RESTRUCTURING & INSOLVENCY

Australia

Consulting editor

Freshfields Bruckhaus Deringer LLP

Restructuring & Insolvency

Consulting editors

Catherine Balmond, Katharina Crinson

Freshfields Bruckhaus Deringer LLP

Quick reference guide enabling side-by-side comparison of local insights, including a general overview; types of liquidation and reorganisation processes; insolvency tests and filing requirements; directors' and officers' regime; stays of proceedings and moratoria; doing business during reorganisations; asset sales; creditor remedies, involvement and proving claims; security; clawback and related-party transactions; treatment of groups of companies; international cases; and recent trends.

Generated 15 November 2022

The information contained in this report is indicative only. Law Business Research is not responsible for any actions (or lack thereof) taken as a result of relying on or in any way using information contained in this report and in no event shall be liable for any damages resulting from reliance on or use of this information. © Copyright 2006 - 2022 Law Business Research

Table of contents

GENERAL

Legislation
Excluded entities and excluded assets
Public enterprises
Protection for large financial institutions
Courts and appeals

TYPES OF LIQUIDATION AND REORGANISATION PROCESSES

Voluntary liquidations
Voluntary reorganisations
Successful reorganisations
Involuntary liquidations
Involuntary reorganisations
Expedited reorganisations
Unsuccessful reorganisations
Corporate procedures
Conclusion of case

INSOLVENCY TESTS AND FILING REQUIREMENTS

Conditions for insolvency
Mandatory filing

DIRECTORS AND OFFICERS

Directors' liability – failure to commence proceedings and trading while insolvent
Directors' liability – other sources of liability
Directors' liability – defences
Shift in directors' duties
Directors' powers after proceedings commence

MATTERS ARISING IN A LIQUIDATION OR REORGANISATION

Stays of proceedings and moratoria
Doing business
Post-filing credit
Sale of assets

© Copyright 2006 - 2021 Law Business Research

Negotiating sale of assets
Rejection and disclaimer of contracts
Intellectual property assets
Personal data
Arbitration processes

CREDITOR REMEDIES
Creditors' enforcement
Unsecured credit

CREDITOR INVOLVEMENT AND PROVING CLAIMS
Creditor participation
Creditor representation
Enforcement of estate's rights
Claims
Set-off and netting
Modifying creditors' rights
Priority claims
Employment-related liabilities
Pension claims
Environmental problems and liabilities
Liabilities that survive insolvency or reorganisation proceedings
Distributions

SECURITY
Secured lending and credit (immovables)
Secured lending and credit (movables)

CLAWBACK AND RELATED-PARTY TRANSACTIONS
Transactions that may be annulled
Equitable subordination
Lender liability

GROUPS OF COMPANIES
Groups of companies
Combining parent and subsidiary proceedings

INTERNATIONAL CASES

© Copyright 2006 - 2021 Law Business Research

Recognition of foreign judgments
UNCITRAL Model Law
Foreign creditors
Cross-border transfers of assets under administration
COMI
Cross-border cooperation
Cross-border insolvency protocols and joint court hearings
Winding-up of foreign companies

UPDATE AND TRENDS
Trends and reforms

© Copyright 2006 - 2021 Law Business Research

Contributors

Australia

Peter Bowden
pbowden@gtlaw.com.au
Gilbert + Tobin

Anna Ryan
anna.ryan@gtlaw.com.au
Gilbert + Tobin

Charbel Moujalli
cmoujalli@gtlaw.com.au
Gilbert + Tobin

© Copyright 2006 - 2021 Law Business Research

GENERAL

Legislation

What main legislation is applicable to insolvencies and reorganisations?

The Corporations Act 2001 (Cth) (the Act) is the primary piece of federal legislation that governs the registration, administration, insolvency and reorganisation of companies incorporated in Australia. The Act prescribes, among other things, the manner to administer and regulate the winding up, liquidation, administration and distribution of assets vested in insolvent corporations and other prescribed commercial vehicles.

Law stated - 08 September 2022

Excluded entities and excluded assets

What entities are excluded from customary insolvency or reorganisation proceedings and what legislation applies to them? What assets are excluded or exempt from claims of creditors?

The Act governs the insolvency proceedings for all companies incorporated in Australia and companies incorporated or possessing separate legal personality in foreign jurisdictions that carry on business in Australia. It also governs building societies, credit unions and managed investment schemes. The provisions of the Act do not govern the potential insolvency proceedings for government agencies, state or federal corporate bodies, or entities created by statute that are not companies. The individual statutes creating these bodies will normally provide for their dissolution or winding up.

Law stated - 08 September 2022

Public enterprises

What procedures are followed in the insolvency of a government-owned enterprise? What remedies do creditors of insolvent public enterprises have?

There is no precedent in Australia for a government-owned enterprise becoming insolvent. Generally, each government-owned enterprise is established under a specific piece of legislation separate to the Act (be it federal or at a state or territory level). The relevant legislation will provide for the winding-up procedure and remedies creditors may have available (noting they are limited compared to a corporate insolvency). Creditors of public enterprises do have remedies; however, as the provisions vary from enterprise to enterprise, and as there has never been an actual example of these provisions being tested, it is difficult to generally comment on how such remedies work in practice.

Law stated - 08 September 2022

Protection for large financial institutions

Has your country enacted legislation to deal with the financial difficulties of institutions that are considered ‘too big to fail’?

No.

Law stated - 08 September 2022

© Copyright 2006 - 2021 Law Business Research

Courts and appeals

What courts are involved? What are the rights of appeal from court orders? Does an appellant have an automatic right of appeal or must it obtain permission? Is there a requirement to post security to proceed with an appeal?

The Federal Court of Australia and the supreme court of each state and territory have jurisdiction to hear matters relating to companies incorporated in Australia (which include insolvency matters and the prosecution of both civil and criminal offences arising from insolvency proceedings). Matters pertaining to debt recovery and monetary compensation can also be dealt with by other courts such as district courts, county courts and magistrates' courts within their jurisdictional limits. The judicial institutions have discretion to transfer matters between them if considered appropriate. It is generally only the Federal Court and the supreme courts that have jurisdiction to wind up a company. An appellant has an automatic right to appeal any final decision of the court, including an order for the winding up of a company. Three of the more common insolvency processes (voluntary administration, deeds of company arrangement and receivership) often have no court involvement.

Where a decision is appealed, the court has discretionary power to order security for costs if an application is made by the respondent. While the order should not provide a complete indemnity for costs, fixing the amount to be provided by way of security is part of the court's discretion. The security may take a form that the court considers adequate to provide protection to the defendant and permits guarantees, charges or the provision of a bank bond to be made in lieu of more traditional payments.

Law stated - 08 September 2022

TYPES OF LIQUIDATION AND REORGANISATION PROCESSES

Voluntary liquidations

What are the requirements for a debtor commencing a voluntary liquidation case and what are the effects?

Under the Corporations Act 2001 (Cth) (the Act), both the members of the company and the creditors have the option, under certain circumstances, to commence a voluntary winding up of a company. Neither procedure requires court sanction. The determinative factor for which a voluntary regime may be pursued is the company's solvency position.

Members' voluntary winding up

A members' voluntary liquidation is a solvent winding up. It requires that the directors of the company make a declaration of solvency under section 494 of the Act. The declaration of solvency requires that the directors of the company must form the opinion, after an inquiry into the affairs of the company, that the company will be able to discharge its debts in full within 12 months of the commencement of winding up. This is coupled with a special resolution (ie, at least 75 per cent of votes cast by members entitled to vote on the resolution) of the members to wind up the company. A copy of this resolution must be lodged with the Australian Securities and Investments Commission (ASIC) within seven days.

Creditors' voluntary winding up

A creditors' voluntary winding up arises when the company is in fact insolvent. It can occur in a number of

© Copyright 2006 - 2021 Law Business Research

circumstances, including in situations where a liquidator appointed by the members forms the opinion that the company is in fact insolvent. This will convert the process from a members' voluntary winding up into a creditors' voluntary winding up. A company may also enter a creditors' voluntary winding up where the directors determine that the company is insolvent and should be wound up or at the end of an administration if the creditors pass a resolution at the second creditors' meeting that the company should be wound up.

Law stated - 08 September 2022

Voluntary reorganisations

What are the requirements for a debtor commencing a voluntary reorganisation and what are the effects?

Voluntary administration

The purpose and operation of voluntary administration is outlined in Part 5.3A of the Act. Voluntary administration has been compared to the Chapter 11 process in the United States; however, unlike the Chapter 11 process, voluntary administration is not an 'in situ' debtor process. In a voluntary administration, the creditors control the outcome to the exclusion of management and members. The creditors ultimately decide on the outcome of the company, and in practice, it rarely involves returning management of the company back to the former directors.

The purpose of Part 5.3A is to administer the business, property and affairs of the insolvent company in a way that either:

- maximises the chances of the company, or as much as possible of its business, continuing in existence; or
- results 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 in existence.

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

- by resolution of the board of directors that in their opinion the company is, or is likely to become, insolvent;
- a liquidator or provisional liquidator of a company may, by writing, appoint an administrator of the company if he or she is of the opinion the company is, or is likely to become, insolvent; and
- a secured creditor who is entitled to enforce security over the whole or substantially whole of a company's property may, by writing, appoint an administrator if the security interest is over the property and is enforceable.

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 that restricts the exercise of rights by third parties under leases and security interests and in respect of litigation claims. The purpose of this statutory moratorium is to allow 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. A secured creditor with security over the whole or substantially the whole of the assets of the company has 13 business days following the appointment of the administrator to exercise its right under the security granted in its favour (ie, appoint a receiver).

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

© Copyright 2006 - 2021 Law Business Research

after the commencement of the administration (this may be extended by application to the court). At the second 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:

- enter into a deed of company arrangement (DOCA) with creditors;
- wind the company up; or
- terminate the administration.

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

DOCA

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

A DOCA may incorporate terms that make its operation similar to a voluntary administration (giving similar rights to a deed administrator as a voluntary administrator), but may also 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 to achieve a debt-for-equity swap.

Entering into a DOCA requires the approval of a bare majority of creditors, both by value and number voting at the second creditors' meeting. A DOCA will bind the company, its shareholders, directors and unsecured creditors. A validly passed DOCA can bind all creditors but does not prevent a secured creditor from dealing with their security interest so long as the secured creditor does not vote in favour of the DOCA.

Upon the 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 goal it will terminate. If a DOCA does not achieve its goals or is challenged by creditors, it may be terminated by the court.

Schemes of arrangement

A scheme of arrangement is a restructuring tool that sits outside of formal insolvency. 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. The pre-existing management retains control of the company during the process (and also depending on the terms of the scheme itself after its implementation). In recent times, schemes of arrangement have become more common, in particular, for complex restructures involving debt-for-equity swaps in circumstances where the number of creditors within creditor stakeholder groups may make a contractual and consensual restructure difficult.

© Copyright 2006 - 2021 Law Business Research

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 creditor. Classes are determined by reference to commonality of legal rights and only those creditors whose rights will be affected, compromised or amended by the scheme need be included. 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 view to a 'common interest'. The outcome of a scheme of arrangement is dependent on the terms of the arrangement or compromise agreed with the creditors, but most commonly, upon implementation, a company is returned to its normal state 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 (ie, class issues), uncertainty of implementation, timing issues (ie, because of various procedural requirements for holding the meetings, and as it must be approved by the court it is subject to the court timetable and can only be expedited to a certain extent) and the overriding issue of court approval (ie, a court may exercise its 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 only to be undertaken in large corporate restructures and in scenarios with sufficient time for execution and implementation to accommodate the procedural and courts' requirements.

Law stated - 08 September 2022

Successful reorganisations

How are creditors classified for purposes of a reorganisation plan and how is the plan approved? Can a reorganisation plan release non-debtor parties from liability and, if so, in what circumstances?

Scheme of arrangement

A scheme of arrangement must be approved by a majority of creditors voting on the resolution and holding at least 75 per cent in value and 50 per cent in number of voting creditors in each class. Classes are determined by reference to commonality of legal rights and only those creditors whose rights will be affected, compromised or amended by the scheme need be included. If approved by the creditors, supplementary approval by the court is required at the second court hearing. Schemes of arrangement may provide for the release of third parties (as opposed to DOCAs where the courts have held that such releases are not possible).

DOCA

In the context of a voluntary administration, a majority of creditors with at least 50 per cent in number and 50 per cent in value may resolve that the company should execute a DOCA. The company must execute the instrument 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 will bind the company, its shareholders, directors and unsecured creditors. Unlike a scheme of arrangement, court approval is not required for a DOCA to be implemented provided it is approved by the requisite majority of creditors.

The High Court in Lehman Brothers Holdings Inc v City of Swan & Ors [2010] HCA 11 (Lehman Brothers), held that creditors were not bound by provisions in a DOCA that involved releases of claims against entities other than the company the subject of the DOCA.

This position was later followed by the Supreme Court of New South Wales in In the matter of Eastmark Holdings Pty

© Copyright 2006 - 2021 Law Business Research

Limited (receivers and managers appointed (subject to a deed of company arrangement) & ors [2015] NSWSC 2070, where the Court determined that third-party release clauses were severable for the following reasons:

- the third-party releases were never intended to be part of the DOCA proposal in the first place and they were not in the proposal or discussed at the meeting of creditors;
- when one considered the administrator's report to creditors and the minutes of meeting of the creditors, it was clear that there was never an intention to include third-party releases; and
- severance of the third-party releases would allow the DOCA to operate as intended by the creditors (ie, creditor's claims against the company would be extinguished upon receipt of a distribution from the deed fund).

Accordingly, the Court held that the third-party releases were void but severable, which allowed the DOCA to continue.

These decisions support the general notion that claims against third parties cannot be released under a DOCA. Therefore, it is unlikely that a creditor will be bound by a DOCA to give up claims save for other than claims against the company the subject of the DOCA.

Law stated - 08 September 2022

Involuntary liquidations

What are the requirements for creditors placing a debtor into involuntary liquidation and what are the effects? Once the proceeding is opened, are there material differences to proceedings opened voluntarily?

Under Australian law, a compulsory liquidation involves the application to, and orders from, the court. A creditor or other eligible applicant must lodge an application with the court to wind up a company. On an application to wind up the company in insolvency, the creditor must show that the company is unable to pay its debts as and when they fall due.

There are two situations in which a company will be held to be unable to pay its debts:

- if the company has not paid a claim for a sum due to a creditor exceeding A$4,000 within 21 days of service of a prescribed written statutory demand (the Act sets out specific requirements); or
- if it is proved to the court as a question of fact that the company is unable to pay its debts as and when they fall due.

Grounds are also available for a creditor to apply to the court for winding-up orders against a company not necessarily related to solvency, including that it is 'just and equitable' to do so or because of a deadlock at a shareholder or director level affecting the ability to manage the company.

After a winding-up order, management of the company is removed from the directors and the company will likely cease as a going concern (except as is necessary to proceed with the winding up). The liquidator appointed will take control of the affairs of the company, and his or her other duties include realising the company's assets for the benefit of the creditors as a whole.

There are no material differences between a liquidation ordered by the court and a creditors' voluntary liquidation.

Small business liquidation process

© Copyright 2006 - 2021 Law Business Research

In response to the covid-19 pandemic, the federal government introduced significant amendments to Australia's insolvency landscape via the Corporations Amendment (Corporate Insolvency Reforms) Act 2020 (Cth) (the Insolvency Reform Act). These amendments to the Act came into effect on 1 January 2021 and relate specifically to small businesses. As part of these amendments, a liquidator may adopt a new small business liquidation (SBL) process under section 500A of the Act instead of the general creditor's voluntary liquidation process, which is aimed at providing a quick alternative to a creditor's voluntary winding up.

This may be undertaken if the company has resolved to be wound up voluntarily, the directors have given the liquidator a report as to the company's affairs and declared that the company is eligible for the SBL process, the total liabilities of the company do not exceed A$1 million and the company has made all required tax lodgements.

In circumstances where the liquidator becomes aware that the eligibility criteria is no longer met or where the liquidator has reasonable grounds to believe that the company or any of its directors have engaged in fraudulent or dishonest conduct that has had or is likely to have a material adverse effect on creditors' interests, the liquidator is required to discontinue the SBL process.

Law stated - 08 September 2022

Involuntary reorganisations

What are the requirements for creditors commencing an involuntary reorganisation and what are the effects? Once the proceeding is opened, are there any material differences to proceedings opened voluntarily?

Receivership

Unlike in the United Kingdom, receivership is still an option available to secured creditors in Australia. Receiverships, particularly coordinated appointments at a holding company level, can and have been used to effect corporate restructures and reorganisations.

There are two ways in which a receiver or receiver and manager 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 are usually done to preserve the assets of the company in circumstances where it may not be possible to otherwise trigger a formal insolvency process. However, given the infrequency of court-appointed receivers, 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, sell or borrow against the secured assets. The appointment is normally effected contractually through a deed of appointment and indemnity, and the receiver will be the agent of the debtor company, not the appointing secured party.

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 the receiver is appointed over 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 obtainable in the circumstances. This obligation is enshrined in section 420A of the Act.

It is this duty under section 420A of the Act that has traditionally posed the most significant stumbling block to the adoption of prepackaged restructure processes through external administration. Often referred to as a 'prepack', this is

© Copyright 2006 - 2021 Law Business Research

where a restructuring is developed by the secured lenders before the appointment of a receiver and is implemented immediately or very shortly after the appointment is made. There is a concern that a prepackaged restructuring that involves a sale of any asset without testing against the market could be seen to be in breach of the duty under section 420A. Sales processes conducted immediately before appointment or the potential for immediate dilution of value are increasingly facilitating receivership sales without a full testing of the market.

Once a receiver has realised the secured assets and distributed the net proceeds to the secured creditors (returning any surplus to subordinated security holders or the company) he or she will retire in the ordinary course.

The appointment of a receiver to all or substantially all of the assets of a company will usually lead to, or will closely follow, the appointment of voluntary administrators by the directors, with both processes proceeding in tandem.

Voluntary administration

A secured creditor can often appoint an administrator to effect a reorganisation as an alternative to exercising its security. Once the voluntary administration occurs, the creditors are in control of the company's fate (including any restructuring or reorganisation), the success of which will be dependent on the relevant majority, by number and dollar value, voting in favour of it.

Small business restructuring process

Further to the SBL process, recent amendments to the Act also establish the framework for the small business restructuring (SBR) process under Part 5.3B. The SBR process enables eligible companies to engage a small business restructuring practitioner to develop and propose to creditors a restructuring plan that, if accepted, will bind the company and certain creditors. A company's eligibility for this process is dependent on whether it has liabilities of less than A$1 million, the company has paid the entitlements of its employees that are payable, its current or former directors (in the preceding 12 months) have not engaged the SBR process or SBL process (in respect of another company) within the past seven years and it is not currently subject to another form of external administration under the Act or other restructuring arrangements.

The SBR process follows the general structure and key features of voluntary administration under Part 5.3A of the Act but differs in that it follows a 'debtor-in-possession' model, which allows the directors to maintain control of the company.

Law stated - 08 September 2022

Expedited reorganisations

Do procedures exist for expedited reorganisations (eg, 'prepackaged' reorganisations)?

There is no legislation that specifically facilitates prepackaged reorganisation in Australia.

That being said, it is possible under certain circumstances for an administrator or a receiver to give effect to sale transactions that have been negotiated to near completion before their appointment.

Administration

The voluntary administration regime was introduced into the Act to provide distressed companies with a process to initiate an expedited reorganisation without court approval. A voluntary administrator is required to complete the investigations relating to the company's business, property, affairs and financial circumstances about four to six weeks

© Copyright 2006 - 2021 Law Business Research

after his or her appointment. The administrator is then required to convene a creditors' meeting at which the administrator provides the creditors with a detailed report of the investigation and recommendations.

The creditors then decide between three alternatives:

- to execute a DOCA;
- to wind up the company; or
- to end the administration.

As administrators have the power to dispose of a debtor company's property under section 437A of the Act, it is possible for an administrator to effect prepackaged transactions in certain circumstances; that is, transactions that have been negotiated to near completion before their appointment, before convening the second meeting of creditors. However, the scope of that power is subject to the objects of Part 5.3A of the Act, being that the sale maximises the chances of the company continuing or, if that is not possible, results in a better return for creditors and members than a liquidation. As such, practitioners are often reluctant to effect a quick sale where that sale may not meet these objectives.

Receivership

As receivers also have the power to dispose of a debtor company's property under section 420(2)(b) of the Act, it is possible, in certain circumstances, to implement a prepackaged reorganisation. However, section 420A of the Act is the single largest impediment to receivers giving effect to a prepackaged reorganisation where Australian courts have construed that section with a focus on the process undertaken by the receiver to sell the property. The very nature, and indeed the key benefit, of a prepackaged transaction, is that it is a quick sale of the debtor company carried out soon after the appointment of the insolvency practitioner. This, therefore, poses two difficulties for a receiver. The first relates to timing. If the receiver had no pre-appointment involvement with the prepackaged transaction, it would be difficult to demonstrate they complied with their obligations as set out in section 420A of the Act. On the other hand, if the receiver did have pre-appointment involvement, that might contravene the strict independence requirements for insolvency practitioners in Australia. The second difficulty is the requirement to achieve market value or otherwise achieve the best price that is reasonably attainable, having regard to the circumstances existing when the property is sold. It may be difficult to demonstrate that market value has been achieved in an expedited prepackaged sale. This requirement places a heavier burden than that placed on receivers in the United Kingdom, who are only required to show they were not negligent in exercising their power of sale.

Law stated - 08 September 2022

Unsuccessful reorganisations

How is a proposed reorganisation defeated and what is the effect of a reorganisation plan not being approved? What if the debtor fails to perform a plan?

Scheme of arrangement

A scheme of arrangement may either be defeated by a creditors' vote or if it is not sanctioned by the court. Should either of these occur, there is no automatic process that occurs; rather, the company reverts to its pre-existing state (which may include financial difficulties).

© Copyright 2006 - 2021 Law Business Research

DOCA

A proposed reorganisation through a DOCA may be defeated by a majority of creditors at the second meeting. At this meeting, the creditors may vote for the company to be wound up or to give back control of the company to the directors, thus ending the administration, rather than executing a DOCA. Further, if the company fails to execute a DOCA within 15 business days of a successful resolution at a second creditors' meeting, the company will enter into a creditors' voluntary winding up. Once executed, if there is a material contravention of the DOCA by the debtor company, a creditor or other interested person may apply for the termination of an executed DOCA by an order of the court. If an order is granted, the company again enters into a creditors' voluntary winding up.

An aggrieved creditor might also look to terminate a DOCA on the grounds of, for example, unfair prejudice.

Law stated - 08 September 2022

Corporate procedures

Are there corporate procedures for the dissolution of a corporation? How do such processes contrast with bankruptcy proceedings?

Deregistration can be voluntary upon the application of the company, a director, a member or a liquidator, and can be initiated by ASIC or court-ordered in circumstances where the company has no assets or liabilities, or its winding up has been finalised. Upon the deregistration of the company, it ceases to exist as a corporate identity.

Also, ASIC may unilaterally deregister a corporation if it has reason to believe that the company is no longer carrying on its business, has been fully wound up, has been at least six months late in lodging its annual return or has not lodged the relevant corporate documentation (including financial reports) required by the Act in the preceding 18 months. There is, however, a process under the Act for the reinstatement of deregistered companies in certain circumstances.

Law stated - 08 September 2022

Conclusion of case

How are liquidation and reorganisation cases formally concluded?

Voluntary administration

There are three outcomes of a voluntary administration upon which the creditors decide:

- entering into a DOCA;
- winding the company up; or
- terminating the administration.

The outcome chosen will dictate how the voluntary administration ends. Once a DOCA is executed, the company comes out of voluntary administration, and if the administration terminates, the administrative control vests back in the board of directors.

Liquidation

At the conclusion of a liquidation, the company is deregistered. The process of deregistration is regulated by Chapter 5A of the Act. After the company's affairs are fully wound up, the liquidator must produce an account showing how the

© Copyright 2006 - 2021 Law Business Research

winding up has been conducted and the company's property disposed of. ASIC must deregister the company when three months have elapsed after the liquidator has lodged the account, or minutes if a final meeting is held, with ASIC.

In a compulsory winding up, the liquidator may also apply to the court, pursuant to section 480 of the Act, for an order that the liquidator be released and that the company be deregistered after the liquidator has:

- realised all 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;
- distributed a final dividend (if any) to the creditors;
- 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.

Receivership

A receivership concludes when the secured assets are realised and the secured creditors are repaid (either in full or where there are no further assets to realise, to the maximum extent possible). In such circumstances, control of the company is handed back to either the directors or voluntary administrator, and in most instances, the company is deregistered or wound up.

Law stated - 08 September 2022

INSOLVENCY TESTS AND FILING REQUIREMENTS

Conditions for insolvency

What is the test to determine if a debtor is insolvent?

Section 95A of the Corporations Act 2001 (Cth) (the Act) states that a company is solvent if it can pay its debts as and when they become due and payable. A company that cannot pay its debts when due and payable, or in other words is not solvent, is insolvent.

The focus in Australian case law is the cash-flow position of the company as opposed to a balance-sheet test. The courts have held that any assessment of solvency should be considered in light of the commercial reality of the company's financial position taken as a whole as opposed to a point-in-time assessment of the balance sheet taken in isolation.

Law stated - 08 September 2022

Mandatory filing

Must companies commence insolvency proceedings in particular circumstances?

When a company is insolvent or likely to become insolvent, its board of directors can appoint a voluntary administrator under Part 5.3A and the appointment itself is a defence under the Act to insolvent trading. There is, however, no explicit statutory provision obliging companies to commence such insolvency proceedings.

Law stated - 08 September 2022

© Copyright 2006 - 2021 Law Business Research

DIRECTORS AND OFFICERS

Directors' liability – failure to commence proceedings and trading while insolvent

If proceedings are not commenced, what liability can result for directors and officers? What are the consequences for directors and officers if a company carries on business while insolvent?

Under section 588G of the Corporations Act 2001 (Cth) (the Act), directors have a duty to prevent insolvent trading. If a company enters into liquidation, Division 4, Part 5.7B of the Act makes directors who breach this duty liable to compensate the company for all new debts incurred from the time a company is found to have become cash-flow insolvent. Therefore, a director may suffer civil or criminal liability for insolvent trading where he or she knew, or had reasonable grounds for suspecting, that the company was insolvent or would become insolvent. These provisions are intended to compel directors to take active steps (eg, the appointment of a voluntary administrator) in an expeditious manner, thereby protecting members and creditors from the continuation of insolvent businesses.

In addition to the potential liability for directors, if the company continues to carry on business while insolvent, certain transactions that the company entered into with third parties during that time may be subject to challenge and ultimately be held to be void if the company formally enters into liquidation (eg, unfair preference or uncommercial transaction).

Law stated - 08 September 2022

Directors' liability – other sources of liability

Apart from failure to file for proceedings, are corporate officers and directors personally liable for their corporation's obligations? Are they liable for corporate pre-insolvency or pre-reorganisation actions? Can they be subject to sanctions for other reasons?

A director or officer of a company may be held liable under the Act for civil and criminal penalties or to compensate the company if the company incurs a debt while insolvent (otherwise known as insolvent trading). Directors and officers may also attract personal 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 proper purposes. Statutory liability may also be imposed where directors or officers improperly use their position or information acquired because of their position to gain an advantage for themselves or cause detriment to the company.

In some situations, directors may become personally liable for unremitted amounts of income tax or goods and services tax. 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 discretion under the Act to excuse directors from liability in some circumstances if they can be shown to have acted honestly and reasonably.

Law stated - 08 September 2022

Directors' liability – defences

What defences are available to directors and officers in the context of an insolvency or reorganisation?

© Copyright 2006 - 2021 Law Business Research

The statutory defences available to a director for a breach of the duty to prevent insolvent trading are set out in section 588H of the Act. A director is not liable for a breach of duty if it is proved that, at the time the relevant debt was incurred, the director had reasonable grounds to expect and did expect that the company was solvent at that time and would remain solvent even if it incurred that debt (as well as any other debts that it incurred at the same time).

Further, a director is not liable if it is proved that he or she took all reasonable steps to prevent the relevant debt from being incurred. In this context, the Act states specifically that matters to which regard is to be made in considering this defence include any action the director took with a view to appointing an administrator when such action was taken and the results of that action.

A breach of the duty to prevent insolvent trading by a director will expose that director to prospective liability for a civil penalty order, an order for payment of compensation to the company or an order for payment of compensation to the creditor. The amount of compensation awarded against a director who breaches such a duty will be calculated by reference to the actual loss that the company or the creditor suffers by reason of the debt being incurred. In ascertaining the quantum risk of a potential insolvent trading action, the question as to when a debt is incurred becomes important. Ordinarily, a director will not be liable for a pre-existing debt that falls due when a company is found to be insolvent. Rather, directors are liable if the debt is 'incurred' at a time when the company is insolvent.

Section 588GA of the Act affords directors protection in certain circumstances to enable a company to delay entering into a formal insolvency process and instead pursue a turnaround plan (ie, provide directors with a 'safe harbour' protection). Under this section, a director will not be 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 that seeks to rely upon section 588GA of the Act bears the evidential burden in relation to that matter. That is, adducing or pointing to evidence that suggests a reasonable possibility that the matter exists or does not exist. The safe harbour protection will not apply in certain circumstances, including where, at the time the debt is incurred, the company has failed to pay employee entitlements or comply with certain reporting or taxation requirements. The new safe harbour provision also extends to providing a safe harbour for holding companies from liability to compensate its subsidiaries' creditors where directors of those subsidiaries hold the benefit of the safe harbour. Holding companies bear the same evidential burden as directors to adduce evidence that suggests a reasonable possibility that the company took steps to ensure that the directors did enjoy the benefit of the safe harbour provisions. We note that a court is yet to properly consider or opine on the operation of section 588GA.

While the introduction of this 'safe harbour' provision is seen as a positive development, section 588GA of the Act will not provide protection for directors against more general breach of duty claims.

As part of the 2021-22 Federal Budget, the federal government announced that it would commission an independent review of the 'safe harbour' provisions (as required under section 588HA of the Act) to examine and report on the operation of the safe harbour provisions. Appointed on 19 August 2021, the independent panel assessed whether the safe harbour provisions are achieving their aims, including giving financially distressed but viable companies more 'breathing space' to restructure their affairs. On 24 March 2022, the Federal Treasury tabled its review , relying on contributions from advisers, directors and other stakeholders. While the review notes that the assessment of the efficacy of safe harbour had been limited by the disruption caused by the covid-19 pandemic, recurring feedback from stakeholders included a view that awareness around insolvent trading and safe harbour ought to be increased, a need for a high-level reconsideration of directors' duties as they relate to corporate distress generally and the difficulties associated with adopting a single safe harbour framework to companies of all types and sizes. The review made various recommendations, including the following:

- amendments to the wording in the legislation to clarify the operation and application of the safe harbour provisions;

© Copyright 2006 - 2021 Law Business Research

- extending safe harbour protection to cover transactions that avoid employee entitlements;
- development of a best practice guide to safe harbour in 'plain English' by the Treasury in consultation with key industry groups;
- that data on safe harbour utilisation be collected and reported on as part of the reports received from voluntary administrators and liquidators; and
- that the Treasury commission a holistic in-depth review of Australia's insolvency laws generally.

It remains to be seen whether these recommendations will be adopted.

Law stated - 08 September 2022

Shift in directors' duties

Do the duties that directors owe to the corporation shift to the creditors when an insolvency or reorganisation proceeding is likely? When?

In discharging their duty to act in good faith and in the best interests of a company, directors must have regard to the interests of the company's creditors as the company is nearing insolvency.

However, it is not an independent duty to creditors, and any claim must be brought by the company (or more likely, its external administrators).

Law stated - 08 September 2022

Directors' powers after proceedings commence

What powers can directors and officers exercise after liquidation or reorganisation proceedings are commenced by, or against, their corporation?

Upon the appointment of a voluntary administrator or while the company is being wound up, company officers are not removed from office but, in general, they cannot, without the administrator or liquidator's written approval, perform or exercise a function or power as an officer of the company.

If the receiver is appointed over all or most of the assets of a company, the receiver effectively has control, although the directors still have certain responsibilities and duties, and may retain residual control.

Law stated - 08 September 2022

MATTERS ARISING IN A LIQUIDATION OR REORGANISATION

Stays of proceedings and moratoria

What prohibitions against the continuation of legal proceedings or the enforcement of claims by creditors apply in liquidations and reorganisations? In what circumstances may creditors obtain relief from such prohibitions?

The Corporations Act 2001 (Cth) (the Act) imposes an automatic stay on the enforcement of ipso facto clauses in certain contracts entered into on or after 1 July 2018. The automatic stay applies where one of the following insolvency events occurs in relation to a company:

© Copyright 2006 - 2021 Law Business Research

- voluntary administration;
- a receiver or controller is appointed over the whole or substantially the whole of the company's assets;
- the company announces, applies for or becomes subject to a scheme of arrangement to avoid a winding up; or
- the appointment of a liquidator immediately following an administration or a scheme of arrangement.

The automatic stay does not apply retrospectively (ie, for agreements entered into before the automatic stay provisions coming into force). Relevantly, the automatic stay does not apply to other types of contractual defaults (eg, if the company has failed to meet its payment or other performance obligations under the relevant agreement).

The length of the automatic stay depends on which formal insolvency process applies to the company, as follows (subject to courts order extending the stay):

- in the case of a scheme of arrangement: the stay will end within three months of the announcement, or where an application is made within that three months, when the application is withdrawn or dismissed by the court or when the scheme ends or the company is wound up;
- in the case of a receivership or managing controllership: the stay will end when the receiver's or managing controller's control ends; and
- in the case of a voluntary administration: the stay will end at the latest of when the administration ends or the company is wound up.

The scope of the automatic stay, specifically what contract types, rights and self-executing provisions are excluded by the automatic stay are set out in the Corporations (Stay on Enforcing Certain Rights) Regulations 2018 (the Regulations) and the Corporations (Stay on Enforcing Certain Rights) Declaration 2018 (the Declaration). The Regulations prescribe the types of contracts, agreements or arrangements that are excluded from the operation of the automatic stay and rights in those kinds of arrangements remain available to the parties to those arrangements should a trigger event occur. The Declaration declares the various rights (including self-executing clauses that, when executed, provides those rights) that are excluded from the operation of the automatic stay and those rights that remain available to the parties should a trigger event occur.

Under the ipso facto regime, contracts entered into before 1 July 2018 are exempted from the application of the automatic stay. However, there has been some uncertainty as to whether a novation, assignment or variation of contracts entered into prior to this date could result in the contract becoming subject to the ipso facto regime. Notwithstanding this uncertainty, contractual parties have continued to novate or vary contracts entered into before 1 July 2018 in an effort to avoid the application of the automatic stay.

The Regulations provide some clarification in this regard, specifically stating contracts resulting from novations, assignments and variations of contracts before 1 July 2018 are also excluded from the ipso facto regime where those novations, assignments and variations are made before 1 July 2023. This differs from the position in the exposure draft Regulations, which had previously not limited the exemption to the five-year period. Accordingly, contracts before 1 July 2018 will no longer be excluded from the application of the automatic stay after 1 July 2023.

The automatic stay does not prevent secured creditors from appointing a receiver during the decision period pursuant to section 441A of the Act (if they have security over the whole or substantially the whole of the company's property) or enforcing security interests over perishable goods or prevent secured creditors or receivers from continuing enforcement action that commenced before the administration.

As at 8 August 2022, the operation of the automatic stay has not been judicially considered.

© Copyright 2006 - 2021 Law Business Research

Receivership

During a receivership, no moratorium exists, 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 is likely to be in control of the company's material assets and is permitted to realise such assets for the benefit of the secured creditor only (any surplus is provided to the company and would be available for distribution to unsecured creditors).

Voluntary administration

In addition to the above-mentioned automatic stay, the Act provides for a moratorium over legal proceedings as an automatic consequence of a company entering into voluntary administration. Consequently, no legal proceedings can be initiated or proceeded with except with the administrator's written consent or leave of the court. An exception, however, is made in the case of criminal proceedings.

The above-mentioned automatic stay does not apply once or if a company executes a deed of company arrangement (DOCA). The automatic stay ends when the 'administration ends', that is, when a DOCA is executed by the company and the deed administrator. Accordingly, if a company does execute a DOCA and needs the protection of the automatic stay, then subject to limited exceptions, it will need to obtain court orders.

Liquidations

The automatic stay does not apply where a liquidator is appointed, unless the liquidation immediately follows an administration or a scheme of arrangement.

After the commencement of a winding up of a company, or after the appointment of a provisional liquidator, legal proceedings are not to be commenced or continued against a company without leave of the court, pursuant to section 471B of the Act. Secured creditors are generally granted immunity from this process by section 471C, assuming the validity of their security, as they remain entitled to realise their security despite the liquidation.

Where a statutory moratorium exists, while not determinative, a court is more likely to grant leave for a claimant to proceed against the company if there is a public interest aspect to the claim, such as in the case of claims brought by regulators for statutory breaches, or where the claimant will have access to insurance proceeds.

Law stated - 08 September 2022

Doing business

When can the debtor carry on business during a liquidation or reorganisation? Is any special treatment given to creditors who supply goods or services after the filing? What are the roles of the creditors and the court in supervising the debtor's business activities?

During an informal reorganisation or formal scheme of arrangement, the ability of a debtor company to carry on its business will depend upon the terms of agreement with its creditors.

This position differs, however, if the restructuring occurs within the context of a receivership or an administration. Control of the company is transferred from the directors to the administrator or receiver. An administrator has wide-ranging powers to carry on the business of the company where that is consistent with the purpose of the administration, whereas a receiver has wide-ranging powers provided for under the Act and the security agreement itself.

© Copyright 2006 - 2021 Law Business Research

For the purposes of carrying on the business, the administrator has the power under section 437A to pay creditors who supply goods or services to the company after the company has gone into administration in preference to ordinary unsecured creditors. An administrator may seek directions from the committee of creditors or the court. Creditors may also apply for relief against the administrator, which could involve removal.

A receiver may continue to run the business as a going concern with a view to maximising the return available to the secured creditor. Services engaged (including the providers of goods and services) are treated as costs of the receivership and the preferential payment of these costs is provided for in the appointment document.

Generally, after formal insolvency proceedings are commenced, the power and roles of company officers are at the discretion of the insolvency administrator appointed (receiver, administrator or liquidator) who is ultimately responsible for those roles (eg, carrying on the business of the company). In an informal workout where there has been no formal appointment, the company officers continue to be able to exercise all powers unless otherwise agreed with creditors.

Law stated - 08 September 2022

Post-filing credit

May a debtor in a liquidation or reorganisation obtain secured or unsecured loans or credit? What priority is or can be given to such loans or credit?

Voluntary administration

A voluntary administrator is given the power under section 437A of the Act to manage the affairs of the company and to raise loans on security over company assets to carry on the business of the company. The repayment of this credit is treated as an expense of the administration and is given statutory priority over ordinary unsecured creditors.

DOCA

Whether a deed administrator has the power to raise loans will depend on the terms of the DOCA. The repayment of this credit will usually be treated as an expense of the deed administration and will be given priority over distributions to creditors.

Liquidation

Liquidators are expressly permitted to obtain credit under section 477, whether on the security of company property or otherwise, as far as is necessary for the beneficial disposal or winding up of the company. Such credit will have priority over ordinary unsecured creditors but only in respect of the new funds and up to the value of the security.

Receivership

The terms of the appointment document and section 420 of the Act provide receivers with wide-ranging powers (including the ability to borrow). These borrowings are treated as expenses of the receivership and are provided priority, or alternatively, the original security document may provide that this financing is to be afforded the same priority as the first-ranking security.

Schemes of arrangement

Obtaining financing and use of assets as security in a scheme of arrangement or an informal voluntary reorganisation

© Copyright 2006 - 2021 Law Business Research

is solely a matter for agreement between the company and its creditors.

Law stated - 08 September 2022

Sale of assets

In reorganisations and liquidations, what provisions apply to the sale of specific assets out of the ordinary course of business and to the sale of the entire business of the debtor? Does the purchaser acquire the assets 'free and clear' of claims or do some liabilities pass with the assets?

Receivership

As noted, 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 under section 420A of the Act. Upon a sale, the receiver will transfer the assets free of security interests (a release will be provided by the appointing secured creditor) and often the terms of any inter-creditor arrangements will provide for the automatic release of subordinated security. In circumstances where an automatic release mechanism is not provided for, direct negotiations will need to take place with the secured subordinated creditors.

Voluntary administration

A voluntary administrator may sell assets, noting, however, it is not permitted to sell assets subject to security without consent (normally, a receiver will be appointed and have control over such assets). Administrators can apply to the court if this consent is not given and the court may make an order if it is satisfied that the secured creditor is adequately protected.

Liquidations

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 encumbrancer 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 price 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 of the creditors as a whole, to be distributed according to the relevant distribution rules.

Schemes of arrangement

The terms of the scheme itself will provide for the disposal of assets and any associated release of security required. These releases will not be automatic, however, and will need either agreement from the creditors or the provision of such release in associated finance and security documents.

© Copyright 2006 - 2021 Law Business Research

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.

Law stated - 08 September 2022

Negotiating sale of assets

Does your system allow for 'stalking horse' bids in sale procedures and does your system permit credit bidding in sales?

Stalking horse bids

While there is nothing to prevent stalking horse bids, they seldom occur in the Australian context.

Credit bids

Credit bids are permissible under Australian law and are a means of pursuing loan-to-own strategies. The offer will be assessed in the context of the relevant sales process conducted and the nature of the insolvency administration to which the company is subject. Courts generally have limited involvement in assessing a credit bid (save as part of a scheme of arrangement or where a sale has been challenged). In these circumstances, the court will scrutinise the credit bid together with the situation generally, against other proposals received and in light of any sale process run (if required). There is no prohibition on an assignee of the original secured creditor making a credit bid (provided the assignment was valid under law).

Law stated - 08 September 2022

Rejection and disclaimer of contracts

Can a debtor undergoing a liquidation or reorganisation reject or disclaim an unfavourable contract? Are there contracts that may not be rejected? What procedure is followed to reject a contract and what is the effect of rejection on the other party? What happens if a debtor breaches the contract after the insolvency case is opened?

Liquidators are given the specific ability to disclaim property or uncommercial contracts under Division 7A, Part 5.6 of the Act. A liquidator can, subject to objections being made to the court by aggrieved parties, disclaim onerous property in writing. Court approval is required for disclaiming contracts as this is likely to adversely affect third-party interests. There are no specific provisions for disclaimers in a voluntary liquidation, although the court has wide powers to control these reorganisations and application can be made to the court.

Receivers and administrators are not given specific powers to disclaim contracts; they may, however, look to ignore contracts with any resulting damages claim being unsecured against the company (not the receiver or the administrator personally).

If the debtor (either acting by the insolvency administrator appointed or otherwise) breaches the contract after formal insolvency has commenced, then the aggrieved counterparty has all remedies available to it under contract law (including a claim for damages and any right to terminate). Any such damage will be an unsecured claim as against the debtor company itself and only in very limited circumstances will an order for specific performance be made against the debtor company.

© Copyright 2006 - 2021 Law Business Research

Law stated - 08 September 2022

Intellectual property assets

May an IP licensor or owner terminate the debtor's right to use the IP when a liquidation or reorganisation is opened? To what extent may IP rights granted under an agreement with the debtor continue to be used?

Pre-existing contractual arrangements will govern a licensor's ability to terminate a debtor's entitlement to use intellectual property. These rights may be affected by the automatic stay provisions (ie, the 'ipso facto' protection), where the debtor enters into a relevant formal insolvency process.

A company administrator's power under section 437A to carry on and manage the property of the business extends to the use of intellectual property granted under an agreement with the debtor. Likewise, a receiver, in the absence of a licensor exercising termination rights, may also continue to use intellectual property.

Law stated - 08 September 2022

Personal data

Where personal information or customer data collected by a company in liquidation or reorganisation is valuable, are there any restrictions in your country on the use of that information or its transfer to a purchaser?

There are no restrictions on the use of personal information or customer data that apply in an insolvency that would not have otherwise applied to use by the company in a solvent context. For example, while there are restrictions against the use of personal information under Australian privacy laws, those laws will generally not prevent the transfer of that information to a purchaser as part of the sale of the company's business.

An administrator's power under section 437A to carry on and manage the property of the business extends to the use of customer data collected by the company in its business. Likewise, a receiver, in the absence of specific contractual terms to the contrary, may also continue to use customer data collected by the company in the course of the business.

Law stated - 08 September 2022

Arbitration processes

How frequently is arbitration used in liquidation or reorganisation proceedings? Are there certain types of disputes that may not be arbitrated? Can disputes that arise after the liquidation or reorganisation case is opened be arbitrated with the consent of the parties?

There are no restrictions under Australian law preventing a distressed company or its creditors from pursuing alternative dispute resolution options, such as arbitration or mediation. The success or willingness to engage in these procedures will obviously be dictated by the parties involved. These arrangements, however, are not without their limitations. For example, there is no obligation on creditors to agree to an informal arrangement and any one creditor can veto a proposed arbitration or mediation outcome if its rights with regard to the other creditors are directly affected (or act outside its restrictions). Its non-binding nature provides sufficient disincentive for creditors to consider these procedures, and it is rarely seen.

Courts will generally allow arbitration proceedings to continue while insolvency proceedings remain open to aid the just

© Copyright 2006 - 2021 Law Business Research

and expeditious resolution of creditors' claims.

Law stated - 08 September 2022

CREDITOR REMEDIES

Creditors' enforcement

Are there processes by which some or all of the assets of a business may be seized outside of court proceedings? How are these processes carried out?

The main way in which a secured creditor may enforce its security over assets of the company outside of court proceedings is through the private appointment of a receiver. The security agreement (ie, charge or mortgage) will normally grant the secured creditor the ability to appoint a receiver. Once appointed, the receiver will realise the company's assets solely for the benefit of the secured creditor to the exclusion of the rest of the company's creditors. A creditor may also exercise rights as mortgagee in possession and take control of the property with a view to realising value.

Retention of title clauses are another way a creditor may enforce proprietary and contractual rights outside court proceedings. If effective, this will allow the creditor to reclaim property supplied to the company in the event of the company's receivership, administration or liquidation. Retention of title clauses fall within the definition of 'security interest' under the Personal Property Securities Act 2009 (Cth) (PPSA) and are therefore required to be registered under the provisions of the PPSA. A traditional retention of title arrangement will be considered a 'purchase money security interest' under the PPSA, and, upon registration, will give the holder priority over other registrable interests. In this sense, while the requirements for enforcing a retention of title clause will change, the effect shall remain the same.

A number of common law and statutory liens are also available (and do not require registration under the PPSA).

Law stated - 08 September 2022

Unsecured credit

What remedies are available to unsecured creditors? Are the processes difficult or time-consuming? Are pre-judgment attachments available?

A creditor may commence proceedings through the courts to recover outstanding amounts owing by a recalcitrant debtor company. A creditor, at the same time, may also request that the court order injunctive relief to freeze the assets of the company if there is a risk of assets or value being dissipated. A failure to plead a substantive defence will generally enable a default judgment to be granted and the creditor may, after this, take steps to wind the debtor company up.

The court has extensive powers to compel compliance and enforce a range of remedies including seizure of assets, diversion of a debtor company's income and orders for winding up of the company. Foreign creditors may be required to provide security for costs (ie, a sum of cash to the courts) of enforcing a judgment in Australia.

The options available to unsecured creditors of an insolvent company or company in distress are limited. Once a company is placed into administration or liquidation, a statutory moratorium will apply to any proceedings commenced, including any enforcement proceedings.

Law stated - 08 September 2022

© Copyright 2006 - 2021 Law Business Research

CREDITOR INVOLVEMENT AND PROVING CLAIMS

Creditor participation

During the liquidation or reorganisation, what notices are given to creditors? What meetings are held and how are they called? What information regarding the administration of the estate, its assets and the claims against it is available to creditors or creditors' committees? What are the liquidator's reporting obligations?

Meetings and notices – voluntary administration

Notice of the appointment of an administrator must be lodged with the Australian Securities and Investments Commission (ASIC) within one day and creditors must be notified of the appointment within three days.

The administrator must convene a meeting of creditors within eight business days of his or her appointment. Notice of this meeting must be given in writing to as many creditors as is reasonably practicable at least five business days before the meeting and published on ASIC's insolvency notices website. At this meeting, creditors have the opportunity to appoint a different administrator and may also decide whether to appoint a consultative committee of creditors to assist the administrator. Although the committee cannot give directions to the administrator, it can compel the administrator to report on matters relating to the administration. The committee is also in a fiduciary relationship with the creditors and thus cannot profit from their role.

The second creditors' meeting must be convened by the administrator within five business days after the convening period. The convening period is 20 business days from the date the administration begins, and the same notice requirements apply. This is extended to 25 business days if the administration begins in December or occurred less than 25 days before Good Friday. The notice of the meeting must be accompanied by a report setting out the company's business, property, affairs and financial circumstances and a statement expressing the administrators' opinion on each of the options available to the creditors (executing a deed of company arrangement (DOCA), returning control of the company to the directors or winding up the company). If the administrator proposes a DOCA, details of the proposed DOCA must also be provided. At the meeting, the creditors decide and vote on which of the three available options they wish to pursue. The administrator presides at both the first and second meetings.

The reporting obligations of an administrator include the following:

- lodge notice of appointment with ASIC by the next business day following appointment, and publish on ASIC's insolvency notices website within three business days;
- prepare and lodge a report with ASIC where it is suspected that an officer, employee or member of the company has committed an offence in relation to the company; and
- where the creditors vote to wind up the company, to lodge a copy of that resolution with ASIC within five business days of it being passed.

Meetings and notices – creditors' winding up

In a creditors' winding up, no meetings of creditors are automatically held. A liquidator must hold a meeting if requested by a creditor with a minimum percentage of overall debt by value and if the liquidator considers that it is reasonable to do so. It would not be reasonable for a creditor to request a meeting if complying with the request would prejudice the interests of one or more creditors or a third party, there is insufficient property to hold the meeting, a meeting of creditors dealing with the same matters has been held or will be held within 15 business days, or if the request is vexatious.

© Copyright 2006 - 2021 Law Business Research

A liquidator must send to creditors:

- within 10 business days of their appointment, notice of their appointment, information about creditors' rights, and a summary of the company's affairs and information about the company's creditors;
- within three months of their appointment, a statutory report that includes information about the estimated assets and liabilities of the company, inquiries undertaken and to be undertaken by the liquidators, the likelihood of receiving an interim dividend and possible recovery actions; and
- any other reports the liquidator decides or that are reasonably requested by creditors.

These notices and reports must be lodged with ASIC.

Meetings and notices – receivership

During a receivership, there is no obligation to call a creditors' meeting but notice of the appointment must be lodged with ASIC. Reports must be lodged with ASIC during the receivership and notification must be given on its termination.

Requests for information

Creditors of a company in administration or liquidation have a right to request information at any time. An administrator or liquidator must provide the information required if the information is relevant to the administration or liquidation, the provision of the information would not cause the administrator or liquidator to breach their duties, and if the request is reasonable. A request for information would not be reasonable if complying with the request would prejudice the interests of one or more creditors or a third party, if the information is the subject of client legal privilege or disclosure would be actionable for breach of confidence, if the request is vexatious, if there is not sufficient property to comply with the request, or the information has already been provided or is required to be provided within 20 business days of the request. In relation to the last three reasons, the administrator or liquidator will still have to provide the information if the creditor meets the cost of complying with the request.

Law stated - 08 September 2022

Creditor representation

What committees can be formed (or representative counsel appointed) and what powers or responsibilities do they have? How are they selected and appointed? May they retain advisers and how are their expenses funded?

Committees in the Australian insolvency regime are creatures of statute and are not seen in the context of representing creditor stakeholder groups as they might be in the United States.

At any stage during the winding up, the members or creditors of the company may request that a committee of inspection be appointed.

In such a case, the liquidator must call separate meetings of creditors and members for the purpose of determining whether a committee of inspection should be appointed and, if a committee is to be appointed, the numbers of creditors and members to be appointed and the persons who are to be members of the committee.

In a voluntary administration, a committee of inspection may be formed at the first creditors' meeting.

The role of the committee of inspection is to supervise and assist the administrator or liquidator. Examples of the types

© Copyright 2006 - 2021 Law Business Research

of direction the committee may make include approving the remuneration of the administrator or liquidator, approving the institution of legal proceedings on behalf of the company, and directions as to the compromise of debts owing to the company. Committees of inspection are most often used in large liquidations or administrations where it is difficult for the liquidator to engage with the entire body of creditors on a regular basis.

The committee must have at least two members, drawn from the body of creditors and members. A company can be a member, acting through an authorised agent. Generally, the members of the committee of inspection will comprise those with a substantial interest in the winding up of the company, such as large creditors, employees and members holding a large proportion of the company's shares.

The administrator or liquidator of the company must have regard to the directions of the committee but is not required to comply with these directions.

Members of the committee of inspection owe the general body of creditors and members fiduciary duties and therefore must act in the best interests of the creditors and members rather than for their own benefit.

There is no statutory provision governing the remuneration of the committee of inspection. Except with leave of the court, a committee member may not derive any income from their position. They also must not become the purchaser of any property of the company.

It is almost unheard of for such committees to retain counsel and advisers.

Law stated - 08 September 2022

Enforcement of estate's rights

If the liquidator has no assets to pursue a claim, may the creditors pursue the estate's remedies? If so, to whom do the fruits of the remedies belong? Can they be assigned to a third party?

An administrator, liquidator or provisional liquidator can sell or otherwise dispose of, in any manner, all or any part of the property of the company. As a claim available to an estate forms part of the company's property, a liquidator may assign the claim to a creditor for consideration. The beneficiary of the 'fruits of the remedies' is thus dependent upon the terms of the assignment. When the liquidator is without funds, creditors may provide an indemnity or funding to the liquidator so that apparently meritorious claims may be pursued for the benefit of all creditors. In such circumstances, the creditors providing the indemnity or funding may be entitled to receive a higher dividend than they would otherwise receive by operation of section 564 of the Corporations Act 2001 (Cth).

In addition to administrators' and liquidators' power to assign causes of action, third-party litigation funding has been increasing in acceptability and prevalence since the endorsement of the practice in the non-insolvency context by the High Court of Australia in C ampbells Cash and Carry Pty Ltd v Fostif Pty Ltd (2006) 229 CLR 386. This has brought with it increased access to litigation funding for liquidators and administrators.

Law stated - 08 September 2022

Claims

How is a creditor's claim submitted and what are the time limits? How are claims disallowed and how does a creditor appeal? Can claims for contingent or unliquidated amounts be recognised? Are there provisions on the transfer of claims and must transfers be disclosed? How are the amounts of such claims determined?

A liquidator will notify creditors of the submission date and may do so by advertising it in a newspaper and also on the

© Copyright 2006 - 2021 Law Business Research

centralised insolvency notice website. This date may not be less than 14 days after the date of notice being given to creditors. Once the particulars of a debt are submitted by a creditor, the liquidator may admit:

- all or part of the claim;
- reject all or part of the claim; or
- require further evidence to be submitted in support of it.

If further evidence is required, the liquidator must notify every creditor in writing of the day on which the formal proof must be submitted. A liquidator must deal with submitted formal proof of claims within 28 days of receipt.

Where a proof of debt is rejected by a liquidator, grounds for the rejection must be provided to the creditor within seven days. A creditor can appeal the liquidator’s decision in court within the time specified in the notice (at least 14 days after service).

It is possible for a creditor’s claim to be assigned in writing. An assignee may apply to the liquidator and the court to have its new proof of debt stand as substituted for the assignor’s proof of debt. Such an assignee will be able to enforce the full value of the claim irrespective of whether it was acquired at a discount (ie, below par).

Claims for contingent debts are admissible in the winding up of a company. When a proof of debt is contingent in nature, the liquidator may either make an estimate of the value of the debt or claim as at the date of winding up or refer the question to the court for judicial consideration.

A creditor aggrieved with the estimate made by the liquidator may appeal to the court. If the contingent event occurs after the date of winding up, the creditor is entitled to prove for the actual amount of the claim.

A creditor can claim for interest accrued after the opening of the insolvency case and there is a prescribed rate in the Act of 8 per cent. Payment of this interest will rank behind all other claims (except subordinated equity claims).

Transfer of debts

In attempts to counter illegal phoenixing, amendments were made to the Insolvency Practice Rules (Corporations) Amendment (Restricting Related Creditor Voting Rights) Rules 2018 (the Amending Rules) to prevent the ‘stacking’ of related creditor votes and, accordingly, the ability for phoenix operators to control the appointment and replacement of an external administrator of a company.

The Amending Rules introduced two principal amendments to the Insolvency Practice Rules:

- the insertion of 75-95(1A) providing a requirement for an external administrator to ask any creditor voting an assigned debt for evidence of the debt and the consideration for the assignment; and
- the insertion of 75-110(7) providing a regime by which the value of any related creditor vote of an assigned debt is to be calculated as the value of the consideration given for the assignment.

Accordingly, where the consideration given by a related creditor for the assigned debt is less than the value of the debt, the value of the vote will be limited to the consideration given and not the full value of the debt. As such, external administrators are positively required to call for appropriate evidence of assigned debts and appropriately calculate the value of assigned debts for voting purposes.

Law stated - 08 September 2022

© Copyright 2006 - 2021 Law Business Research

Set-off and netting

To what extent may creditors exercise rights of set-off or netting in a liquidation or in a reorganisation? Can creditors be deprived of the right of set-off either temporarily or permanently?

Liquidation

Set-off refers to the right of a creditor to plead a debt due from the debtor as a defence to all or part of the debtor's claim made against it. Section 553C of the Act provides that statutory set-off is available in a liquidation scenario 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 the one is to be set off against any sum due from the other.

Only the balance of the account is admissible as proof against the company or is payable to the company. The Act allows a broad range of claims to be set off. The rule entitles creditors who are also debtors to have preference over the general body of creditors. Only creditors that choose not to rely on their security may take advantage of the rule.

A creditor is, however, unable to claim the benefit of set-off if he or she had, at the time of the relevant transaction, notice of insolvency of the company. Further, a creditor cannot offset any existing claim or debt of the company against new claims or debts that may arise during the period of administration.

Other reorganisations

In other reorganisations, there is no statutory right of set-off and the creditor must rely on any contractual rights they may have. Those rights will be subject to a statutory lien that has attached to the company's property at the time that the set-off is made. In practice, however, administrators and deed administrators will ordinarily recognise set off as if section 553C did apply, as generally creditors can claim prejudicial treatment if they receive less from administrators or under DOCAs than they would under a liquidation scenario (and often wording similar to section 553C is built into a DOCA).

Law stated - 08 September 2022

Modifying creditors' rights

May the court change the rank (priority) of a creditor's claim? If so, what are the grounds for doing so and how frequently does this occur?

Generally speaking, unsecured claims rank pari passu (with some exceptions), with secured creditors afforded a level of priority by virtue of the security arrangements in place.

The court has power to change the rank of a creditor's claim in only very limited circumstances. Section 564 of the Act provides an incentive to creditors to give financial assistance or indemnities to liquidators to pursue asset recovery proceedings or to protect or preserve property. If creditors provide such assistance, the liquidator may apply to the court for an order that the contributing creditors receive a higher dividend from the company's assets than they would otherwise be entitled to.

In assessing any claim under section 564, the court will consider all the circumstances surrounding the claim. Therefore, it is difficult to assess the frequency and likelihood of success attributable to any individual claim. The courts, in exercising their discretion, will have particular regard to factors such as the amount of risk to creditors, the amount recovered and the proportion between the debts of participating creditors and others, as well as the public

© Copyright 2006 - 2021 Law Business Research

interest in encouraging creditors to provide indemnities to enable assets to be recovered. Litigation funding can also be obtained outside the court process.

A DOCA may determine the creditors to be paid and how much they are to be paid (noting that a level of protection is afforded to employees unless they agree otherwise). Aggrieved creditors can apply to the court to overturn a DOCA if they are discriminated against.

Law stated - 08 September 2022

Priority claims

Apart from employee-related claims, what are the major privileged and priority claims in liquidations and reorganisations? Which have priority over secured creditors?

Under the Act, certain unsecured debts are given priority ahead of other unsecured debts. Sections 556 to 564 of the Act govern this, and the priority debts include expenses incurred by the administrator or liquidator in realising the assets of the company and in carrying on the company's business and the costs in relation to any applications to the court in respect of the winding up and employee-related entitlements.

A company's debts to the Commonwealth government do not receive any special priority. Amounts in respect of unpaid income tax rank as unsecured debts and are payable only if there are sufficient funds left over after all preferential debts have been paid.

Certain employee entitlement claims will have priority over secured debts, which are secured by a security interest of circulating assets (ie, receivables and stock, etc).

Law stated - 08 September 2022

Employment-related liabilities

What employee claims arise where employees' contracts are terminated during a restructuring or liquidation? What are the procedures for termination? (Are employee claims as a whole increased where large numbers of employees' contracts are terminated or where the business ceases operations?)

Outstanding employees' wages, superannuation, leave entitlements and redundancy payments are given priority over payment of ordinary unsecured creditors in the distribution of assets in the winding up. Pursuant to the Commonwealth's Fair Entitlement Guarantee (FEG), when a company is placed into liquidation leaving employee entitlements unpaid, the Commonwealth government, through FEG, can make payments to employees of certain levels of unpaid wages, leave and other entitlements. The Commonwealth then becomes a creditor of the company and is afforded the same priority in the distribution as the employee claims it paid.

Upon the making of a winding-up order by the court, the publication of that order acts as a notice of dismissal of all employees of the company. An employee who was engaged subject to a contract of employment for a fixed term, or was entitled by his or her contract of employment to a period of notice before termination of the contract, may lodge a proof of debt for damages for breach of contract. While the appointment of a voluntary liquidator does not necessarily operate as a notice of dismissal, the liquidator has the power to terminate contracts of employment.

In relation to a company in administration and receivership, upon appointment, the administrator or receiver takes control of the company's business, property and affairs. The retention of employees will depend upon the outcome of the administration process. If the business continues to operate, employees may be retained. An administrator and receiver can also terminate employment contracts in the same way as management of the company could when the

© Copyright 2006 - 2021 Law Business Research

company was operating as a going concern.

The Act affords a level of protection to employee entitlements following the company and its creditors entering into a DOCA. The Act provides that the entitlements of employees be given certain priorities in a deed, those priorities to be at least equal to what they would receive if the company were being wound up.

Law stated - 08 September 2022

Pension claims

What remedies exist for pension-related claims against employers in insolvency or reorganisation proceedings and what priorities attach to such claims?

Employee entitlements are afforded a level of priority in liquidations, receiverships and administrations. Under section 556 of the Act, employee entitlement claims are afforded a level of priority over other unsecured claims (noting that expenses of the liquidation still rank higher). A cap applies to the level of employee entitlements that are afforded priority for former officers of the company. In a receivership, employee entitlements are afforded priority over secured claims that are only secured by a security interest of circulating assets (the old floating charge).

A claim for unpaid employee entitlements is lodged in the same manner as other unsecured claims (ie, a proof of debt in the ordinary course). A statutory regime also exists (FEG) to supplement amounts available for employee claims.

Where there is unpaid superannuation in an insolvency, a super guarantee charge (SGC) is required to be paid before payments are made to ordinary unsecured creditors. This is an incurred penalty charge administered to employees owing to a failure to pay an employee's minimum superannuation guarantee on time and to the correct fund. SGC payments are ranked equally with employees' entitlement to wages and super contributions in circumstances where there are assets available for distribution to priority creditors. Priority SGC claims for excluded employees, such as directors and their spouses, are capped at A$2,000 and any amounts exceeding A$2,000 will rank pari passu with other unsecured claims.

Further, DOCAs are required to include a clause to the effect that eligible employee creditors will enjoy a priority under the administration, which is at least equal to what they would have received had there been a winding up.

Law stated - 08 September 2022

Environmental problems and liabilities

Where there are environmental problems, who is responsible for controlling the environmental problem and for remediating the damage caused? Are any of these liabilities imposed on the insolvency administrator personally, secured or unsecured creditors, the debtor's officers and directors, or on third parties?

Ultimate responsibility for any environmental issues will continue to rest with the relevant distressed debtor company. Upon appointment, an insolvency administrator will not automatically assume responsibility for these liabilities but will need to be aware of any such concerns and damage should they seek to continue to trade the company. Should further damage accrue during the course of the insolvency administrator trading the business, they may be held liable in the same way that directors have been held liable pre-appointment. Further, in scenarios where the insolvency administrator seeks to sell or realise the relevant asset, engagement with the environmental regulator will be required where there is pre-existing environmental damage and often remediation will be a contractual condition to the sale.

Creditors will not be held liable for controlling or remediating any environmental damage. The debtor's officers and directors could potentially be held liable for such liabilities in circumstances where the company enters formal

© Copyright 2006 - 2021 Law Business Research

liquidation and it can be shown the company was cash-flow insolvent at the time such liabilities were incurred. Third parties may be liable, but it will depend on the circumstances surrounding the environmental damage and any contractual obligations in place at that time.

Law stated - 08 September 2022

Liabilities that survive insolvency or reorganisation proceedings

Do any liabilities of a debtor survive an insolvency or a reorganisation?

The liabilities of a corporate debtor do not subsist after a liquidation has concluded. Under either a voluntary or involuntary arrangement, the creditors will receive compensation from the company's assets in proportion to the debts owing to them in satisfaction of their claims. The company's debts will be discharged in the context of these restructuring proceedings and thus the creditors' claims will not subsist after winding up. Upon deregistration, a company will cease to exist as a corporate entity and any surplus assets will vest in the corporate regulator.

Unsecured claims subsist after a receivership has concluded and such creditors may bring an action against the company (noting they are unlikely to do so unless significant assets remain). The outcome of the second creditors' meeting during a voluntary administration will determine what creditors' claims subsist (ie, either a DOCA or winding up is likely to commence).

Under a scheme of arrangement, those creditors whose rights are not compromised or affected will continue to have their original claim against the company.

Law stated - 08 September 2022

Distributions

How and when are distributions made to creditors in liquidations and reorganisations?

In liquidation, distribution will occur when funds are available. Under a DOCA or a scheme of arrangement, the distribution arrangements are generally set out in the terms of the respective instruments. It is possible for interim distributions to be made as funds become available.

Law stated - 08 September 2022

SECURITY

Secured lending and credit (immovables)

What principal types of security are taken on immovable (real) property?

The principal type of security that is taken on real property in Australia is a 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 title register grants a legal charge over the land as opposed to transferring legal title to the mortgagee. The mortgagor and 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.

Under the Australian system, it is also possible for an equitable mortgage to exist concerning land. This arises in circumstances where the mortgage is not yet registered but the parties have an intention (often a written agreement) to enter into one or the mortgagor deposits the title deeds with the mortgagee.

© Copyright 2006 - 2021 Law Business Research

Law stated - 08 September 2022

Secured lending and credit (movables)

What principal types of security are taken on movable (personal) property?

In 2012, the Personal Property Securities Act 2009 (PPSA) came into force in Australia, modelled largely on equivalent legislation in New Zealand and Canada. This legislation consolidated all of the existing registers on which security interests were previously registered and amended many of the concepts and terms associated with taking security over assets.

Security interest

The PPSA introduced a uniform concept of a 'security interest' to cover all existing 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 arrangement 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' is broadly defined and essentially includes all property other than land, fixtures and buildings attached to land, water rights and certain statutory licences.

The legislation has introduced a new lexicon relating to security in Australia. For instance, the traditional concept of a fixed and floating charge has now been replaced by 'general security agreement' and the PPSA now determines whether an asset is, in effect, subject to a floating charge on the basis that only circulating assets, as defined by the PPSA, will be treated as being subject to a floating charge for the purposes of other legislation including the provisions of the Corporations Act 2001 (Cth) that provide priority of certain claims over floating charge assets. 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 the PPSA register. However, security interests over certain assets can be perfected other than by way of registration; for example, by the security holder controlling the relevant asset in the manner prescribed by the PPSA.

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

One of the most significant changes implemented by the PPSA is to require the registration of retention of title arrangements to protect a supplier's title to the relevant supplied goods.

If a security interest is not perfected in accordance with the PPSA, the security interest will, on liquidation of the grantor, vest in the grantor. This has created a paradigm shift for retention of title arrangements as failure to perfect the retention of title arrangement (by registration) will vest title in the relevant goods in the recipient of the goods, despite the agreement between supplier and recipient that the supplier retains title to those goods until they are paid for.

Non-PPSA property

The PPSA does not cover security interests in land or fixtures and buildings attached to land. A mortgage over real property must be registered under the Torrens Title system, which operates under Australian law by registration on the relevant state or territory land title register. There are also certain assets such as statutory licences (eg, mining licences), which, by virtue of statute, are expressed to be outside the operation of the PPSA, and any security interest over any such asset is governed by common law.

© Copyright 2006 - 2021 Law Business Research

Law stated - 08 September 2022

CLAWBACK AND RELATED-PARTY TRANSACTIONS

Transactions that may be annulled

What transactions can be annulled or set aside in liquidations and reorganisations and what are the grounds? Who can attack such transactions?

The following types of transactions may be held to be void and set aside after a company has entered into liquidation:

- insolvent transactions (which includes both unfair preferences and uncommercial transactions);
- unfair loans;
- unreasonable director-related transactions; and
- transactions entered into for the purpose of defeating, delaying or interfering with creditors' rights on a company's winding up.

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. To be set aside, the relevant transaction must have been entered into or given effect to within two years of the 'relation back day' (being the commencement of the winding up or in certain circumstances the date when an administrator was appointed). The courts have held a transaction '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 from 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 or changed their position in reliance on the transaction. To be set aside, an unfair preference must have been entered into when the company was insolvent and within six months of the 'relation back day'.

Loans to a company are 'unfair' and thus voidable if the interest or charges in relation to the loan were, or are, not commercially reasonable. 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.

A liquidator can seek a court order under section 588FF of the Corporations Act 2001 (Cth) (the Act) with respect to suspected voidable transactions. Such orders must be sought within three years of the relevant 'relation back day' or within 12 months after the first appointment of a liquidator (whichever is later). Potential orders include the repayment of money paid or retransfer to the company of property it transferred. Orders may also be made varying a contract that is part of the transaction.

A liquidator can also apply to set aside 'creditor-defeating' transactions. Section 588FE(6B) of the Act enables liquidators to apply to set aside dispositions of property where the relevant transaction (or 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. The term 'Creditor-defeating dispositions' is defined in section 588FDB of the Act as a disposition 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.

In 2019, various amendments to the Act were introduced to enhance recovery measures for employee entitlements, namely:

© Copyright 2006 - 2021 Law Business Research

- an extension of the previous criminal offence provision to capture a person recklessly entering into transactions to avoid the recovery of employee entitlements;
- a new civil offence for such action with an objective reasonable person test; and
- an ability for a liquidator, among others in certain circumstances, to seek compensation for loss or damage suffered because of a contravention of the civil penalty provision.

Law stated - 08 September 2022

Equitable subordination

Are there any restrictions on claims by related parties or non-arm's length creditors (including shareholders) against corporations in insolvency or reorganisation proceedings?

No. However, related party claims are likely to be subject to greater scrutiny.

Law stated - 08 September 2022

Lender liability

Are there any circumstances where lenders could be held liable for the insolvency of a debtor?

Generally, lenders will not be held liable for the debts owed by an insolvent debtor. However, in certain circumstances, lenders working closely with a borrower (eg, lenders guiding a borrower in an effort to protect their debt exposure) may be considered 'de facto' or 'shadow' directors for the purposes of the Act and, therefore, exposed to liabilities associated with an insolvent debtor. A person may be held to be a de facto or shadow director of a company where, despite not holding an officer role in the company, they are a person in accordance with whose instructions and wishes others are accustomed to act (as detailed in the expanded definition of 'director' in section 9 of the Act). Such circumstances, for example, could expose a lender or their directors to liability for insolvent trading and other breach of directors' duties claims.

The New South Wales Court of Appeal considered this issue in the decision of Buzzle Operations Pty Ltd (in liquidation) v Apple Computer Australia Pty Ltd [2011] NSWCA 109. In that case, while the Court did not find that the relevant persons were acting as shadow directors (and therefore were not liable for insolvent trading claims), it did consider that for a person to be considered a shadow director, something more than mere control is needed: the decision-making must be deferred to the relevant persons such that the existing directors follow the instructions of the purported shadow director because those instructions are themselves treated as a sufficient reason to act. That is, a secured creditor will not be taken to be acting as a shadow director merely because they influence decisions by virtue of any leverage concerning their secured interests. Rather, others must be accustomed to acting in accordance with their instructions in a general sense (eg, even if those instructions are contrary to the interests of the company).

Law stated - 08 September 2022

GROUPS OF COMPANIES

Groups of companies

In which circumstances can a parent or affiliated corporation be responsible for the liabilities of subsidiaries or affiliates?

Cross-collateralisation and group guarantees are often sought by lenders into a corporate group. These guarantees provide comfort that a holding company will stand behind special purpose vehicles or operating companies. There is

© Copyright 2006 - 2021 Law Business Research

also a statutory form of cross-guarantee lodged with the Australian Securities and Investments Commission allowing corporate groups to lodge consolidated financial statements. This statutory cross-guarantee provides for a group to be liable for each other group member's debts and is designed to afford a level of comfort to creditors providing services or lending to operating subsidiaries. It also affords relief to corporate groups from the onerous reporting obligations imposed by Chapter 2M.3 of Corporations Act 2001 (Cth) (the Act). ASIC may grant an exemption order in respect of the specified class of companies described as 'class orders'. If such an order is made, the holding entity and its wholly owned entities will be considered a single legal entity for financial reporting purposes and will be able to prepare consolidated financial report. Class Order 2016/785 currently provides relief to wholly owned subsidiaries, provided:

- the group executes the standard deed of cross guarantee form;
- the holding company's directors lodge a written resolution in which they state they believe that the subsidiary members of the cross-guarantee group can meet their obligations or liabilities under the deed;
- a lawyer has certified that the relevant deed's wording is in accordance with the ASIC pro forma; and
- the holding company prepares and lodges audited financial statements for the group as a whole.

Further, under section 588V of the Act, a holding company of a company may, in certain circumstances, be held liable for the insolvent trading of a subsidiary.

Pooling

Under the Act, a court can make a 'pooling order' such that in the liquidation of a group of companies each of the separate group companies are treated as if they were a single company. This means that the creditors of the group will have their claims 'pooled' so that, in effect, they are treated as creditors of one entity with a combined pool of assets for distribution.

Notwithstanding that the Act makes no provision for the pooling of assets and liabilities of a group of companies in administration, Australian courts have sanctioned the use of pooling arrangements for groups in administration proposing to execute a pooled deed of company arrangement (DOCA). Ultimately this will be a decision of the creditors voting; however, a pooled DOCA will be persuasive if the return creditors of the group as a whole will provide a greater return than if the individual entities ratified separate DOCAs or were placed into liquidation.

Law stated - 08 September 2022

Combining parent and subsidiary proceedings

In proceedings involving a corporate group, are the proceedings by the parent and its subsidiaries combined for administrative purposes? May the assets and liabilities of the companies be pooled for distribution purposes?

Identity

In insolvency proceedings involving corporate groups, a consolidated group is not considered as a single legal entity. Where companies operate as a consolidated group, the starting legal position is that the 'separate personality' principle prevents creditors of an insolvent company from gaining access to the funds of other companies for payment of their debts.

The Act, however, provides for a holding company to be liable for the debts of their insolvent subsidiaries in certain circumstances. These provisions enable the subsidiary's liquidator to recover amounts equal to the loss or damage suffered by creditors from the parent company if the parent failed to prevent the subsidiary from incurring debts while

© Copyright 2006 - 2021 Law Business Research

there were reasonable grounds to suspect that the subsidiary was 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. Australian courts have, however, displayed greater reluctance than their UK counterparts to lift the corporate veil in these circumstances.

The only form of external administration that expressly permits combining proceedings by parent and subsidiary companies is under a scheme of company arrangement. To enable a scheme, an application must be made to the court requesting a meeting of the creditors and members. Where a scheme of arrangement is proposed involving a large corporate group, the application may request for the meeting to occur on a consolidated basis. An application for an order to transfer the whole of the assets and liabilities of the subsidiaries to the parent company may also be made when seeking approval of a proposed scheme.

This scheme requires significant court involvement and thus execution is generally slower and more expensive than voluntary administration.

Pooling

Pooling of group funds may occur in limited circumstances, as prescribed by Division 8, Part 5.6 of the Act, being sections 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 that members of the group are jointly liable to creditors. The liquidator of the corporate group 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 pooling order must satisfy all the requirements of section 579E of the Act. In forming a view, the court will often consider the operational realities of an insolvent group of companies; whether they are centrally managed, which entities are income-generating and what role is played by the parent entity. The court does not have power to make a pooling order if it will materially disadvantage an unsecured creditor, or if the possibility for disadvantage is not outweighed by the potential advantages of pooling assets.

In relation to a company in liquidation, the court may make orders for the transfer of assets from a winding up in Australia to an external administration outside Australia, either pursuant to section 581 of the Act or pursuant to the UNCITRAL Model Law on Cross-Border Insolvency, incorporated into Australian law by the Cross-Border Insolvency Act 2008 (Cth).

Law stated - 08 September 2022

INTERNATIONAL CASES

Recognition of foreign judgments

Are foreign judgments or orders recognised, and in what circumstances? Is your country a signatory to a treaty on international insolvency or on the recognition of foreign judgments?

The Foreign Judgments Act 1991 (Cth) (FJA) creates a general system of registration of judgments obtained in foreign countries. The FJA 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. Judgments of other foreign countries may also be recognised under the common law rules for the recognition of foreign judgments.

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

© Copyright 2006 - 2021 Law Business Research

years of the last judgment in the appeal proceedings.

Law stated - 08 September 2022

UNCITRAL Model Law

Has the UNCITRAL Model Law on Cross-Border Insolvency been adopted or is it under consideration in your country?

Australia formally adopted the UNCITRAL Model Law on Cross-Border Insolvency by implementing legislation called the Cross-Border Insolvency Act 2008 (Cth) (the Cross-Border Act).

This legislation adopts the UNCITRAL Model Law with as few changes as necessary to adapt it to the Australian context. Some of the most important features of the legislation include:

- the participation by foreign creditors in local insolvency proceedings;
- facilitated cooperation between courts and insolvency practitioners from different countries;
- allowing a person administering a foreign insolvency proceeding to have access to local courts and in which circumstances this is possible;
- the setting out of conditions for recognition of an insolvency proceeding and for granting relief to representatives of such a proceeding; and
- the ability to effectively coordinate insolvency proceedings occurring concurrently in different states.

Law stated - 08 September 2022

Foreign creditors

How are foreign creditors dealt with in liquidations and reorganisations?

Under the Cross-Border Act, 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 proceedings.

Law stated - 08 September 2022

Cross-border transfers of assets under administration

May assets be transferred from an administration in your country to an administration of the same company or another group company in another country?

In relation to a company in liquidation, the court may make orders for the transfer of assets from a winding up in Australia to an external administration outside Australia, either pursuant to section 581 of the Corporations Act 2001 (Cth) or the Cross-Border Act.

Law stated - 08 September 2022

COMI

What test is used in your jurisdiction to determine the COMI (centre of main interests) of a debtor company or group of companies? Is there a test for, or any experience with, determining the COMI of a corporate group of companies in your jurisdiction?

© Copyright 2006 - 2021 Law Business Research

Australia formally adopted the UNCITRAL Model Law on Cross-Border Insolvency by implementing the Cross-Border Act. Under the Cross-Border Act, there is a rebuttable presumption that the centre of the debtor's main interest is its registered office, or in the case of a natural person, his or her habitual residence. The UNCITRAL Model Law is silent on the standard required for COMI determination.

Given this, the Australian courts have looked to and adopted similar reasoning to other jurisdictions when considering COMI (eg, the bankruptcy courts in the United States) and have equated the concept of COMI with the principal place of business. In considering where the COMI of a debtor or group of companies exists, the courts will look at a number of factors, including:

- the location of the debtor's headquarters;
- the location of those who actually manage the debtor;
- the location of the debtor's primary assets;
- the location of the majority of the debtor's creditors or a majority of creditors who would be affected by the case; and
- the jurisdiction whose law applies to most disputes.

Law stated - 08 September 2022

Cross-border cooperation

Does your country's system provide for recognition of foreign insolvency proceedings and for cooperation between domestic and foreign courts and domestic and foreign insolvency administrators in cross-border insolvencies and restructurings? Have courts in your country refused to recognise foreign proceedings or to cooperate with foreign courts and, if so, on what grounds?

Section 581 of the Act provides that an Australian court may request a foreign court with jurisdiction in external administration matters to render assistance in the recovery of overseas property of the company. In deciding whether to authorise a letter of request, one important consideration will be how likely it is that the foreign court will act upon the request.

The Cross-Border Act provides an alternative method whereby an Australian insolvency practitioner may seek recognition under the UNCITRAL Model Law in a foreign jurisdiction and thereby give the foreign court independent jurisdiction to provide assistance. Under the UNCITRAL Model Law, the insolvency practitioner may then have authority to recover assets in the foreign jurisdiction.

In relation to insolvency proceedings conducted in a foreign jurisdiction, section 581 of the Act also provides that an Australian court must assist bankruptcy courts of prescribed countries and has a discretion to assist courts of other countries. The prescribed countries are Canada, Jersey, Malaysia, New Zealand, Papua New Guinea, Singapore, Switzerland, the United Kingdom and the United States. Once again, the UNCITRAL Model Law provides an alternative procedure, whereby a representative in a foreign jurisdiction may approach an Australian court requesting assistance in the recovery of property located in Australia belonging to the foreign company. In Re Cow Cho Poon (Private) Limited (2011) 249 FLR 315, a Singaporean liquidator made an application to an Australian court pursuant to section 581 of the Act seeking declarations that he was authorised to open, close, redesignate and operate certain bank accounts held by the company in Australia. In granting the relief sought, the Australian court noted that to so order would be of utility and would aid the effectuation of the winding-up orders made by the Singapore court. It is likely that a similar result would have been reached had the UNCITRAL Model Law been invoked.

While in most cases Australian courts have formally recognised foreign proceedings under section 581 of the Act when

© Copyright 2006 - 2021 Law Business Research

requested to do so, there have been exceptions. For example, in Yu v STX Pan Ocean Co Ltd (South Korea), in the matter of STX Pan Ocean Co Ltd (receivers appointed in South Korea) [2013] FCA 680, the court was reluctant to grant additional relief as the relief sought would adversely affect any rights that other Australian creditors may otherwise have had, whether under the Act or otherwise.

There is an example where an Australian court has refused to recognise foreign proceedings or grant relief sought under the Cross-Border Act in relation to a corporate insolvency. In Indian Farmers Fertiliser Cooperative Ltd v Legend International Holdings Inc (2016) 52 VR 1, the court refused to recognise US Chapter 11 proceedings in circumstances where the holding company's COMI was Australian (relevantly its assets and operations that were undertaken by its subsidiaries are all in Australia), and the company's US presence was purely administrative.

Law stated - 08 September 2022

Cross-border insolvency protocols and joint court hearings

In cross-border cases, have the courts in your country entered into cross-border insolvency protocols or other arrangements to coordinate proceedings with courts in other countries? Have courts in your country communicated or held joint hearings with courts in other countries in cross-border cases? If so, with which other countries?

In January 2020, the Federal Court of Australia published the Cross Border Insolvency Practice Note: Cooperation with Foreign Courts of Foreign Representatives, which states that the court's cooperation obligation will be guided by the Guidelines for Communication and Co-operation between Courts in Cross-Border Insolvency Matters and the Modalities of Court-to-Court Communication (both published by the Judicial Insolvency Network), and the Practice Guide on Cross-Border Insolvency Co-operation 2009 (published by UNCITRAL).

Many of the cases involving cross-border elements heard in Australian courts involve the protection of assets and the issuance of injunctions or stay orders. One such example was the case of Lawrence v Northern Crest investments Limited (in liq) [2011] FCA 672, where an interim injunction was granted against the Australian directors of an insolvent New Zealand company restraining them from dealing with the company's assets, pending an application by the liquidator for orders that the winding-up proceedings in New Zealand be classified as a 'foreign main proceeding'.

The case of Re Kelly, Halifax Investment Services Pty Ltd (in Liq) (No. 5) [2019] FCA 1341 is a recent example of the Federal Court of Australia cooperating with the High Court of New Zealand to conduct a joint hearing of liquidators' application for directions.

In that case, the Federal Court of Australia considered that an application for the issuance of a letter of request to the High Court of New Zealand requesting that it act in aid of and be auxiliary to the Federal Court of Australia was to be at least partially informed by the Guidelines for Communication and Co-operation between Courts in Cross-Border Insolvency Matters. Gleeson J granted the relief sought pursuant to section 581(4) of the Act, which provides that the Court may request a court of another country that has jurisdiction in external administration matters to act in aid of and be auxiliary to it in an external administration matter. The substantive hearing was subsequently heard jointly by the Federal Court of Australia and the High Court of New Zealand (being the first concurrent hearing between these two courts).

Law stated - 08 September 2022

Winding-up of foreign companies

© Copyright 2006 - 2021 Law Business Research

What is the extent of your courts' powers to order the winding-up of foreign companies doing business in your jurisdiction?

The rise of foreign investment in Australia has also seen a steady increase in the number of insolvencies of foreign companies in Australia. A foreign company that falls within the classification of a 'Part 5.7 body', that is, a foreign company that is registered under the Act or carrying on business in Australia, can be wound up under Australian insolvency processes. Once a foreign company carries on business in Australia, it is susceptible to a winding-up order, regardless of whether it has subsequently ceased to carry on business in the jurisdiction (see Australian Securities and Investments Commission v Edward [2004] QSC 344). Pursuant to section 583 of the Act, a Part 5.7 body can be wound up where it is unable to pay its debts, has been dissolved or deregistered, has ceased carrying on business in Australia or on just and equitable grounds. Largely mirroring the procedure for winding up an insolvent Australian company under Part 5.4 of the Act, the creditor is required to serve on the Part 5.7 body a statutory demand requiring payment of debt of at least A$4,000 within 21 days. In response to the covid-19 pandemic, the Australian government made temporary changes to insolvency laws that included increasing the threshold amount for which creditors can issue a statutory demand (from what was then a minimum of A$2,000 to A$20,000) and the time for compliance of a statutory demand (from 21 days to six months). Following the expiry of these temporary changes on 31 December 2020, the Corporations Amendment (Statutory Minimum) Regulations 2021 amended regulation 5.4.01AAA of the C orporations Regulations 2001 (Cth) such that, from 1 July 2021, the statutory minimum amount for issuance of a creditor's statutory demand increased from $2,000 to $4,000 but the period within which a debtor must respond to a statutory demand remains at 21 days.

However, failure by a Part 5.7 body to pay the debt within the prescribed period does not result in an automatic presumption of insolvency (as is the case in a winding up under Parts 5.4 and 5.4B), but rather gives rise to a presumption that the company is unable to pay its debts (see Cato Brand Partners Pty Ltd v Air India Limited [2016] VSC 28). Where concurrent foreign and local liquidations are taking place regarding the same debtor and there is inconsistency between Part 5.7 of the Act and the UNCITRAL Model Law, section 22 of the Cross-Border Act dictates that the UNCITRAL Model Law prevails.

The Australian courts also have jurisdiction to order an ancillary liquidation where a foreign company registered in Australia is subject to a contemporaneous foreign liquidation. Section 601CL(14) of the Act provides that where a registered foreign company is being wound up, dissolved or deregistered in its place of origin, the Australian court must, on application by the foreign liquidator, or by the Australian Securities and Investments Commission, appoint an Australian liquidator of the foreign company. The powers of the Australian liquidator are limited, and unless the court otherwise orders, the net amount of all property of the foreign company recovered and realised by the Australian liquidator must be paid to the foreign liquidator.

Law stated - 08 September 2022

UPDATE AND TRENDS

Trends and reforms

Are there any emerging trends or hot topics in the law of insolvency and restructuring? Is there any new or pending legislation affecting domestic bankruptcy procedures, international bankruptcy cooperation or recognition of foreign judgments and orders?

Inquiry into corporate insolvency in Australia

On 28 September 2022, the federal government commenced an inquiry into the effectiveness of Australia's corporate

© Copyright 2006 - 2021 Law Business Research

insolvency laws in protecting and maximising value for the benefit of all interested parties. The investigating committee has noted that it recognises the need for Australia's corporate insolvency regime to be 'fit for purpose' and to 'effectively serve the Australian economy and all participants in it'. Accordingly, it has announced a broad review of recent and emerging trends in the use of corporate insolvency in Australia, including temporary covid-19 insolvency measures, and other policy measures introduced in response to the pandemic; and recent changes in domestic and international economic conditions, increases in material and input costs for businesses and inflationary pressures more broadly, and supply shortages in certain industries. Potential areas flagged for reform by the committee include the unfair preference regime, the treatment of trusts with corporate trustees as they relate to corporate insolvency, insolvent trading, safe harbour protection, and international approaches and developments. The committee is accepting submissions from interested persons and stakeholders up until 30 November 2022, with a view to submitting a report to both Houses of Parliament by 30 May 2023.

Developments in case law

Recently, the courts have affirmed several long-standing principles and clarifying the position at law for practitioners.

For example, the High Court's decision in Walton v ACN 004 410 833 Limited (formerly Arrium Limited) (in liquidation) [2022] HCA 3 held that 'eligible applicants' (in this case, shareholders of failed companies) were entitled to summon former officers of those companies for public examination pursuant to section 596A of the Corporations Act 2001 (Cth) (the Act). The majority of the High Court held that public examinations under section 596A conducted for the purpose of obtaining evidence and information to support the commencement of proceedings against a company, its officers or advisers (and which was not for the ultimate benefit of the company or its creditors) is not an abuse of process. With that said, the Court retains its overarching jurisdiction to refuse an application for public examination if it considers that it would amount to an abuse of process.

Another separate example of the Court clarifying and affirming the position at law is in the case of Morton as Liquidator of MJ Woodman Electrical Contractors Pty Ltd v Metal Manufacturers Pty Limited [2021] FCAFC 228, where it was held that a creditor who has received an unfair preference cannot rely on set off under section 553C of the Act to reduce the amount it must repay to the liquidator in respect of the preference. The Court considered how the Act's unfair preference provisions interact with insolvency set-off under section 553C. Crucially, this included analysis of the requirement of 'mutuality'. That is, the claims that are sought to be set-off against one another must be between the same parties, and those parties must hold those claims for their own benefit and interest. Also relevant was the requirement that the liability being set off must already exist (even if in the form of a contingent liability) at the commencement of the liquidation.

Rent relief during voluntary administrations

Section 443B of the Act sets out the circumstances in which an administrator will be liable for payments for property used, occupied or in the possession of the relevant company during the administration period. Section 443B(2) provides that an administrator will be liable for rent and amounts payable under the relevant agreement that are attributable to the period commencing five business days after the administration begins (the grace period) and during which the company continues to use, occupy or possess the relevant property during the administration period.

The administrator may give notice before the end of the grace period stating they do not wish to continue to exercise rights in relation to the period. The effect of this notice is that, from the date of the notice until it is revoked, the administrator will not be liable for amounts owing under the relevant leasing arrangement for the period commencing after the grace period.

Section 443B(8) of the Act (together with the operations of the more general powers under section 447A of the Act) allows an administrator to apply to court to 'excuse' the administrator for any liability even where the notice was not

© Copyright 2006 - 2021 Law Business Research

given to the lessor before the expiry of the grace period. Also, an administrator may apply to court seeking to extend the grace period, in circumstances where:

- further time is required to allow the administrators an opportunity to explore all options available to recapitalise or sell the company as a going concern, or to otherwise explore the possibility of entering into a deed of company arrangement (which includes deciding whether the company or administrators should continue to occupy the leased premises); and
- the extension is in the best interests of the creditors as a whole.

The operation of section 443B only impacts the liability of the administrator. It does not affect the liability of the relevant company in administration.

In response to issues arising out of the covid-19 pandemic, there were three significant decisions regarding section 443B, each demonstrating the court's willingness to extend the grace period under section 443B in light of the logistical challenges and uncertainty in the trading and financial circumstances in connection with the covid-19 pandemic.

First, in Strawbridge (Administrator), in the matter of CBCH Group Pty Ltd (Administrators Appointed) (No. 2) [2020] FCA 472, at the expiration of the grace period, the administrators elected to remain in possession of the relevant property and thereafter paid rent in accordance with the lease agreements that accrued after the grace period (with such payments forming part of the costs of the administration, and payments for which the administrators were personally liable). Subsequently – and as a result of the impact of the covid-19 pandemic – the administrators sought, and were granted, orders that they should not be personally liable for amounts due under the leases, notwithstanding that the company would continue to occupy and remain in possession of the property. Further, the administrators sought, and were granted, a declaration from the court that they would be justified in not causing the company to pay the amounts due even though the company remained liable for those amounts.

Second, in the administration of the Virgin Airlines group of companies (Virgin Group), the administrators applied for, and the court granted, orders modifying the time periods under sections 443B(2) and 443B(3) before the end of the grace period. The effect of the orders resulted in the Virgin Group administrators carrying on the Virgin Group's business with the benefit of an extension of the grace period in respect of certain liabilities for the administration period.

Third, in Ford (Administrator, in the matter of The PAS Group Limited (Administrators Appointed) v Scentre Management Limited [2020] FCA 1023) (PAS Decision), the Federal Court of Australia considered the administrators' application for judicial directions as to whether rental amounts accruing during an administration period should be treated as a priority expense under section 556(1)(a) of the Act. Relevantly, the administrators previously sought, and were granted, an extension of the grace period under section 443B of the Act from the commencement of the administration (29 May 2020) until 22 June 2020. O'Callaghan J rejected the administrators' application, finding that by operation of the principle in Lundy Granite, the amounts payable under the lease arrangements during the extended grace period would be payable in a liquidation as a cost of the administration (that is, afforded priority under section 556(1)(a) of the Act). Having considered the parties' submissions and applying the principle in Lundy Granite, His Honour declined to make the order in circumstances where the administrators had actively traded from all but eight out of 161 leases, the administrators had 'elected to cause the company to continue in occupation of those leased premises for the purposes of the administration'.

Consultation on improving schemes of arrangement

On 3 May 2021, the federal government announced that it would consult with industry on improving schemes of arrangement to better support businesses, including by introducing a moratorium on creditor enforcement while

© Copyright 2006 - 2021 Law Business Research

schemes are being negotiated. On 2 August 2021, the federal Treasury opened consultations and invited stakeholders to make submissions on the proposed reforms by 10 September 2021.

The consultation was aimed at assessing whether the current scheme of arrangement process is useful as a means of restructuring insolvent companies. In its current form, schemes of arrangement are typically used in complex restructurings of large corporate groups, involve a high level of court involvement and, unlike other insolvency processes (eg, voluntary administration), there is no automatic moratorium to prevent creditors from bringing claims against the company during the negotiation and formation of the scheme.

The federal government is considering the efficacy of introducing an automatic moratorium on creditor claims to provide 'breathing space' to financially distressed companies and what effect that could have on creditor rights. In particular, the consultation sought input from stakeholders as to:

- whether an automatic moratorium should apply from the time a company proposes a scheme of arrangement;
- whether the moratorium applicable in a voluntary administration would be a suitable model on which to base the proposed moratorium for a scheme of arrangement, if any adjustments are required and if the court ought to be granted the power to modify or vary the moratorium;
- when any moratorium should commence and terminate, and how long it should last;
- whether any additional protections against liability for insolvent trading are required to support the proposed moratorium;
- what safeguards are required to protect creditors that extend credit to the company during the automatic moratorium period; and
- whether insolvency practitioners assisting with the scheme should be permitted to act as voluntary administrators of the company where the scheme fails.

The consultation also sought input on the efficacy of the current scheme of arrangement framework generally. As of 8 August 2022, there were 22 submissions from stakeholders, including advisers, industry bodies and insolvency practitioners.

In our view, the addition of a moratorium on creditor claims during the formulation of a scheme of arrangement is a welcome change and is likely to lead to higher uptake of the process by financially distressed (but still solvent) companies.

Law stated - 08 September 2022

© Copyright 2006 - 2021 Law Business Research

Jurisdictions

Jurisdiction	Firm
Australia	Gilbert + Tobin
Austria	Freshfields Bruckhaus Deringer
Belgium	Freshfields Bruckhaus Deringer
Bermuda	Carey Olsen
British Virgin Islands	Carey Olsen
Canada	Thornton Grout Finnigan
Cayman Islands	Carey Olsen
China	Dentons
Croatia	Schoenherr
Dominican Republic	Guzmán Ariza
European Union	Freshfields Bruckhaus Deringer
Finland	Waselius & Wist
France	Freshfields Bruckhaus Deringer
Germany	Freshfields Bruckhaus Deringer
Ghana	B&P Associates
Greece	PotamitisVekris
Guernsey	Carey Olsen
Hong Kong	Freshfields Bruckhaus Deringer
Hungary	Nagy és Trócsányi
India	Chandhiok & Mahajan, Advocates and Solicitors
Indonesia	Oentoeng Suria & Partners
Ireland	Dillon Eustace LLP
Italy	Freshfields Bruckhaus Deringer
Japan	Anderson Mōri & Tomotsune
Jersey	Carey Olsen

© Copyright 2006 - 2021 Law Business Research

Jurisdiction	Firm
Malta	Ganado Advocates
Mauritius	Benoit Chambers
Netherlands	Freshfields Bruckhaus Deringer
Romania	CITR SPRL
Singapore	Ashurst
Slovenia	Jadek & Pensa
South Africa	Fasken
Spain	Freshfields Bruckhaus Deringer
Switzerland	Walder Wyss Ltd
Taiwan	Lee and Li Attorneys at Law
Thailand	Weerawong, Chinnavat & Partners Ltd
Ukraine	Vasil Kisil & Partners
United Arab Emirates	Freshfields Bruckhaus Deringer
United Kingdom - England & Wales	Freshfields Bruckhaus Deringer
USA	Paul, Weiss, Rifkind, Wharton & Garrison LLP
Vietnam	Freshfields Bruckhaus Deringer

© Copyright 2006 - 2021 Law Business Research