period is generally longer if the transaction involves a related party.

Upon the finding of a voidable transaction, a court may make a number of orders, including directions that the offending person pay an amount equal to some or all of the impugned transaction, directions that a person transfer the property back to the company or directions that an individual pay an amount equal to the benefit received.

xv Insolvent trading

Directors may be held liable for new debts incurred by a company trading while cash flow insolvent. This potential liability does not extend to debts incurred prior to the date a company became cash flow insolvent, or recurring payments that become due after that date under the terms of pre-existing arrangements such as rent or interest (i.e., when the liability to pay such amounts already existed at the time of insolvency).

In terms of a director's personal liability, a court may make an order requiring the director to compensate the company for loss arising out of the insolvent trading, prevent a director from managing a corporation for a period of time and, in rare circumstances in which the failure to prevent insolvent trading is ruled as a result of dishonesty, levy a fine of A$200,000 against the offending director.

The appointment of a voluntary administrator or a liquidator by the directors protects a director from any claim that they allowed the company to trade while insolvent in respect of any debts incurred after the date of such an appointment.

With effect from September 2017, the new Section 588GA of the Act provides that a director is not liable for debts incurred by a company while it is insolvent if, 'at a particular time after the director starts to suspect the company may become or be insolvent, the director starts developing one or more courses of action that are reasonably likely to lead to a better outcome for the company' than the 'immediate appointment of an administrator or liquidator to the company'. A director who seeks to rely upon Section 588GA(1) of the Act bears the evidential burden in relation to that matter (i.e., providing evidence that suggests

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a reasonable possibility that the matter exists or does not). This safe harbour protection does not apply in certain circumstances, including when, at the time the debt is incurred, the company has failed to pay employee entitlements or comply with certain reporting or taxation requirements.

In order to assist directors in seeking to ensure they obtain the benefit of the safe harbour protection, the Act lists some indicia for a director to regard when determining whether a course of action is reasonably likely to lead to a better outcome for the company. This includes whether the relevant director is:

a properly informing themselves of the company's financial position; or
b taking appropriate steps to:
  - prevent any misconduct by officers or employees of the company that could adversely affect the company's ability to pay all its debts;
  - ensure that the company is keeping appropriate financial records consistent with the size and nature of the company;
  - obtaining advice from an appropriately qualified entity that was given sufficient information to give appropriate advice; or
  - developing or implementing a plan for restructuring the company to improve its financial position.

To date, there has been very little case law providing judicial interpretation of Section 588GA as a defence to insolvent trading, including guidance as to how some of the important concepts and terminology associated with the safe harbour provisions should be applied.

III RECENT LEGAL DEVELOPMENTS

i Increase to threshold for statutory demands

In May 2021, the federal government introduced the Corporations Amendment (Statutory Minimum) Regulations 2021 (Cth), which permanently increased the minimum debt required to serve a statutory demand on or after 1 July 2021. As described above, the issue of a statutory demand for payment of a debt is usually the first step towards winding up a company taken by a creditor, because the failure to pay a statutory demand raises a rebuttable presumption of insolvency. A creditor was previously prohibited from issuing a statutory demand for a debt lower than A$2,000. This threshold was increased from 1 July 2021 to A$4,000. The increase to the threshold followed consultation undertaken by the government during February and March 2021 and was aimed at helping to prevent viable companies from being pushed into liquidation because of small debts.[26]

ii Anti-phoenixing regime

As part of the 2018–2019 federal budget, the federal government announced a series of reforms to combat illegal phoenix activity (i.e., transactions taking place at a time when a company is nearing insolvency that are intended to defeat creditors). As part of the wider reforms, the Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020 (Cth) amended the Act to introduce new criminal offences and civil penalty provisions for officers and advisers who fail to prevent the company from making creditor-defeating dispositions,

26 Treasury (Cth), 'Further insolvency reforms to support business dynamism' (media release, 3 May 2021).

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whereby consideration is less than the lesser of market value and the best price reasonably obtainable, and the disposition has the effect of delaying the process for the property becoming available to creditors in liquidation. The reforms also enabled the Australian Securities and Investments Commission (ASIC) to make orders, on its own initiative or upon request by liquidators, to recover company property lost through illegal phoenix activity, or require a person to pay to the company the amount that, in ASIC's opinion, fairly represents the benefits that that person has received because of the disposition.

The first decision of a court enforcing the new anti-pheonixing regime was handed down by the Supreme Court of Victoria in *Re Intellicomms Pty Ltd (in liq)* [2022] VSC 228, where it was held that the sale of a business to a related party immediately prior to the company going into liquidation was a creditor-defeating disposition under Section 588FDB of the Act. The Court noted that the transaction had 'all the hallmarks of a classic phoenix transaction', as it involved the transfer of the assets of an insolvent enterprise to an entity controlled by persons closely associated with the sole director and the subsequent placement into voluntary liquidation with no explanation given as to why it was necessary to urgently sell the business rather than leave the sale process to liquidators or appoint administrators to conduct an orderly sale for the benefit of creditors.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

i Adaman Resources

Gilbert + Tobin advised Barry Wight and Jeremy Nipps of Cor Cordis in their capacity as voluntary administrators and deed administrators of gold mining business Adaman Resources and six of its subsidiaries. Adaman Resources and six of its subsidiaries were placed into voluntary administration on 1 May 2021 after undergoing issues with ore quality, delays to capital investment projects and the effects of covid-19.

The matter was complex and involved significant litigation in the Western Australian registry of the Federal Court of Australia, which, among many other issues, involved a challenge to the validity of the administrators' appointment. The administration obtained seven favourable judgments from the Court in a span of under three months, ultimately securing orders from the Court that the administrators were justified in entering into the DOCA that was approved by creditors at the second creditors' meeting, enabling the sale of the Adaman business.

The sale was structured through a DOCA and creditors' trust allowing the continuation of the businesses and the preservation of approximately 77 jobs. The sale followed a substantive expression of interest campaign during which 18 non-binding indicative offers were received.

ii Basslink

Gilbert + Tobin currently has a major role advising a debt holder of Nexus Australia Management Pty Ltd (Administrators Appointed) (Receivers and Managers Appointed), the borrowing entity of Basslink Pty Ltd (Administrators Appointed) (Receivers and Managers Appointed), which entered into voluntary administration and receivership on 12 November 2021.

Basslink Pty Ltd and its related entities own and operate the Basslink electricity interconnector, a 370km undersea high voltage direct current electricity cable between the southern Australian states of Victoria and Tasmania. The company is ultimately owned by

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Keppel Infrastructure Trust, a Singapore-based infrastructure asset investment company. The appointment of administrators and receivers followed a long-running dispute between Basslink Pty Ltd and its only customer, Hydro Tasmania Corporation, a clean energy business owned by the state of Tasmania. The dispute arose from an interconnector outage that began in 2015 and continued in 2016.

During the administration, Hydro Tasmania terminated its services agreement with Basslink Pty Ltd. At the time of writing, the administration is ongoing, the administrators having obtained a six-month extension of the convening period from the Federal Court of Australia on 16 May 2022.

iii Probuild

In February 2022, the companies comprising the major Australian construction business Probuild Group were placed into voluntary administration after their South African parent company, Wilson Bayly Holmes-Ovcon Limited (WBHO), announced that it would discontinue further financial assistance to its Australian subsidiaries. WBHO stated that the 'hard-line approach' of the federal government to managing covid-19 had reduced demand in key sectors of the construction industry.[27]

Prior to the appointment of administrators, Probuild Group was completing several major projects across Australia. Being a highly visible developer, its administration attracted significant media attention. More recently, there has some been speculation in the Australian financial and general press that Probuild might be indicative of further forthcoming collapses in the Australian construction industry.[28]

At the time of writing, the administration is ongoing, the administrators having obtained a six-month extension of the convening period from the Federal Court of Australia on 16 March 2022.

V INTERNATIONAL

Australian courts cooperate with foreign courts and insolvency practitioners and will recognise the jurisdiction of the relevant court in which the centre of main interests is located. This approach follows the UNCITRAL Model Law on Cross-Border Insolvency, which was codified into Australian law through the Cross-Border Insolvency Act 2008 (Cth).

The CBI Act enables Australian courts to recognise foreign insolvency proceedings in Australia, and other legislation (such as the Foreign Judgments Act 1991 (Cth)) enables Australian courts to recognise foreign judgments more generally. In addition, under

27 Wilson Bayly Holmes-Ovcon Limited, 'Decision to Discontinue Financial Assistance to WBHO Australia Pty Ltd', https://www.wbho.co.za/wp-content/uploads/2022/02/DECISION-TO-DISCONTINUE-FINANCIAL-ASSISTANCE-TO-WBHO-AUSTRALIA-PTY-LTD.pdf (Accessed 22 June 2021).

28 Mark Ludlow, 'More construction companies to go under: Hutchinson Builders' (*Australian Financial Review*, 22 April 2022), https://www.afr.com/policy/economy/more-construction-companies-to-go-under-hutchinson-builders-20220422-p5afci (Accessed 25 May 2022); Sarah Danckert, ''Contagion': Experts warn 'zombie' businesses will drive collapses' (*The Sydney Morning Herald*, 23 May 2022), https://www.smh.com.au/business/the-economy/contagion-experts-warn-zombie-businesses-will-drive-collapses-20220518-p5amdw.html (Accessed 25 May 2022).

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Section 581 of the Act, Australian courts have a duty to render assistance when required by a foreign insolvency court. Further, the Act has extraterritorial application; for example, an Australian court has jurisdiction to wind up a foreign company.

In 2022, the highest court in the Australian judicial system, the High Court, considered the extent of the obligation of an insolvency practitioner to 'give possession' of an aircraft object to a lessor under the Convention on International Interests in Mobile Equipment (Cape Town Convention) and its protocol (Aircraft Protocol).[29] The Cape Town Convention and its Aircraft Protocol are given force in Australia by the International Interests in Mobile Equipment (Cape Town Convention) Act 2013 (Cth) and will prevail to the extent of any inconsistency with any Australian law. Article XI(2) of the Aircraft Protocol provides that an insolvency practitioner must give possession of an aircraft object to the lessor within 60 days of the occurrence of an 'insolvency-related event' (which includes, relevantly, the appointment of administrators under Part 5.3A of the Act). The High Court held that the obligation to give possession under Article XI(2) of the Aircraft Protocol requires the insolvency practitioner to provide the lessor with 'the opportunity to take possession'. The High Court held that an insolvency practitioner is required only 'to take whatever steps may be necessary to provide an opportunity for the exercise of the right to take possession'. In this case, the invitation by the insolvency practitioner to the lessor located in the United States to take control of the aircraft engines where they were situated in Australia was sufficient; delivery of the aircraft engines to the United States was not required. The decision of the High Court on the construction of Article XI(2) of the Aircraft Protocol is the first by an ultimate court of appeal worldwide and is likely to be of seminal importance to the global aircraft finance industry.

VI FUTURE DEVELOPMENTS

i Review of safe harbour

In the 2021–2022 federal budget, the federal government committed to commence an independent review of the insolvent trading safe harbour. The review panel engaged in consultation with industry participants in September and October 2021, with the aim of determining whether the safe harbour is 'fit for purpose in enabling company turnaround and promoting a culture of entrepreneurship and innovation'.[30] The final report was ultimately circulated on 24 March 2022. The review panel made 14 recommendations in the report, including several changes to the drafting of the safe harbour provision to increase its accessibility. Perhaps most notably, the review panel departed from its focus on the safe harbour to recommend that the federal government initiate 'a holistic in-depth review of Australia's insolvency laws'.[31] In its response circulated concurrently with the review on 24 March 2022, the government agreed to implement nine of the recommendations. The government noted the five other recommendations, including the recommendation to initiate a holistic review, and referred to the other recent reforms of Australia's insolvency laws.

29 *Wells Fargo Trust Company, National Association (As Owner Trustee) & Anor v VB Leaseco Pty Ltd (Administrators Appointed) & Ors* [2022] HCA 8.

30 Australian Federal Treasury, 'Review of the Insolvent Trading Safe Harbour' (Consultation Paper, 2021).

31 Genevieve Sexton, Leanne Chesser and Stephen Parberry, 'Review of the Insolvent Trading Safe Harbour' (Report, 23 November 2021).

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ii Consultation regarding treatment of trusts and schemes of arrangement

The federal government also committed in the 2021–2022 federal budget to undertake a consultation on the options to improve the operation of schemes of arrangements to support businesses, as well as clarifying the treatment of trusts under insolvency law. Consultation with insolvency experts and industry representative groups took place between 2 August 2021 and 10 September 2021 on schemes of arrangement, and between 15 October 2021 and 10 December 2021 on the treatment of trusts. At the time of writing, there have been no announcements from the government regarding the outcome of the consultations.

iii Unfair preference claims

In March 2022, the federal government announced that it was acting to simplify the law regarding unfair preference payments.[32] Under the proposed reforms, liquidators will no longer be able to claw back transactions that are either less than A$30,000 or made more than three months prior to the company entering external administration, provided that the transactions are in the ordinary course of business and involve unrelated creditors. The government also committed extra funding to the Assetless Administration Fund, a fund administered by ASIC, which provides funding to liquidators to carry out certain investigations in respect of assetless administrations.

32 Michael Sukkar, 'Simpler and fairer insolvency processes' (media release, 30 March 2021).

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Appendix 1

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Peter Bowden is a partner in Gilbert + Tobin's restructuring and insolvency group. Mr Bowden specialises in front-end restructuring and insolvency. He has significant experience in advising hedge funds, banks, special situations groups, investment banks, insolvency practitioners, creditors and debtors on restructuring, insolvency, workouts, banking and distressed debt transactions in a range of industries, including financial services, mining, mining services, property, construction, agriculture and manufacturing.

Mr Bowden is admitted to practise in both Australia and the UK. He also gained significant international experience while working in Tokyo for a leading global law firm in 2008 and 2009. Prior to joining Gilbert + Tobin, he was a partner of a global law firm where he focused on front-end restructuring, insolvency and distressed debt.

Mr Bowden is listed in *Best Lawyers* for 2017–2023 in insolvency and reorganisation law and in was named 'Lawyer of the Year (Melbourne)' for distressed investing and debt trading. He was also named as a rising star partner in *IFLR1000* in 2021 in insolvency and reconstruction. He is listed as Band 3 in the 2022 *Chambers Australia* guide for restructuring/insolvency. Mr Bowden is a member of the Australian Restructuring Insolvency and Turnaround Association and the Turnaround Management Association (TMA) and is on the VIC TMA Committee. Recently, Mr Bowden has worked on a number of prominent restructuring and insolvency matters including *Greensill Capital*, *Virgin Australia*, *Sargon Capital*, *Bardot*, *Kikki. K*, *Toys"R"Us*, *Norske Skog*, *Mirabela Nickel*, *Nexus Energy*, *Arrium*, *LM First Mortgage Income Fund*, *Acquire Learning*, *Northern Energy/Colton Coal*, *Blue Sky Investments*, *Banksia Secured Investments*, *Timbercorp*, *Eastmark/One Denison* and *Adaman Resources*.

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