ALLEN & OVERY

Restructuring, liquidation and solvent dissolution options in Australia

Overview

Australia has a well-developed and comprehensive legal framework for the restructuring, insolvent liquidation or solvent dissolution of Australian companies – both solvent and insolvent. A number of options are available to Australian companies looking at those different circumstances.

Broadly, these options can be categorised into two categories, being (1) solvent, and (2) insolvent:

– Solvent options are available to solvent companies that wish to explore a restructure or dissolve.

– Insolvent options are typically used by companies that are (or are likely) to be insolvent, and that need to be restructured or wound up on an insolvent basis.

A summary table is immediately below.

Item	Option	Solvent or insolvent?	Directors or creditors	When is it suitable?
1	Members' Voluntary Liquidation	Solvent	Shareholders	Solvent dissolution of a company that had trading activity.
2	Voluntary Deregistration	Solvent	Directors or shareholders	Solvent dissolution of a company with no or limited trading activity (e.g. a holding company or dormant company).
3	Informal Workout	Solvent	Directors or creditors	Whenever informal solutions with creditors are feasible. Particularly relevant where resolving more tightly-held financial debt (as opposed to widely owed trading debt) is key to a solution for the company.
4	Safe Harbour	Insolvent or near-insolvent	Directors	A support tool for enabling directors of a distressed company to continue trade while working on an informal workout or planning for a formal insolvency.
5	Deed of Company Arrangement ("DOCA") following voluntary administration	Insolvent	Directors	A flexible, formal insolvency restructuring tool. It follows a voluntary administration. Widely suitable for restructuring debts (but limited usefulness with secured debt – a creditors' scheme of arrangement may be preferable).
6	Creditors' Scheme of Arrangement	Insolvent	Creditors	Another flexible formal insolvency restructuring tool – more cumbersome to implement than a DOCA, but with the advantage of being able to bind secured creditors. Ideally suited to financial restructuring of large/complex debt stacks.
7	Small Business Restructuring Plan	Insolvent	Directors	For small and micro businesses (less than $1,000,000 in total debts) – a quick and straightforward alternative to a DOCA.
8	Creditors' Voluntary Liquidation	Insolvent	Directors	Best suited to a terminal liquidation of a failed/insolvent company – where an attempt at restructuring through administration and DOCA would be unlikely to work.
9	Court liquidation	Solvent or insolvent	Directors or shareholders	A rarely used option, but can be effective in instances of shareholder/management failure (e.g. in a failed or dysfunctional joint venture). Also commonly used by creditors to attempt to force an involuntary liquidation on a debtor company that has failed to pay its debts.

When considering restructuring options it is prudent for directors and companies to engage early with legal and restructuring advisors. A good understanding of the various restructuring options will enable the company to take prompt action to implement a strategy that can result in the most desired and optimal outcomes, whether that is a complete internal restructuring, informal workout of existing debt obligations, winding down of certain business units, or implementing formal insolvency processes.

Allen & Overy can assist clients in analysing the situation, engaging with restructuring advisors, and in preparing an effective restructuring strategy.

The above options are explained in more detail below.

Solvent options

Members' voluntary liquidation

Where it is determined that a company's business should be wound down, it is possible to have the company liquidated on a voluntary basis (that is, without a Court order). It is a process that is instigated by the shareholders of the company.

Members' voluntary liquidation is the best option for a winding down of a solvent company if the company does not meet the criteria for a voluntary deregistration.

A members' voluntary liquidation will usually be initiated by the directors and can be commenced if:

– the directors make a declaration of solvency in relation to the company to the effect that in their opinion the company will be able to pay its debts in full within 12 months after the commencement of the winding up; and

– within five weeks of the directors making the solvency declaration, the shareholders resolve to have the company wound up and to have a liquidator appointed. The resolution to wind up the company requires at least 75% of the votes cast to be in favour in order to be passed.

The liquidator appointed will then have the conduct of the winding down and have the power to realise the company's assets and pay the company's creditors.

Voluntary Deregistration

Voluntary deregistration is an option a corporate group may pursue as part of the restructure and streamlining of the group. It is only an appropriate and available option where the company has ceased trading and the strict criteria is met.

In order to qualify for a voluntary deregistration all of the following conditions must be satisfied:

– all the shareholders of the company agree to the deregistration;

– the company is not carrying on business;

– the company's assets are worth less than $1,000;

– the company has paid all fees and penalties payable under the Corporations Act;

– the company has no outstanding liabilities; and

– the company is not a party to legal proceedings.

If that criteria is met, the company, its directors or shareholders can make an application to ASIC for the deregistration of the company. If ASIC agrees to deregister the company, it will publish notice of the proposed deregistration and then deregister the company once more than two months from the date of publication have passed.

On deregistration, the company will cease to exist. If the company owns any assets on deregistration, those assets will vest in the Commonwealth or ASIC.

If the company is solvent but does not satisfy all of the criteria outlined above, the company can be wound down via a members' voluntary liquidation.

Informal Workout

An informal workout is typically a non-judicial process whereby a distressed company and its creditors come to a consensual agreement to adjust the obligations the company (or group of companies) is under. Informal workouts can be in various forms, which commonly include refinancing of debt obligations, agreements to restructure existing facilities (such as by way of amendments to margin on the facilities and extension of maturity date), debt-for-equity swaps, and agreements to facilitate a sell-down in return for a standstill or waiver of defaults. To the extent that an event of default has occurred and is subsisting, it is standard practice that deeds of forbearance and standstill agreements be entered into to enable ongoing negotiations between the company and its creditors.

A key feature (and advantage) of an informal workout is that the directors remain in control of the company, who have intimate knowledge of the business to maximise the chance of survival of the company. This is in contrast to formal procedures such as voluntary administration, where an independent insolvency practitioner is appointed to and is responsible for operating the company.

Informal workouts can therefore be the preferable option for a company to explore in the first instance as these tools can, if implemented early, involve lower costs and be delivered on an expedited timeline as determined by the directors of the company. Informal workouts also have additional advantages; for example, an informal workout can be conducted confidentially (subject to mandatory disclosure obligations concerning listed companies) with the workout carried out with little or no attention from competitors and the market during the process. This can assist in preserving value in the business and seek to protect the company from destruction in brand and operational value which can result where formal workout and restructuring options are pursued.

An informal workout could also potentially avoid the risk of any cross-default under the company's bank facilities or "insolvency" defaults under key contracts (depending of course on how the defaults are drawn).

A disadvantage of attempting to pursue an informal workout is that it generally requires the consent of the affected creditors (except for very limited circumstances – for instance, the restructuring of certain provisions of a syndicated facility can be consented to by majority lenders as opposed to all lenders). Any creditor who refuses to participate in the informal workout cannot be bound to the arrangements and remains free to pursue their legal rights against the company which may include action to recover debts owing and the enforcement of securities.

Safe Harbour

While not a restructuring procedure as such, the "safe harbour" is relevant as a tool for an informal workout for a stressed or distressed company, outside of a formal insolvency proceeding.

As background, in Australia, directors are under a duty to prevent the company from trading while insolvent. If the directors fail to prevent the company from trading while insolvent and the company subsequently goes into liquidation, the directors can be made personally liable for the debts incurred by the company while insolvent if at the time the debt was incurred the director was aware there were reasonable grounds for suspecting insolvency or a reasonable person in the director's position would have been so aware and no defences apply.

The "safe harbour" regime if implemented properly is a defence to such a claim.

In order to obtain the benefit of the "safe harbour" regime the directors must, at a time after they suspect the company may be insolvent, have started developing one or more courses of action (essentially as part of a plan for restructuring the company to improve its financial performance) that are reasonably likely to lead to a better outcome for the company when compared to immediate formal options – i.e. voluntary administration or liquidation.

It is usual for directors seeking to rely on the "safe harbour" to appoint appropriately qualified accounting and legal advisors to assist with the restructuring plan.

The "safe harbour" applies to debts incurred during the period from when the company starts developing the restructuring plan and continues while the plan is active and being actioned. If the plan is not followed or actioned within a reasonable time, the plan is discontinued or no longer being actioned or the plan ceases to be likely to lead to a better outcome for the company then the "safe harbour" also ceases.

In order to qualify for the "safe harbour" defence, directors must also ensure that while the plan is being pursued the company does the following:

- is paying employee entitlements as they fall due; and
- is giving returns, notices, statements, applications or other documents as required by taxation laws.

A key purpose of the "safe harbour" is to enable the company to pursue a restructuring plan outside of the formal processes reducing both cost and time required to complete the turnaround by carving out personal liability for directors if the procedures are followed. Absent this carve-out, at least anecdotally, the duty to prevent insolvent trading and the potential personal liability of directors has historically led to directors instigating voluntary administration or voluntary liquidation as a means of reducing that risk rather than seeking to restructure the company via an informal workout.

For completeness, it is worth noting that the "safe harbour" can be adopted in conjunction with informal workout strategy. It has been observed that the availability of "safe harbour" has slowly changed the restructuring and turnaround landscape by permitting directors to take reasonable risks to restructure a business (and to save jobs and minimise loss to creditors in the process) without the fear of personal liabilities.

Insolvent options

Deeds of Company Arrangement – following a voluntary administration

When it is determined by the directors that the company is or may become insolvent, the directors may resolve that the company be placed into voluntary administration and that an independent insolvency practitioner be appointed as administrator of the company.

The appointment of the voluntary administrator sets up a broad-based moratorium on action against the company – giving time for the administrator to explore options for restructuring of the company.

A deed of company arrangement is one potential outcome of a voluntary administration. The aim of a DOCA is to try to improve the prospects of the company continuing in existence or alternatively increasing the returns to creditors that would otherwise be available if the company had immediately gone into liquidation.

A DOCA is a statutory contract between the company and its creditors that governs the relations between the company and its creditors. DOCAs can be a desirable restructuring tool; while they are formal, they still offer a high degree of flexibility to the DOCA proponent, as they can be tailored specifically to the circumstances of the company. For example, the DOCA may provide for a moratorium/standstill of creditor claims, it may compromise creditors' claims, it may contemplate a debt-for-equity swap or a sale of certain assets of the company, it may contain a plan to pay creditors in instalments over a longer period of time or a combination of these characteristics. The DOCA will also specify the property of the company available to pay creditor claims and the order of priority of payment (typically following the priority in a liquidation).

For example, existing management could continue trading the company with a DOCA in place that provides for a simple compromise of claims and a moratorium on enforcement. A DOCA of this kind would likely require a third party (for example the directors or shareholders) to make a contribution to the

fund together with a plan to fund or recapitalise the company to enable it to continue to trade. Alternatively, a DOCA could be proposed as part of an offer to acquire the shares in the company. A DOCA enables the company to be "cleansed" of certain of its debts which reduces the risk of a share purchase. If the shareholder of the company is not subject to the control of the administrators, the shares can still be sold with the consent of the owners of the shares or leave of the Court (if the shares have no residual value).

During the voluntary administration, the administrators will call for expressions of interest in the business/DOCA proposals and at the same time seek to reduce operational costs and "re-package" the business in order to achieve the greatest possible return to creditors and to allow the company to continue in existence. A DOCA proposal is essentially a term sheet setting out the key terms of the DOCA that an interested party wishes to propose.

Creditors make a decision about the future of the company at the second meeting of creditors. Prior to that meeting, the administrators are required to prepare and circulate a report to creditors, which amongst other things, will set out the details on any DOCA Proposals received by the Administrators and provide their recommendation as to the best course of action.

If a DOCA proposal is approved by the requisite majorities, the terms will be recorded in a written document (i.e. the DOCA) and until the DOCA has been terminated, the company will need to include the words ("subject to a deed of company arrangement") at the end of its name.

If the terms of the DOCA are achieved, then the DOCA will be "effectuated" and the company should emerge out of the restructuring process solvent. If for whatever reason the DOCA does not effectuate (i.e. because it is terminated for another reason) then the company will automatically be placed into a creditors' voluntary liquidation.

A key advantage of a DOCA is that it binds creditors of the company as at the date of the appointment of the administrators to the statutory contract with only a simple majority of creditors voting in favour (the requisite majorities are 50% of the creditors voting and 50% of the debt voted). It therefore has an advantage over an informal workout which typically requires each affected creditor to agree. Also, and unlike with a scheme of arrangement (more details below), all creditors vote together as one class. A DOCA is also a quicker and cheaper process than a scheme of arrangement as it does not require Court supervision.

A key disadvantage of the DOCA is that it typically cannot compromise or interfere with secured creditors' rights or the rights of owners of property in relation to that property (for example, premises rented or goods hired or leased) unless that creditor or owner voted in favour of the DOCA. A DOCA can also only be initiated following a voluntary administration and the appointment of administrators may cause reputational and brand damage and with it a potential destruction in value. It also means that company management are not in control during the restructuring process.

Creditors' Scheme of Arrangement

A creditors' scheme of arrangement is another statutory means of restructuring creditor claims. Due to the various disadvantages described below, it is not a popular or commonly used restructuring tool in Australia. It can however achieve a compromise of secured creditor claims and in recent years has been used for this purpose either to alter the terms of the secured loans (e.g. interest rate or due dates or both) and/or to effect a debt for equity swap.

A scheme of arrangement is propounded by the company although it will usually have the support of a majority of creditors proposed to be affected by the scheme (often recorded in a restructuring support deed).

An explanatory statement (or scheme booklet) is required to be prepared which explains to creditors proposed to be affected by the scheme both the proposed terms of the scheme and the approval process and typically appends an expert report addressing whether the scheme is fair and reasonable to scheme creditors.

The scheme booklet must be lodged with Australian Securities and Investments Commissions (**ASIC**) for review at least 14 days prior to a first court hearing (in England called the "convening hearing") at which the court will be asked to convene a meeting or meetings of the affected creditors and approve the scheme booklet for dispatch to the affected creditors. If the meeting or meetings of affected creditors is convened (called a scheme meeting), creditors will be asked at that meeting to consider a resolution to approve the scheme. The resolution is passed if the requisite majorities are met (being 50% of the creditors voting and 75% of the debt voted having voted in favour of the scheme) at the scheme meeting of if multiple scheme meetings are held for different classes of creditors, at each scheme meeting.

If creditors approve the scheme then following the scheme meeting(s) a second court hearing will be held (in England called the "sanction hearing") where the Court will be asked to make orders approving the scheme. The scheme will become effective once those orders are lodged with ASIC and bind all affected creditors even dissenting creditors.

Please refer to our detailed discussions around deeds of company arrangement (**DOCA**) below. In our experience, schemes are more expensive and take longer to have approved than a DOCA due to the approval mechanisms and the Court and ASIC oversight. They also have a higher voting threshold than a DOCA and each class of affected creditor votes at a separate meeting (potentially giving a dissenting creditor a greater opportunity to vote down the scheme as each class affected must approve the scheme).

Schemes do however continue to have various advantages including the ability to compromise secured creditors and the ability to include releases by creditors of third parties. Schemes can also be proposed outside of a formal insolvency regime (unlike a DOCA) and be implemented with the company remaining under the control of existing management.

Small Business Restructuring Plan

Effective from 1 January 2021, reforms have been introduced that are intended to help small businesses restructure when in financial distress. These reforms allow eligible companies to develop a formal restructuring plan with the assistance of a small business restructuring practitioner and enter into a binding restructuring plan with creditors if accepted.

In order to be eligible to propose a restructuring plan, the total liabilities of the company must not exceed $1,000,000.

The restructuring plan has similar characteristics to a DOCA but the process for entering into the restructuring plan is more streamlined (and intended to be more cost-effective) while also allowing management to retain control of the company while the restructuring plan is being developed and implemented (unlike the voluntary administration process which is a necessary precursor to a DOCA).

A "restructuring proposal period" begins when the board of the company appoints a qualified restructuring practitioner to provide advice to the company on the proposed restructuring and assist the company to make a compliant restructuring plan. Once the restructuring proposal period has commenced, the company then has 20 business days (unless that period can be extended) to execute a compliant restructuring plan.

If a restructuring plan has been executed within the restructuring proposal period, the restructuring practitioner is required to sign a declaration and provide a copy of the plan, the declaration and certain other documents to the affected creditors and ask them to confirm whether or not they accept the restructuring plan (amongst other things). Affected creditors then have 15 business days (unless that period is extended) (the "acceptance period") to provide a statement to the restructuring practitioner confirming whether or not they accept the restructuring plan.

In order to qualify as a compliant restructuring plan, immediately before the restructuring practitioner provides the declaration, the company must:

– have paid employee entitlements that are payable; and

– have given returns, notices, statements, applications or other documents as required by taxation laws.

A restructuring plan is accepted if a majority in value of creditors who have provided a statement by the end of the acceptance period have indicated that they accept the restructuring plan. The restructuring plan is then taken to have been made on the later of either the day after the end of the acceptance period or if the plan is expressed to be conditional on the occurrence of an event within a specified period (and the condition is satisfied), the day after the end of that specified period. The parties to the restructuring plan will be the company and all persons with an admissible debt or claim against the company (and so dissenting creditors are bound).

The role of the restructuring practitioner is to administer the plan and (amongst other things) pay money to creditors in accordance with the plan. Key features of a restructuring plan include that all creditors rank equally, are to be paid proportionately and all payments to creditors are to be made within three years from the date of the restructuring plan. This is to be contrasted with a DOCA which affords greater flexibility and can allow certain claims to be excluded or receive a differential dividend. However, similar to a DOCA, the restructuring plan must identify the property of the company that is to be dealt with and specify how it is to be dealt with.

Also similar to a DOCA, a restructuring plan cannot compromise or interfere with secured creditors' rights or the rights of owners of property in relation to that property (for example, premises rented or goods hired or leased) unless that creditor or owner accepted the restructuring plan.

A restructuring plan will successfully terminate where the obligations imposed on the company and any other party have been fulfilled and all admissible debts have been dealt with in accordance with the plan. In those circumstances, the company is released from all admissible debts and claims. If it terminates for any other reason then any admissible debt or claim that has not been dealt with according to the plan is taken to be due and payable on the business day after the date of termination.

Creditors' voluntary liquidation

A creditors' voluntary liquidation can also be initiated by the directors and commenced if the shareholders resolve to have the company wound up and to have a liquidator appointed. The resolution to wind up the company requires at least 75% of the votes cast to be in favour in order to be passed. The difference between a creditors' voluntary liquidation and members' voluntary liquidation initiated in this way is the absence of the directors' solvency declaration.

A creditors' voluntary winding up can also be the direct outcome of a voluntary administration or the deemed outcome following a termination of a DOCA (other than where the DOCA is effectuated). In those circumstances the administrator or deed administrator will automatically become the liquidator.

The liquidator appointed will then have the conduct of the winding down and have the power to realise the company's assets and pay the company's creditors.

Court liquidation

Shareholders or directors may apply for a court-ordered liquidation in some instances – albeit rare. The Court may appoint a liquidator to the company on "just and equitable" grounds – this can occur most commonly in instances of irreversible shareholder deadlock or failure of an incorporated joint venture (where management of the company becomes implausible).

While outside the scope of this note: Court liquidation is a common enforcement measure for creditors against debtor companies, to force an involuntary insolvent liquidation – this is typically initiated by a creditor following failure by the debtor company to pay undisputed debts in a timely fashion. It is a very common measure taken by "regular" creditors, such as the Commonwealth and State revenue authorities where taxes remain unpaid.

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