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Restructuring Across Borders

Australia:

Corporate restructuring and insolvency procedures | September 2020

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Introduction

When a corporate borrower in Australia faces financial difficulties, there are a variety of restructuring and insolvency options which may apply.

The three principal formal insolvency regimes for companies under Australian law are:

– voluntary administration

– receivership

– winding up in insolvency (liquidation)

Australian corporate restructuring and insolvency law is incorporated in Chapter 5 of the *Corporations Act 2001* (Cth) (**Corporations Act**).

Voluntary administration is an out of court process where the administrators will conduct a review of the business, work to eliminate loss making elements and engage with potential buyers in an attempt to sell the streamlined business to a new owner. The administration process may result in the company entering into a deed of company arrangement (**DoCA**) which is a statutory contract that binds the company, its creditors, members, officers and administrators and compromises their claims against the company (though winding up is also a possible outcome).

Where a secured creditor has taken an interest in the appointment of an insolvency practitioner to the company, then this will usually be in the form of a receiver, or a receiver and manager. However, a secured creditor may alternatively appoint an administrator to the company if they have security over all or substantially all of the company's property.

It is possible for a company under administration (or in liquidation) to also be in receivership.

Schemes of arrangement are typically used in Australia as an alternative form of takeover. However, the popularity of creditors' schemes of arrangement is increasing as a means of undertaking a formal restructuring particularly with respect to secured debts.

Where there is no viable business to be rescued, ie the company is unable to be restructured or sold (and is beyond any chance of recovery), or if the court has ordered it, then the company will enter into liquidation where one or more insolvency practitioners will be appointed to be liquidator(s) of the company for the purposes of winding up the affairs of the company.

Ipso facto stay

With an aim of enabling companies to continue to trade and to take reasonable risks to facilitate solvent restructuring, the Corporations Act provides a stay on ipso facto clauses in contracts, which prevents contractual counterparties from terminating the contract or exercising other rights against a company (unless an exception applies) upon the occurrence of an insolvency event of default, such as:

– the company going into administration;

– proposing a creditors' scheme of arrangement (for the purpose of avoiding being wound up in insolvency); or

– where a receiver is appointed to all or substantially all of the property of the company.

Where the stay applies, a creditor requires the permission of the court or the relevant insolvency practitioner to enforce its rights. The length of the stay depends on the type of insolvency regime the company is undergoing. Specifically, if the company is:

– in voluntary administration, the stay commences when the company enters administration and ends when the administration ends;

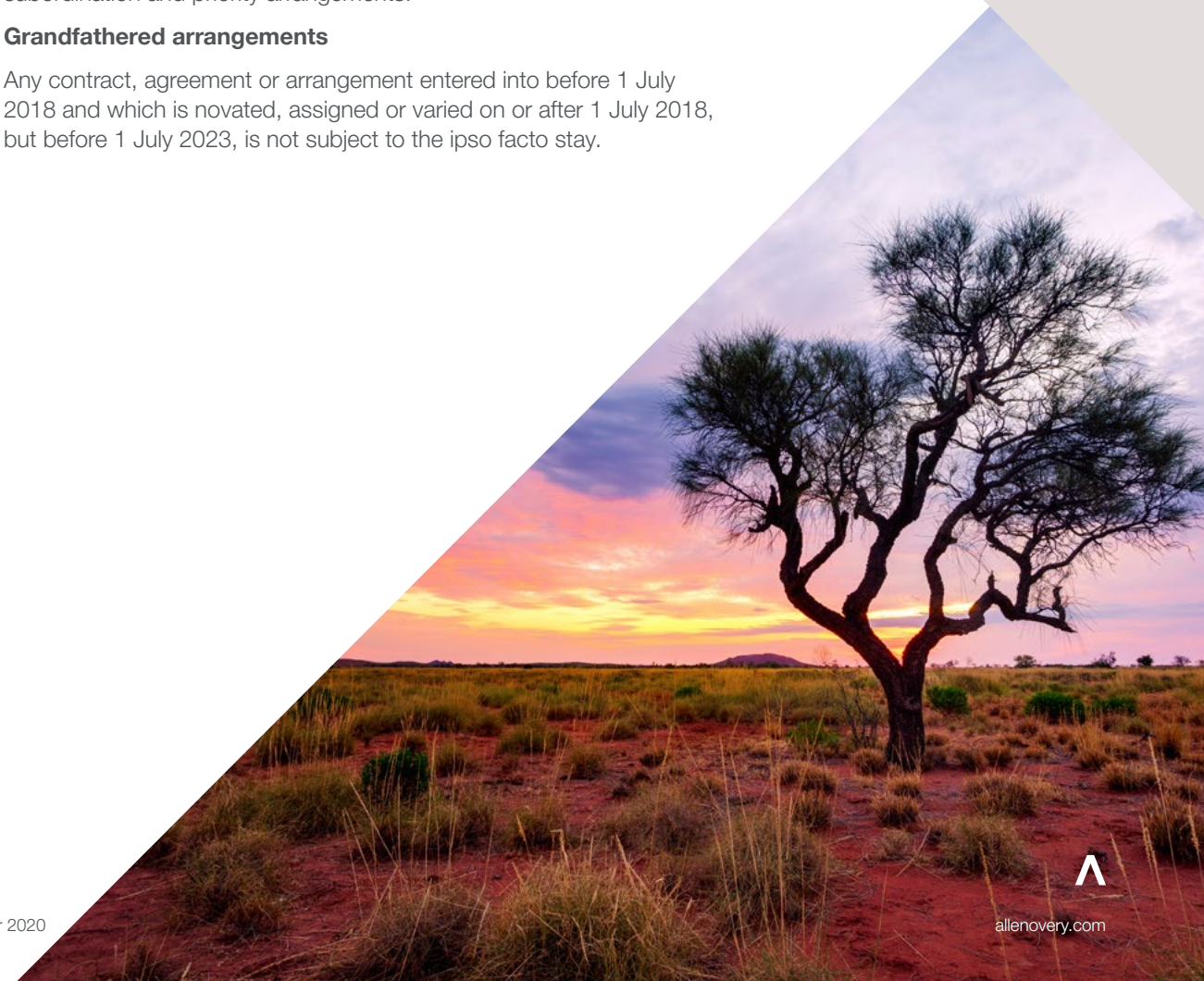
– in receivership, the stay is effective from when the receiver is appointed and will cease when the receivership ends; or

– the subject of a scheme of arrangement, the stay is effective from when the scheme application is made and will cease when the application is withdrawn or dismissed, at the end of the scheme being approved by the court or when the company is wound up.

Certain classes of contracts are excluded from the scope of the restriction including contracts related to the issue of covered bonds, securities, financial products, promissory notes, syndicated loans and related underwriting arrangements, project financing, margin lending, subordination and priority arrangements.

Grandfathered arrangements

Any contract, agreement or arrangement entered into before 1 July 2018 and which is novated, assigned or varied on or after 1 July 2018, but before 1 July 2023, is not subject to the ipso facto stay.



Enforcement of security

The main forms of security used under Australian law are:

– general security interests over all of the assets of a company;

– security interests over specific assets of a company;

– security interests over shares; and

– mortgages over land, other real property interests and statutory interests such as mineral and petroleum licences.

For security over assets other than land (and particular land interests such as mining tenements) to be enforceable, it typically requires registration of the security interest on the Australian Personal Property Securities Register in order to be perfected and place the security holder in priority above unsecured parties.

There are other State and Territory based registration regimes for security over land, interests in land and statutory interests such as mineral and petroleum licences.

Security can be enforced by the appointment of a receiver, or a receiver and manager, who assumes control of the secured assets as permitted under the terms of the security.

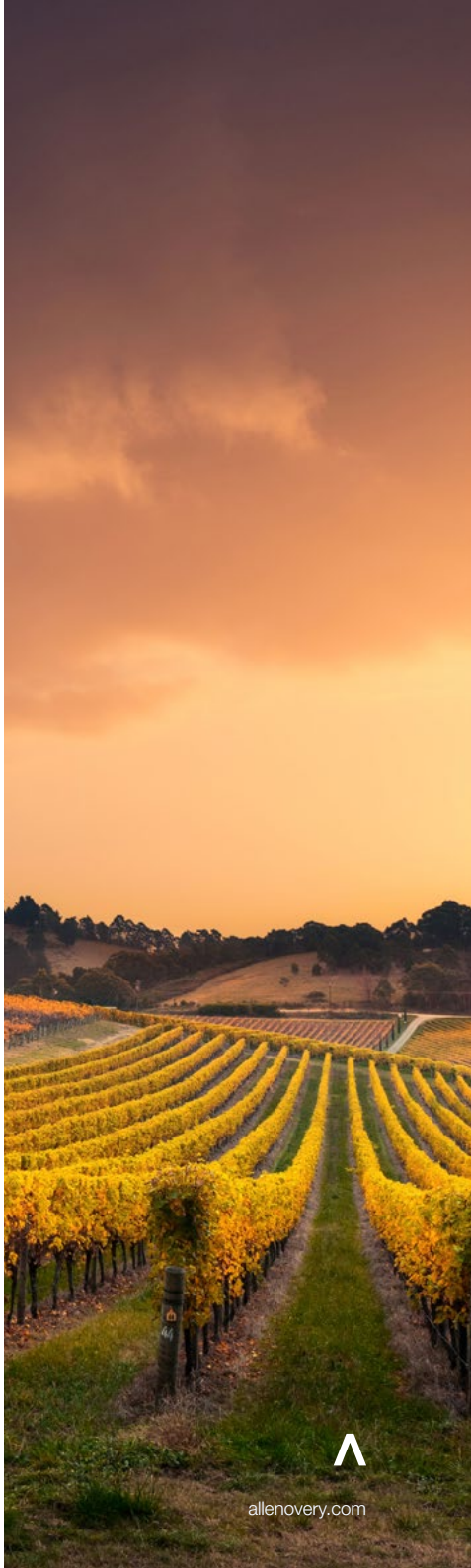
If the creditor has a security interest over the whole, or substantially the whole, of the assets of a company, it can also appoint an administrator to the company.

The enforceability of a security interest is subject to principles of general law and applicable statutory duties. These include the following:

(a) a chargee or mortgagee must exercise its power of sale in good faith and in a manner which is not reckless, harsh or unconscionable. A receiver or receiver and manager has statutory duties when exercising a power of sale to sell the relevant property for not less than market value (where it has a market value) or otherwise for the best price which is reasonably obtainable having regard to the circumstances existing when the property is sold;

(b) the exercise of the power of sale may be restrained until notice requiring payment of unpaid amounts has been served on the relevant security provider and the amounts remain unpaid for a period specified after that notice has been served; and

(c) a secured party's exercise of rights and remedies under security agreements may be subject to the provisions of the Personal Property Securities Act 2009 (Cth), in particular, Chapter 4 of that Act, which regulates the manner in which certain security interests are enforced.



Receivership

The most common method for a secured creditor to enforce its security would be to appoint a receiver, or a receiver and manager, to the relevant secured property. A receiver can be appointed relatively quickly under the terms of the security document without recourse to the courts. It is worth noting that it is common practice in Australia for the secured creditor to provide an indemnity in favour of the receiver.

The receiver, subject to the specific terms of each security document, manages the security with an aim to preserve the assets or business pending a sale of the secured property to satisfy the secured creditors' claims.

A receiver will typically have broad powers to realise the secured assets under the security documents, so long as those powers are exercised within the ambit of the Corporations Act.

The powers of the receiver typically include the power:

– to enter into possession and to take control of the secured property;

– to sell the secured property;

– to carry on the business of the company;

– to enter into contracts and to execute documents on behalf of the company; and

– to initiate legal proceedings.

The duties of the receiver include:

– in exercising the power of sale, to take all reasonable care to sell the secured property for not less than its market value or the best price reasonably obtainable in the circumstances;

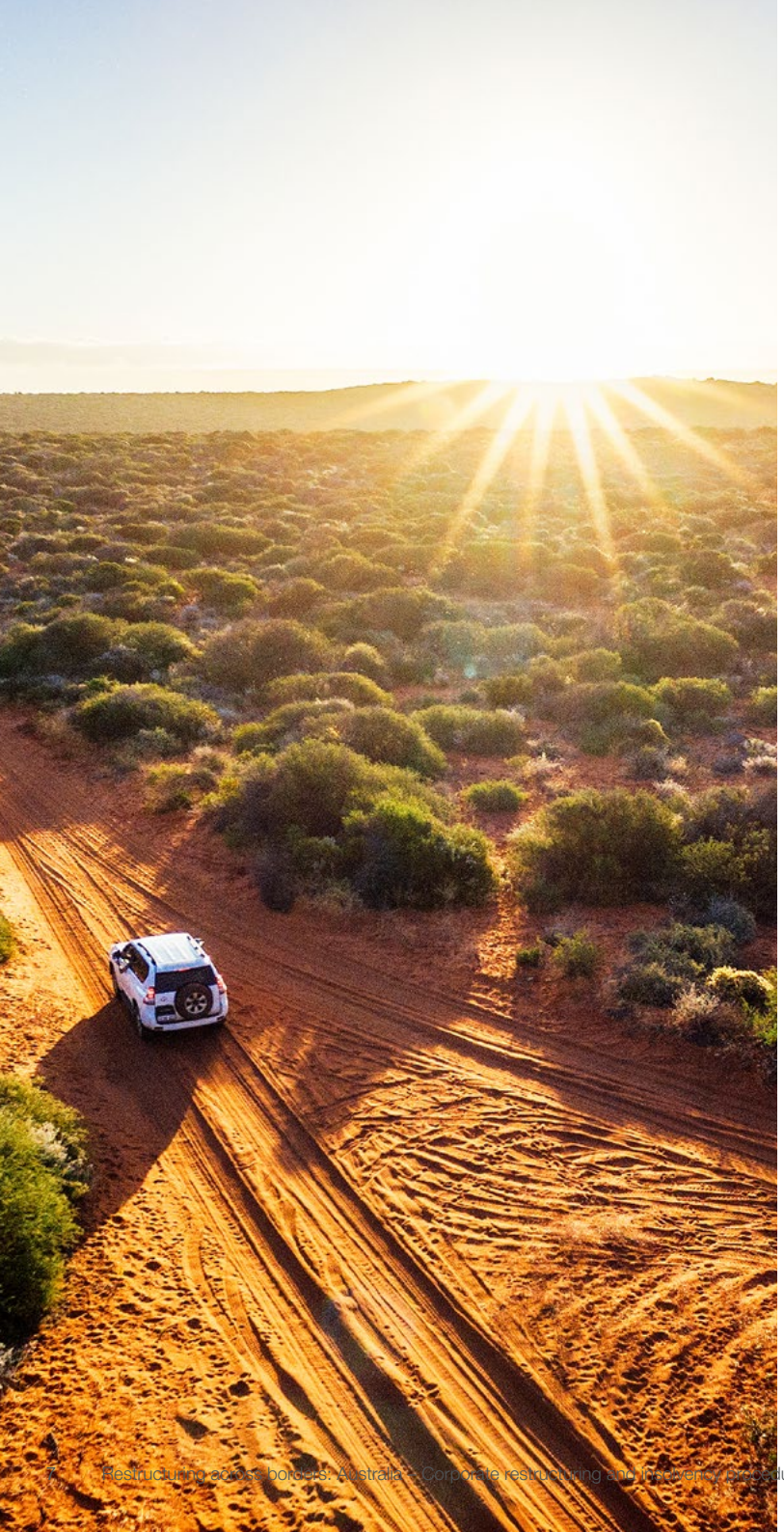
– to act honestly and bona fide;

– to exercise the degree of care and diligence that a reasonable person in a like position would exercise; and

– to comply with the terms of their appointment.

As a receiver, or receiver and manager, is appointed only to the secured property which is the subject of the secured creditor's security, they are not obliged to act in the best interests of all creditors when realising the secured property. They are only required to achieve the best possible outcome for the secured creditor that appointed them.

Receivership is also used in non-consensual "loan to own" structures. Secured creditors may appoint a receiver to acquire de facto control of the debtor and enable ongoing trading to repay debt from cash flows.



Administration

Where the debtor is either insolvent or likely to become insolvent, an administrator may be appointed by:

– the directors themselves;

– a secured creditor who holds a security interest over the whole, or substantially the whole, of the debtor's property;

– a liquidator; or

– the court.

Typically, it is the directors who would appoint an administrator where there is a risk of insolvency to protect themselves from claims that they permitted the relevant company to trade whilst insolvent (such a claim could result in the directors being personally liable for the debts of the company). However, under the safe harbour laws, directors are protected against personal liability for insolvent trading as long as they are pursuing a course of action reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator. These protections only apply in circumstances where:

(a) at a particular time after the director starts to suspect a company may become or already is insolvent, they start developing one or more courses of action that are reasonably likely to lead to a better outcome for the company; and

(b) the debt is incurred directly or indirectly in connection with that course of action and during a specified time period.

Upon appointment of the administrator, the company obtains the benefit of a statutory moratorium preventing creditors from winding up or otherwise commencing proceedings or enforcing their claims against the company during the administration period without the consent of the administrator or the leave of the court.

Secured creditors with security over the whole, or substantially the whole, of the company's property and who have not already enforced their security prior to the appointment of the administrator, will have 13 business days to enforce such security from the date of notice of the appointment of the administrator, or they will also be bound by the moratorium. Secured creditors who do not have security over all or substantially all of the company's property and who have not commenced enforcement of their security prior to an administrator being appointed have very limited rights to commence enforcement during the administration period.

In addition, if a company has entered voluntary administration, the ipso facto laws may operate to stay the ability of a secured creditor to terminate or modify contracts or exercise other rights against the company (unless an exception applies). Where the stay applies, the creditor will require the permission of the court or the relevant insolvency practitioner to enforce its rights.

The primary role of the administrator is to investigate the company's business, property, affairs and financial circumstances, and propose a plan for creditors to consider. Under the Corporations Act, there are three possible outcomes of the administration:

(a) a DoCA – this allows for the company to continue to trade, with creditors agreeing to compromise their debts and provides a better return to creditors than if the company was immediately wound up;

(b) to wind up the company (liquidation) – where there is no prospect that the company would be able to continue trade; or

(c) to return the company to the directors by terminating the administration and resuming trading – this would only occur where the administrator concluded the company was in fact able to pay its debts as and when they fell due (this rarely happens).

The proposed outcome must be approved by a simple majority (ie more than 50%) of creditors present and voting at the second meeting of creditors which must take place by no later than 30 business days after the administration commenced, unless otherwise extended by order of the Court (which is very common in more complex administrations).

In certain circumstances, a poll may be required and a majority by number and value are required to pass the resolution. In the case of deadlock the chairman has a casting vote.

The voluntary administration procedure cannot be used for foreign companies ie a foreign company cannot be placed into voluntary administration.

Deed of company arrangement (DoCA)

A DoCA is a binding arrangement between creditors (subject to more details below) and the company under which creditor claims are compromised against the company. The DoCA will bind all unsecured creditors with claims arising on or before the relevant date specified in the DoCA, including those who voted against the DoCA.

A DoCA will bind secured creditors if the terms of the deed so provide and the secured creditors voted in favour of it, or if a court so orders (though the court will only make such orders if it is satisfied that the secured creditors' interests are adequately protected). It may also bind owners of property and lessors of property to the company if they vote in favour of the DoCA.

The DoCA process is flexible enough to permit discrimination between classes of creditors, though creditors can apply to a court to terminate a deed which is unfairly prejudicial to them.

On execution of a DoCA the administration ends and the deed administrator shall be appointed (who is normally the voluntary administrator). In some instances, a creditors' trust is also adopted in conjunction with the DoCA, such that the creditors' claims are to be transferred to the creditors' trust and the company be out of the administration.

The deed administrator will administer the DoCA until the DoCA is terminated. Termination will occur if the terms of the DoCA have been successfully achieved. A DoCA may also terminate where terms of the DoCA have not been met, resulting in the company being placed into liquidation. Finally, a DoCA may be terminated by application to the Court, which will then place the company into liquidation.

As there is no (or minimal) court involvement in the DoCA process it is often used in Australia in circumstances where it will provide a better return to creditors than if the company were to be wound up. The DoCA process is often considered to be a flexible restructuring tool and can be adopted to achieve various restructuring outcomes, including but not limited to distressed M&A, recapitalisation and debt-for-equity swap.

As a foreign company cannot be placed into voluntary administration, the DoCA option is not available to a foreign company.

Creditors' schemes of arrangement

A creditors' scheme of arrangement is a formal court-sanctioned procedure under the Corporations Act which enables a company to enter into compromises with its creditors. A creditors' scheme of arrangement will bind all creditors to whom the scheme relates, including creditors who voted against the scheme.

A creditors' scheme requires:

(a) in the case of a scheme of arrangement between a company and its creditors or a class of creditors, approval by a majority in number of creditors who represent 75% of the total amount of the debts and claims of creditors present and voting (in person or by proxy) or of the creditors present and voting in that class; and

(b) sanction by the court.

Creditors' schemes are typically used in an insolvency context where creditors (or a specific class of creditors) are of the opinion that they will benefit from continuing the company's operations rather than the company being wound up.

Creditors' schemes of arrangement are increasing in popularity as a means of undertaking formal restructuring of secured debts.

While foreign companies can propose a creditors' scheme of arrangement in Australia, this raises nuanced conflict of laws issues in terms of the effectiveness of any debt compromise in the scheme on creditors located in foreign jurisdictions or debts governed by foreign laws.

Winding up in insolvency (liquidation)

Winding up is the dissolution procedure for companies under Australian law.

A company may be wound up in one of three ways:

(a) Members' voluntary winding up

A members' voluntary winding up can only occur while the company is still solvent, at a meeting of shareholders in which 75% of the company's shareholders, present and voting, must pass a special resolution to wind up the company. The company's directors must also determine, on reasonable grounds, that the company will be able to pay all its debts in full within 12 months of the commencement of winding up and make a declaration to that effect. The shareholders choose the liquidator, though the creditors may have the right to change the liquidator at the first meeting of creditors;

(b) Creditors' voluntary winding up

The creditors' voluntary winding up will occur where 75% of the shareholders pass a resolution for voluntary winding up and to appoint a liquidator. Such a winding up will be conducted under the supervision of the creditors, who are entitled to appoint the liquidator and where the safe harbour laws do not prevent the creditors from taking such action. A creditors' voluntary winding up can also be initiated following a voluntary administration or termination of a DoCA where the DoCA has been unsuccessful; or

(c) Compulsory liquidation

This occurs following the court's acceptance of a petition presented by one or more of a company's directors, shareholders, creditors or the corporate regulator – the Australian Securities and Investment Commission.

An appointed liquidator will take control of the company to investigate, collect, realise and distribute its assets to creditors in accordance with the priority "waterfall" under the Corporations Act and any surplus to shareholders. The liquidator has a duty to all the creditors.

In a winding up, the liquidator is given specific duties and powers under the Corporations Act to investigate the activities of the company, including (but not limited to):

(a) considering whether claims may be made against third parties for compensation in respect of any "voidable transactions", as defined in section 588FE of the Corporations Act, entered into by the company; and

(b) any possible claims against the company's office holders for breach of their duties (whether pursuant to general law or the Corporations Act).

Also, security interests over circulating assets owned by the company and floating charges over assets of the company created within six months of the relation back day (being the day of appointment of the administrator or filing for the liquidation order or the date of the members' meeting in which it was resolved to wind up the company), or after that day but before the winding up commenced, will be void as against the company's liquidator if the security interest secures pre-existing debt and the grantor was also insolvent at the time of granting the security interest.

Secured creditors will rank ahead of unsecured creditors to the extent of any assets secured and typically will have enforced their security prior to the winding up. The general rule is that all unsecured creditors rank pari passu, though this is subject to a few exceptions.

Certain unsecured creditors will have priority status under the Corporations Act. Generally the order in which funds are distributed is: firstly costs and expenses of the winding up (including liquidator's fees); then outstanding employee wages, superannuation and other entitlements (but not where owing to directors and related parties); and then in indemnifying certain classes of preferred creditors. Then, if there are funds left over, the liquidator will pay these to remaining unsecured creditors as a dividend.

The federal government does not receive a priority for a company's unpaid taxes, though the Australian Taxation Office is given direct recourse to the directors under the Corporations Act for payment of unpaid taxes. Also a liquidator cannot distribute any assets that are available to pay unsecured creditors before receiving a clearance from the tax office, regardless of whether the tax office is a creditor.

Where a company's assets are under threat of being destroyed or dissipated, a court may appoint a provisional liquidator to protect the assets between the date of the petition for winding up and determination of the final order for the winding up. Any creditor, shareholder or the company itself can make the application for the appointment of a provisional liquidator, but there must be unusual or urgent circumstances justifying the order.

The provisional liquidator assumes control of the company and the company's officers will be unable to perform or exercise a function or a power as an officer of the company. The provisional liquidator's powers are generally limited and subject to the supervision of the court. His or her role will be predominantly to secure the property of the company pending resolution of the winding up order, although provisional liquidation has been used successfully in Australia to rehabilitate a company.

In addition, new anti-phoenixing laws have come into effect through the *Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020* (Cth) to introduce stricter regulations and harsher penalties for directors if they are found to have failed to prevent the company from making creditor-defeating dispositions. The new laws also empower liquidators to recover dispositioned assets and seek compensation from directors and advisers involved in the disposition.

Foreign companies that are registered in Australia (or have business activities in Australia) can be wound up by order of the Court.

Cross-border issues

Cross-border insolvency issues may arise where an insolvent debtor has assets or creditors, or both, in more than one country. Australian courts must act in aid of courts of prescribed foreign countries in matters of bankruptcy and insolvency and may act in aid of the courts in other countries as well. The countries prescribed under the regulations are: the Bailiwick of Jersey, Canada, Papua New Guinea, Malaysia, New Zealand, Singapore, Switzerland, the United Kingdom and the United States of America. In relation to other foreign courts, the Australian courts are permitted to exercise discretion as to whether to provide assistance.

Under the *Cross-Border Insolvency Act 2008* (Cth) (**Cross-Border Insolvency Act**) (which came into effect on 1 July 2008 and implemented the UNCITRAL Model Law On Cross Border Insolvency in Australia), an Australian court will be able, on application by a foreign insolvency practitioner, to grant a stay of proceedings and other relief in Australia against the assets of an insolvent debtor.

Where a foreign proceeding is instituted in a country where the debtor has the centre of its main interests, it automatically brings about (in Australia) a stay of proceedings, a stay of execution and suspension of power to deal with the debtor's assets. Where the foreign proceeding is instituted in a foreign country where the debtor does not have the centre of its main interests but has a place of operations, it does not automatically bring about stay of proceedings, stay of execution or suspension of power over the debtor's assets.

If the court recognises the foreign proceeding as being instituted in a country where either the debtor has or the debtor does not have the centre of its main interests, in both circumstances the court may grant any appropriate relief necessary to protect the assets of the debtor or the interests of the creditors. Any relief given should be automatic and mandatory (subject to public policy considerations). Foreign creditors are granted the same rights and standing as Australian creditors, enabling them to participate in local insolvency proceedings.

Section 22(1) of the Cross-Border Insolvency Act provides that if the Model Law or a provision of the Cross-Border Insolvency Act is inconsistent with a provision of Part 5.6 Division 9, Part 5.7 of the Corporations Act or Schedule 2 to the Corporations Act, the Model Law or the provision of the Cross-Border Insolvency Act prevails, and the provision of the Corporations Act has no effect to the extent of the inconsistency. For example, whereas under section 581(2)(b) of the Corporations Act courts have discretion to act in aid of courts of countries that have not been prescribed under section 580 of the Corporations Act, they are required by Article 25 of the Model Law to cooperate to the maximum extent possible with foreign courts and foreign representatives.

It is important to emphasise that the only domestic insolvency regime that is available to foreign companies registered or carrying on business in Australia is a court ordered liquidation, and that the voluntary administration and/or DoCA is not available.

Key contacts

If you require advice on any of the matters raised in this document, please call any of our partners or your usual contact at Allen & Overy.

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Further information

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To access this resource, please click **here**.

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