Australia

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The Corporations Act 2001 makes general provision for the incorporation of companies, the regulation of their conduct, and their reorganisation or liquidation. In particular, it provides for three types of procedure:

- voluntary administration;
- liquidation; and
- schemes of arrangement.

The act also regulates a further regime: receivership.

Restructuring is common under voluntary administration and schemes of arrangement. Subject to some limitations, it may also be achieved in a receivership.

Voluntary administration, introduced in 1993, is a flexible regime, operating largely independently of the court. It is designed to allow directors to move swiftly to appoint an external controller (the voluntary administrator) in order to allow an orderly restructuring of the company's business or, if this is not possible, a simple transition to an orderly winding-up of the company. It is also an option available to secured creditors as an alternative to receivership or taking possession of charged assets.

Receiverships remain the insolvency regime of choice for secured creditors. However, owing to its speed and flexibility, voluntary administration is becoming more common, even where the security in place would entitle the appointment of a receiver. Further, receiverships of larger companies (particularly publicly listed companies) are becoming rarer due to the absence of a security, many large companies having complex funding structures involving a raft of financiers. Financiers commonly impose negative pledge requirements on the company, rather than the provision of security via a registered charge.

Liquidation continues to be available, but has also been overshadowed by voluntary administration. For most companies where the business is a going concern, voluntary administration or receivership is initially employed. It is generally only when the restructuring possibilities under those regimes are exhausted, or the objectives of those processes achieved, that liquidation follows. Liquidation is generally a first-choice remedy only where the company is hopelessly insolvent with no real prospect of continuing in business.

Schemes of arrangement permit a company to restructure its business by agreeing a compromise with its creditors, or a class thereof. However, these have become rare since the introduction of voluntary administrations. As the court and legislative process involved in schemes of arrangement is costly and lacks flexibility, they are rarely used to restructure insolvent entities.

Regardless of the insolvency regime adopted, it is common practice for the business to continue trading while attempts are made to sell it as a going concern in order to maximise the return to creditors. In this regard, the Australian 'rescue culture' demonstrates a greater concern for the survival of businesses rather than corporate structures. Where the concern is to preserve

the corporate structure as well as the business, administration followed by a deed of company arrangement may be the best option.

In Australia, there is no 'debtor in possession' regime in Australia analogous to the US Chapter 11 bankruptcy framework. Secured creditors exert significant influence under the receivership process, and unsecured creditors exert significant influence (via a committee of inspection) in the liquidation and voluntary administration process.

1. Legal framework and the effectiveness of court processes/legal remedies

1.1 Describe the nature and effectiveness of the following:

(a) Debt recovery remedies where the creditor has no security

Most of the debtor's obligations will be unsecured. Unsecured obligations are usually enforced by way of civil proceedings in either a state or federal court. The amount of the claim and its basis will determine which court, although the vast bulk of claims are litigated in state courts with jurisdiction in small claims.

Having obtained judgment, the creditor is entitled to seek recovery by way of attachment of either the debtor's tangible property (which may be seized by an officer of the relevant court and sold by auction) or intangible property such as the debtor's receivables.

It is common for creditors with a claim arising under a contract or a judgment to serve a 'notice of statutory demand'. If the company on which such notice is served does not comply with it or have it set aside within 21 days, the company is presumed to be insolvent. This presumption will support an application to have the company wound up. This can be an expeditious means of recovering an unsecured claim.

(b) The enforcement of security

The process for enforcement of security depends on the nature of the security and/or the asset.

Financiers will often require the debtor company to execute a mortgage debenture, containing a fixed and floating charge. The debenture allows the lender to appoint a receiver upon default by the debtor. Receivers enjoy sweeping powers under both the debenture and statute, and can do everything necessary or convenient for, or in connection with, the attainment of the objectives for which they were appointed. This includes the power to take possession of the company's assets, realise those assets or carry on the business of the company.

The terms of the security govern the appointment. The security holder decides the identity of the receiver and, in doing so, is under no obligation to consult with the debtor. Usually, the receiver is a professional insolvency practitioner, although for securities over real property an agent in possession may be appointed to realise the property.

A receiver owes his or her duties to the secured creditor, not to the debtor. However, a receiver is subject to the statutory duties owed by officers of the company. Furthermore, a receiver owes a statutory duty of care in exercising a power of sale, and is subject to the supervision of the court and the corporate regulator, the Australian Securities and Investments Commission (ASIC - www.asic.gov.au).

The appointment of a receiver offers considerable advantages in terms of time (particularly of commencement), cost and flexibility, but it does not create a moratorium on the initiation or commencement of proceedings against the debtor.

(c) Corporate bankruptcy/liquidation processes

Winding-up may be initiated either by court order, which constitutes an official or court liquidation, or by resolution of the members of the company, known as a voluntary liquidation. Moreover, the act distinguishes between the court liquidation of a company in insolvency and a liquidation for other reasons. This distinction has consequences for the conduct of liquidation, its effect and the extent of the liquidator's powers. Additionally, in the case of a voluntary liquidation, a distinction is drawn between a members' voluntary liquidation, which is undertaken when the company is solvent, and a creditors' voluntary liquidation, which is the regime applicable in case of insolvency. In the latter case, while the company members resolve that it be wound up, it is the creditors that nominate the liquidator. Another means by which a creditors' voluntary liquidation may be initiated is consequent upon a voluntary administration (described in greater detail below) where creditors, in the course of that regime, resolve that a restructure is not supported.

(d) Formal corporate rescue processes

Two formal corporate rescue processes are available under Australian law: schemes of arrangement and voluntary administration.

Schemes of arrangement: Corporations can enter into compromises with creditors through a scheme of arrangement under Part 5.1 of the act. The court must sanction such arrangements. Schemes of arrangement have suffered from a number of problems, including:

- high implementation costs;
- the delay involved (at least 10 weeks is the minimum period needed);
- high voting thresholds (75 per cent in value of each class of creditors); and
- inflexibility (eg, the arrangement cannot be altered without obtaining fresh court approval).

In cases of insolvency, voluntary administration has largely replaced the scheme of arrangement as a means of rescuing an insolvent company. However, schemes of arrangement are still used as a means of achieving a merger or acquisition of a business.

Voluntary administration: The most common formal corporate rescue process is voluntary administration under Part 5.3A of the act.

The objectives of voluntary administration are to provide for the business to be independently administered by an insolvency practitioner in order to maximise the chances that the company, or its business, continue in existence, or where this is not possible, to achieve a better return for the company's creditors and members than through winding-up.

The process emphasises expedition and ease. Administrators are given powers to take control of the company's business, property and affairs, and to carry on or terminate the business and perform any function and exercise any powers that the company and its officers could previously have exercised. A voluntary administrator can be easily appointed at short notice (eg, by the directors, a liquidator or the holder of a charge over the company). He must report to the creditors within 21 days of his appointment as to what course of action the company should adopt.

Where the creditors accept a proposal that the company is to continue to trade, they resolve that the company execute a deed of company arrangement. Once this is executed, the administration ends and the terms of the arrangement replace the statutory moratorium on company debts. The arrangement binds all of the company's creditors, as well as the company and the deed administrator. No court approval is required.

The statutory requirements for a deed of company arrangement are relatively few. Accordingly, this affords tremendous flexibility and can be used to implement whatever type of arrangement the situation requires – from a simple compromise of debts to a restructure or sale or a continuation of the business. External parties (eg, a new financier or equity holder) can be made a party to the deed of company arrangement and be bound by it. A deed of company arrangement can stipulate a regime for distributing proceeds from realisations of the company's property, although it is usual to adopt the statutory regime that applies in liquidation. A variation to the priority of creditors is possible, as long as the affected creditors are no worse off than they would have been had the company been wound up.

(e) Informal corporate rescue processes

Most corporate rescues are implemented informally. In particular, the cost of an informal rescue process is generally significantly less than that of a formal corporate rescue. Further, informal corporate rescue processes may avoid potential negative publicity, contractual breaches and commercial implications, which may significantly affect restructuring options. Moreover, directors are generally reluctant to initiate a formal restructuring. Consequently, both companies and their financiers generally prefer informal restructuring wherever possible.

Normally, companies effect an informal arrangement or compromise with their creditors on a purely consensual basis, with the help of legal advisers and insolvency practitioners. These informal compromises or arrangements are usually implemented following negotiation between the relevant company or groups of companies and their financiers. These financiers have often lent on an unsecured basis and have found that the best prospect of maximising their recoveries is to have some informal moratorium which allows the borrower time to trade out of its difficulties. One of the cornerstones of these arrangements is that 'ordinary' or trade creditors, such as employees and suppliers, have their claims paid in the usual course of business. This helps to mitigate potential

liability against directors for insolvent trading or breach of their duties to creditors, discussed in more detail in section 1.5.

A further feature of informal workouts is that, through the negotiation process, the financiers' claims become secured and procedures are established which allow the financiers to monitor the company's performance.

In Australia, secured creditors and banks are also relatively proactive in identifying and initiating the appointment of legal advisers and insolvency practitioners to conduct corporate reviews and provide informal restructuring advice. In view of the reluctance of directors to initiate a formal restructuring, and the relative popularity of informal restructuring, informal corporate rescue is considered very effective.

1.2 What are the formal processes to effect a liquidation of the company's assets?

The formal processes to effect a liquidation of a company's assets are either an official liquidation or a voluntary liquidation as described in section 1.1(c).

1.3 What is the effect on debt collection and the enforcement of security of:

(a) An adjudication of corporate bankruptcy/liquidation?

Once either a court liquidation or a voluntary winding-up has commenced, unsecured creditors may not continue or institute any proceedings against the company except with the leave of the court. Further, where a judgment creditor has levied execution or some similar process against the company, the execution is void. However, secured creditors' rights to realise or otherwise deal with their security are unaffected, except where the secured creditor requires the assistance of a court for the purpose of enforcing its security; it will need leave of the court to institute enforcement proceedings.

(b) The commencement of a formal corporate rescue process?

Scheme of arrangement: Until a scheme of arrangement has been approved by the court, it will not affect the rights of creditors which are to be bound by it to pursue their claims against the debtor, irrespective of the status of those claims. However, once a scheme has been publicly proposed between a debtor and its creditors, the court may restrain the further prosecution of proceedings against the debtor either by a particular creditor or by creditors generally.

Voluntary administration: In a voluntary administration, the claims of all creditors are stayed while the debtor is under administration or during what is described as the 'moratorium period'. A company under administration may not be wound up voluntarily, and the court may adjourn any winding-up application in respect of the company if it is satisfied that it is in the interests of the creditors for the administration to continue. However, the stay on creditors' claims has limited application to secured creditors. It does not apply to a secured creditor which:

- had begun to enforce a charge prior to the commencement of the administration;
- holds a charge over the whole or substantially the whole of the debtor's property and enforces that charge in respect of all the secured property in the 10 business days following the administrator's appointment; or
- holds a charge over perishable property.

Nor does it apply to the owners or lessors of property used by the debtor which have commenced recovery proceedings in respect of that property prior to the administrator's appointment where that property is perishable.

The stay of proceedings or moratorium also does not apply in the case of any creditor, including unsecured creditors, where the creditor exercises a right to set-off or a lien, calls a default, cancels a facility which has not been fully drawn or terminates a contract in accordance with its terms where the court or the voluntary administrator has agreed to the creditor enforcing its rights or either commencing or continuing legal proceedings. In determining whether to agree, both the court and the voluntary administrator will balance the interests of the individual creditor concerned with the wider requirements of the administration.

Receivership: In a receivership there is no moratorium. After a receivership has commenced, the debtor may be placed in liquidation at the initiation of a creditor. However, this does not affect the secured creditor's right to realise the secured assets through the receiver.

(c) The initiation of an informal corporate rescue process?

An informal corporate rescue is dependent on the indulgence and agreement of the creditors, and is not supported by a legal mechanism limiting creditors' enforcement rights. It therefore does not affect the rights of creditors to pursue their normal legal remedies against the company.

(d) The initiation of an insolvency or insolvency-related process under any special legislation?

The Banking Act 1959 and the Life Insurance Act 1995 provide for the administration in insolvency of companies regulated by those pieces of legislation. Additionally, the Insurance Act 1973 provides for insolvency mechanisms in relation to security trusts designated under that act. Insolvency under these acts is extremely rare, although their provisions substantially mirror the Corporations Act.

1.4 Are insolvency procedures involving a corporation incorporated in your jurisdiction recognised if they are started in another jurisdiction?

The act provides for the recognition by Australian courts of insolvency procedures commenced in other jurisdictions. These provisions operate irrespective of whether the company is incorporated in Australia or elsewhere. Moreover, where the insolvency procedure was initiated in the United Kingdom, the United States, Canada, New Zealand, Malaysia, Singapore, Switzerland or Jersey, Australian courts must recognise those proceedings. The only discretion which the court has in these circumstances is the nature of the relief or assistance it will provide to the foreign administrator.

However, Australian courts normally regard any insolvency procedure commenced in Australia for a company incorporated there as the primary insolvency proceedings. The commencement of insolvency proceedings in another jurisdiction would not alter this approach.

Where the insolvency procedure is initiated in a country outside of those mentioned above, the court has discretion not only as to the nature of the assistance it will provide to a foreign administrator, but also as to whether the foreign administration will be recognised.

There are no international conventions or treaties governing the effect of foreign insolvency procedures in Australia.

1.5 In what circumstances would the directors or officers of a company in financial difficulties face potential personal liability for continuing to trade? In practice, are any such provisions actually enforced?

The definition of 'director' under the Corporations Act is wide. The definition includes people:

- who act in the position of a director, whether or not they are named director or validly appointed ('*de facto* directors'); and
- in accordance with whose instructions or wishes the directors of a corporation are accustomed to act ('shadow directors').

A corporation can be a shadow director. Liability as a shadow director poses a potential risk for participants in informal workouts.

Persons acting in a professional capacity or business relationship are exempt from the operation of these provisions, provided they merely advise the directors.

While directors are not generally liable for the company's debts, this is subject to a number of exceptions as detailed below.

The act imposes liability on directors who allow the company to incur debts where the company might be or become insolvent. A holding company can have a similar liability in respect of its subsidiary trading while insolvent.

The Income Tax Assessment Act 1936 (Cth) imposes liability on directors for various unpaid taxes upon non-compliance with specific notices.

The general law and the Corporations Act impose a number of duties on directors and officers. These include duties to act with reasonable care and diligence, in good faith and in the best interests of the company, and not to make improper use of position or information. Liability can include personal liability to compensate the company for loss caused by the breach.

Such provisions are enforced against directors by liquidators, ASIC and the Australian Taxation Office. In recent years, ASIC has been particularly active in this area. However, there are limited examples to date of enforcement against *de facto* directors and shadow directors.

2. What are the advantages and disadvantages of triggering a formal procedure?

Advantages: The advantages of triggering a formal procedure include the following:

- It affords protection against creditor actions.
- An independent person/expert is engaged to achieve the best outcome, free of any vested interest.
- An appointee normally possesses broad skills/experience to achieve a commercial outcome, including commercial acumen, technical insolvency experience, crisis management, restructuring and turnaround experience, selling and negotiation skills, and broad industry experience.

The appointee's powers and obligations are determined by contract, case law and statute. In particular, the appointee is highly accountable to stakeholders.

A formal procedure provides the flexibility to sell the 'assets only' for their market value, removing the need to achieve a price that may be sought to ensure stakeholders are satisfied. This also encourages interested purchasers to pursue the opportunity more vigorously and competitively, knowing a sale outcome will be consummated provided they offer fair market value.

Disadvantages: The disadvantages of triggering a formal procedure include the following:

- The cost may be significant compared to the return to stakeholders.
- The risk may be significant compared to the return to stakeholders. In particular, a formal appointment may expose the appointee to trading liabilities or statutory liabilities, such as environmental clean-up costs, to the extent these cannot be met from asset realisations.
- The stigma may cause the business to close down and/or affect:
  - the morale of management and staff;
  - the perceptions of interested parties, which may only offer a 'fire sale' price for the business instead of its true worth. In the absence of competitive interest, this can lead to lower sale outcomes;
  - suppliers of goods and services, which may withdraw their support from the business; and
  - competitors, which may exploit the uncertainty of the business's future to poach clients and customers.
- The debtor's contracts may become void upon the appointment of an insolvency practitioner under formal procedures. This may lead to the renegotiation or cancellation of leases, supply contracts and licence agreements.
- Financier appointments may create unfavourable publicity for the appointee. Financiers prefer not to be seen as aggressive against customers.
- Formal procedures may be resisted and lead to expensive litigation.

3. What are the practical options for out-of-court restructuring?

Formal appointment out-of-court restructuring: In Australia, restructuring usually occurs out of court. The majority of formal appointments are initiated without court involvement. These formal appointments include liquidations, voluntary administrations and receiverships. Each of these formal appointments gives the appointee broad powers to make commercial decisions to restructure the business and/or corporate entity. These powers are typically subject to approval from stakeholders, especially where the restructuring alters their rights against the company.

While voluntary administration and receivership procedures generally have the most flexible structures, the form of the appointment is not usually the determining factor that affects the practical options for restructuring the business and/or company. Instead, the key issues are typically as follows:

- identification of the need for restructuring before it is too late;
- the underlying strength and/or strategic positioning of the business;
- the relative rights or influence of stakeholders; and
- the willingness and skills of management to make necessary changes.

Therefore, the practical options that may be available are broad and include:

- operational restructuring, including such actions as the purchase or sale of assets;
- negotiation of supply or distribution agreements, cost cutting and/or other performance enhancement initiatives;
- management restructuring;
- debt and equity restructuring; and
- debt moratorium or standstill agreements.

Informal out-of-court restructuring: A significant percentage of restructuring occurs informally. This is often managed by directors with the assistance of insolvency practitioners. While the directors may initiate this action at any time, it typically occurs when a secured creditor becomes concerned about its customer's facilities and initiates the appointment of an insolvency practitioner to review the business and advise on restructuring options.

The practical options that may be available in an informal out-of-court restructuring are the same as for formal appointment out-of-court restructurings, with two main differences regarding debt and equity restructuring and debt refinancing. While debt and equity restructuring is achievable in an informal out-of-court restructuring, it is difficult in the absence of a formal appointment process. Accordingly, it is rarely achieved. In practice, debt refinancing is commonly achieved in informal restructuring, but rare in formal restructuring. In recent years, the refinancing market in Australia has been relatively strong, driven partly by the desire of some financiers to continue to grow market share and partly due to stable economic conditions and low interest rates.

4. What is the effect on the management of a company of:

4.1 An adjudication of corporate bankruptcy/liquidation?

See table opposite.

4.2 The commencement of a formal corporate rescue process?

See table opposite.

4.3 The initiation of an informal corporate rescue process?

See table opposite.

4.4 The initiation of an insolvency or insolvency-related process under any special legislation?

See table opposite.

In all cases outlined in the table, the stigma, uncertainty and/or potential opportunities created under both formal and informal processes may have both positive and negative emotional effects on management, and particularly the directors. These effects vary significantly depending on the circumstances and the individual's outlook in relation to the situation.

4. What is the effect on the management of a company of:

4.1 An adjudication of corporate bankruptcy/liquidation?

	General	Directors/management
Winding-up order/liquidation	• Neither has the effect of removing the company's directors or other officers. • Functions/powers may be exercised only with the approval of the court/liquidators. • May expose directors to issues discussed earlier in section 1.5. Certain liabilities may be triggered by the appointment of a liquidator, or may arise as a result of examination of the company's affairs, where the liquidator may need to determine whether the directors breached their corporate responsibility.	• May be engaged by the liquidator under liquidator's supervision. Are not obliged, but are usually motivated, to maximise returns/save the business etc. • Are required to provide details of the company's affairs to the liquidator. If necessary, the liquidator can apply to court to have the directors examined under oath. • Duties of management usually remain the same.

4.2 The commencement of a formal corporate rescue process?

	General	Directors/management
Scheme of arrangment	• The court will usually require the company to be independently managed by a scheme administrator.	• The will determine the extent to which management/directors have a continuing role.
Voluntary administration	• Officers usually remain in office. • Administrator has powers to remove directors and appoint new ones.	• If the directors stay in office, they may not exercise any power/authority without the approval of the administrators. • The directors must provide a statement of the company affairs. • The administrators can also apply to have directors examined under oath.
Deed of company arrangement	• Deed will specify the roles of the administrator and directors/officers.	• Where the administrator assumes responsibility for settling claims and distributing, management of the company may be returned to the directors.

4.3 The initiation of an informal corporate rescue process?

	General	Directors/management
Workout/ turnaround	• Deed will specify the roles of the administrator and directors/officers. • It will be largely dependent on creditor confidence in the directors management team.	

4.4 The initiation of an insolvency or insolvency-related process under any special legislation?

Instances are rare and generally the same as those outlined for a winding-up.

5. Roles of key players involved in the restructuring and insolvency process

5.1 Who is responsible for the 'case management' control and administration of a corporate bankruptcy/liquidation, a formal rescue or an informal rescue?

Corporate bankruptcy/liquidation and formal rescue		
Type of proceeding/ person responsible for conduct	**Objective**	**Process**
Voluntary administration/ administrator	To provide for the business / company to be administrated so as to maximise the chances of its continuing existence, or, where this is not possible, to achieve a better return for creditors than on winding-up.	The administrator takes on the conduct of the company and its business under a structured timeline, conducts an investigation of the company and reports its findings to the creditors. On the basis of this report, the creditors vote on whether the company arrangement, be wound up or be returned to the control of the directors.
Deed of company arrangement/ administrator of deed of company arrangement	To implement the agreement reached by the creditors and the company, which will set out, among other things, the extent to which the company is released from its debts, what property is available to pay creditors' claims and the terms of any moratorium on claims against the company.	The decision to execute a deed of company arrangement is made by the creditors on the recommendation of the administrator following a voluntary administration. A deed of company arrangement can also be cancelled or varied by resolution of the creditors.
Liquidation/ liquidator	To collect and realise the assets of the company, and apply the resulting proceeds in discharging its debts and liabilities and distributing any balance among its members according to their rights and interests, as set out in the Corporations Act.	A liquidation can be commenced by the members of the company or, where the company is insolvent, by its creditors or the court. A liquidator must give regard to any direction given by resolution of the creditors or a committee of inspection.
Receivership/ receiver or receiver and manager	To enable the secured creditor to take possession of the company and its assets and realise such of them as are necessary for it to be paid.	A receiver is appointed by the secured creditor and takes control of the business of the company, or such of its assets as are necessary, with a view to realising them to satisfy the debt owed by the company.
Scheme of arrangement	To enable the company to reach a compromise with its creditors.	A meeting of creditors to consider the proposed compromise is convened under court order. If the meeting agrees to the proposal by a majority in number representing 75 per cent in value of the claims of creditors voting at the meeting, the court may approve the compromise.

The insolvency practitioners listed in the table opposite may apply to the court for directions in respect of the conduct of the administration, deed of company arrangement, liquidation or receivership.

5.2 Who is responsible for the 'case management' control and administration of a case of corporate insolvency under any special legislation?

Cases of corporate insolvency under special legislation are rare and such experience of them does not allow comments of general application to be made.

5.3 Who is responsible for preparing the restructuring plan in a formal or informal rescue?

In a formal appointment, the appointee normally proposes and implements the restructuring plan. The appointee is invariably a registered insolvency practitioner, and also takes advice from directors, management, solicitors, accountants, financiers and the like.

In an informal rescue, the restructuring plan is usually prepared by an insolvency practitioner subject to agreement by the company and input from its professional advisers. Any bank involved can be expected to play a major role because of the importance of continued financing.

5.4 Who is responsible for preparing the restructuring plan in a case of corporate insolvency under any special legislation?

Cases of corporate insolvency under special legislation are rare and such experience of them does not allow comments of general application to be made.

6. What financial information is available to creditors in a corporate bankruptcy/liquidation, a formal rescue and an informal rescue?

Formal appointments: Under formal appointments, the appointees and directors must lodge various details with ASIC. The majority of this information is available from ASIC to all interested parties (including creditors) and includes:

- the details of the appointment;
- the appointee's details of receipts and payments every six months and then at the conclusion of the appointment;
- the 'report as to affairs' of the company at the date of appointment (this is similar to a balance sheet, and is prepared by the directors and lodged by the appointee); and
- reports to creditors as required by specific legislation. The format and content of the information to be provided depend upon the type of appointment.

There is no requirement to lodge financial accounts with ASIC. However, the appointee will often provide detailed financial information to creditors, particularly secured creditors, where the appointee operates the business. Otherwise, the appointee will not normally provide financial information, unless it is commercially beneficial to do so to obtain stakeholder support.

Informal restructuring: In an informal restructuring, the company's normal statutory reporting obligations continue. Accordingly, the availability of financial information varies depending on the size of the business, the number of employees and the value of its assets. However, secured or key creditors may be in a position to require detailed financial information, regardless of the company's statutory reporting obligations.

If the company is listed on the stock exchange, there are likely to be additional reporting requirements, depending on the nature of the restructuring and the interpretation of whether such information should be disclosed to the market in order for investors to make an informed decision. This point may be the subject of much debate.

7. Financial issues

7.1 What are the main areas from which funding is generally utilised by companies undertaking either formal or informal restructuring?

Informal restructuring: Funding options for an informal restructuring include the company's cash flow or assets, secured or unsecured finance, trade creditor support and equity. Typically, the company's cash flow is not a funding source. Depending on the ratio of financier debt compared to asset values, additional secured or unsecured finance may be limited. In recent times the Australian finance market has been relatively aggressive and, accordingly, secured and unsecured finance has been more prevalent.

Trade creditor support and equity are more common sources of financing. The danger of trade creditor support is that it is usually relatively small and provides only a short-term funding solution.

This can be problematic if the informal restructuring requires longer-term funding.

Formal restructuring: All the informal restructuring funding sources discussed above are available in formal restructurings. However, there is usually a higher reliance on asset divestments, secured creditor finance and trade creditor finance. Generally, the appointee will realise or divest assets to cover trading liabilities, fees and expenses. It is also common for a secured creditor to fund the appointment, particularly where it is a prime beneficiary and has sufficient security cover, and funding is expected to improve its return. Finally, it is customary for trade creditors to fund the appointee (by providing credit), as the appointee is personally liable for the debts he incurs. This liability is normally supported by the company's assets and, where applicable, an indemnity from the secured creditor.

7.2 In what order are creditors paid in a corporate bankruptcy/liquidation?

The order of priority depends on the security and liability mix. Employees rank ahead of the general body of unsecured creditors. They also have priority over secured creditors to the extent that the charge is a floating and not a fixed charge.

When considering the priority between secured creditors, certain charges can have priority over individual assets. For example, a registered mortgage over land affords the mortgage holder priority over that asset, despite the existence of a fixed or floating charge. Where there are multiple charges of the same category, these may be governed by a priority agreement between the parties. Otherwise, they will generally rank in order of registration.

With the exception of employees, who rank higher in priority, unsecured creditors rank *pari passu*. However, prior to making a distribution to any unsecured creditor, whether an employee or otherwise, the costs and expenses of the liquidation and of any previous formal insolvency administration must be paid.

The table below details the general order of priority. However, this is a guide only, as the security and liability mix may vary significantly.

7.3 Are there any legal provisions that might operate to invalidate the creation of security, the disposal of an asset or the payment of a creditor by a company in financial difficulties?

Certain transactions can be invalidated if the company was or became insolvent at the time of the transaction. These are known as 'insolvent transactions' and include:

- unfair preferences given to creditors in the six

Fixed charge assets (examples only)	Floating charge assets (examples only)
Property, plant and equipment	Stock and work progress
Goodwill	Debtors*
Intellectual property	
Less	**Less**
Costs of realising fixed charge assets	Costs of realising floating charge assets
Secured creditor debts	Employee entitlements
Employee entitlements	Secured creditor debts
Unsecured creditors	Unsecured creditors
Shareholders	Shareholders

* These assets may be classified as either fixed or floating charge assets depending on the nature of the security.

months prior to commencement of the winding-up (four years where the creditor is a related entity). An unfair preference is one in which an unsecured creditor receives more than it would in a winding-up;
- uncommercial transactions made by the company in the two years prior to commencement of the winding-up (four years where the other party is a related entity). Whether a transaction is 'uncommercial' depends on its benefits and detriments to the company and the respective benefit to the other party; and
- transactions entered into with the purpose of defeating, delaying or interfering with the rights of creditors within 10 years of commencement of the winding-up.

Additionally, the court may set aside a loan to the company that is unfair, irrespective of when that loan was made. A loan is 'unfair' if the interest or charges are extortionate, having regard to the risk to the lender, the value of any security and the term, conditions and amount of the loan.

A person who enters an agreement or transaction with the intention of preventing the recovery of employee entitlements or significantly reducing the amount of recoverable employee entitlements is liable, in an action commenced by an employee or the liquidator within six years of commencement of the winding-up, to compensate the employees for their losses and damages.

Finally, certain charges may be void – in particular:
- a floating charge created in the six months prior to commencement of the winding-up, except insofar as it secures fresh consideration given to the company; and
- an unregistered floating charge.

There are various defences to insolvent transactions, although there are no defences to unfair loans.

7.4 What is the position of both unsecured and secured creditors that vote against, do not agree with or do not consent to either a formal or an informal rescue plan?

A deed of company arrangement binds all unsecured creditors whose debts arose on or before the date specified in the deed, even if they did not vote for the deed.

A deed of company arrangement does not affect secured creditors or owners or lessors of property, unless it provides that it applies to them and they voted in its favour, or the court orders otherwise. If neither occurs, the secured creditor, owner or lessor may continue to exercise its rights.

If a secured creditor exercises its security rights (which includes making an application for winding-up), or the owner or lessor exercises its proprietary rights, the interests of those parties must be accommodated, particularly where the relevant assets are integral to the business of the company.

Likewise, unless formally party to or bound by an informal rescue plan, a secured creditor may continue to exercise its rights irrespective of the fact that such a plan is in place. The position of an unsecured creditor is the same.

Once a scheme of arrangement has been approved by a meeting of the relevant creditors and the court, it will bind all members of those classes of creditors affected by the scheme. This will include secured creditors if the scheme of arrangement includes a compromise or arrangement in respect of their claims, and irrespective of whether they voted for or against the adoption of the scheme.

7.5 What actions can creditors take if they are not satisfied with the conduct of either a formal rescue procedure or a corporate bankruptcy/liquidation?

In a voluntary administration, creditors have an opportunity to replace the administrator at the first meeting of creditors. In a members' voluntary winding-up, the creditors may also nominate a new liquidator.

Where a creditor or shareholder is dissatisfied with the conduct of a liquidator or the amount of its remuneration, it may apply to court for a review of the matter. If the court is satisfied that there is cause, it may remove a liquidator and appoint a replacement. It may also make orders adjusting a liquidator's entitlement to remuneration. Moreover, any decision of a liquidator is reviewable by way of an appeal *de novo* to the court. Similar provisions are made for the supervision of the conduct and review of the decisions of an administrator of a scheme of arrangement, a voluntary administrator and an administrator of a deed of company arrangement.

Creditors are also entitled to submit a formal complaint to ASIC. Depending on the nature and merits of the complaint, ASIC will investigate the matter to determine whether the issue warrants a

review of the practitioner's qualification as liquidator (required in order to act as a liquidator, receiver and manager and voluntary administrator). In recent times ASIC has been more proactive in investigating and pursuing complaints against insolvency practitioners.

8. General

8.1 Can the insolvency regime be described as systematic and efficient for:

(a) The liquidation of businesses incapable of being restructured?

(b) The restructuring of debt?

The liquidation regime seeks to facilitate a fair and equal return to each class of creditors. This regime includes recovery action to remedy any transactions that give preferential treatment to one party to the detriment of others. Consequently, the insolvency regime is supported by detailed systematic legislation to protect the interests of creditors. However, the speed and efficiency of this system are debatable, with many liquidations involving legal recovery proceedings lasting for over two years.

In respect of restructuring debts, the voluntary administration process seeks to provide an alternative where litigation is not desired and the speed and cost of debt restructuring are of greater focus. Consequently, voluntary administration is in many ways less systematic, yet more efficient.

8.2 What are the biggest legal and non-legal impediments to the systematic and efficient liquidation of businesses and restructuring of debt?

In the context of formal debt restructuring, the principal legal impediment is that in Australia, unlike in other jurisdictions, the initiation of any voluntary administration, scheme of arrangement or receivership does not preclude third parties to contractual arrangements with the company from relying on default provisions in those contracts. Accordingly, to the extent that the restructuring of a company's business may depend on the continued operation of those contracts, efforts to restructure the business may fail by reason of those parties calling a default under such contracts.

The biggest non-legal impediments relate to inadequate information and funding to pursue investigations and recovery actions. While directors are obliged to assist with the liquidation or debt restructuring process, the consequences of not cooperating are not a sufficient motivator. Furthermore, liquidators and restructuring professionals generally rely upon either a stakeholder to pay their fees or asset realisations to cover their costs. In view of the complexity of many recovery actions, professional fees may be significant. Therefore, recovery investigations and legal actions are often disbanded due to a lack of funding.

More recently the government, via ASIC, announced plans to fund 'assetless' company investigations and recovery actions. This initiative has the potential to improve the efficiency of liquidations, provided the funding is sufficiently comprehensive and readily available.

8.3 Has the insolvency regime been reformed in the last two years? If so:

(a) What are the reforms?

(b) Are the reforms being implemented so as to facilitate the systematic and efficient handling of corporate insolvency cases?

No reforms have been enacted to Australia's insolvency laws in the last two years. However, the government recently announced a reform package in response to recommendations following two government-initiated reviews over the last five years. The reform package is expected to be released in draft in early 2006 for public comment. Major initiatives include:

- the adoption of the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency, which would operate in addition to, not in lieu of, the provisions of the act described in section 1.4;
- the allocation of A$23 million over four years to fund recovery actions or investigations in assetless administrations. This will better enable liquidators to identify potential claims against a company's former officers or third parties that have benefited from a transaction which might be set aside; and
- the allocation of an additional A$62 million over four years to enhance the government's safety net employee entitlement programme.

These changes reflect the view that the structure of the Australian regime is sound, with

relatively minor amendments recommended to enhance its effectiveness.

8.4 Are there any other legal or non-legal changes in the last two years that have impacted on the operation of the insolvency law regime?

While this change has not happened in the last two years, there has been, entrenched within this period, the practice of commercial enterprises funding claims put forward by liquidators which otherwise may not have been pursued with the limited resources available from the company's own assets. This has resulted in a significant increase in the number of claims being pursued by insolvency practitioners.

More recently, increased focus on independent corporate governance and directors' obligations has fostered an environment where creditors and the general public are more likely to scrutinise directors, auditors, liquidators and the like. As an example, the act now requires auditors to notify ASIC if they suspect an audit client is insolvent. Coupled with increased resources to fund assetless administrations, as well as increased ASIC resources to investigate companies that are potentially insolvent, the level of accountability is expected to continue to tighten significantly.

8.5 Is statistical information on insolvency cases and corporate insolvency published? If so, how? Is it easily and freely accessible?

Statistical information is maintained and published by both ASIC and a private enterprise.

The ASIC statistical information is easily and freely available, and provides broad information on the number and nature of appointments. The privately produced information mines data from the public record to provide more detailed information such as the appointee. This information is easily obtainable.

8.6 What is the most urgent reform required to facilitate the systematic and efficient handling of corporate insolvency cases (formal and informal)?

At a national level, one proposal that would improve both informal and formal restructuring options is the invalidity of '*ipso facto*' clauses. These trigger contractual rights or remedies on one party in the event that the other party becomes insolvent or commences formal restructuring. They can significantly alter the asset pool, its realisable value and restructuring options – for example, the value of specialised plant and equipment may be reduced to scrap value if the licence to produce the product is terminated and cannot be transfered to a potential purchaser. Consequently, the invalidity of *ipso facto* clauses would potentially improve the liquidation and restructuring efficiency of many business.

The Corporations and Markets Advisory Committee Report review, released publicly in April 2005, concluded as follows:

- There is "no compelling need, or intrinsic shortcoming in the [voluntary administration] procedure, which justifies adopting Chapter 11 as an additional or substitute corporate recovery procedure for large and complex, or other, enterprises".
- Voluntary administration provisions are fundamentally sound and there are no fundamental difficulties in applying them to large and complex enterprises.
- Some legislative amendments could enhance the voluntary administration process, but any necessary changes can be accommodated within the voluntary administration regime (50 recommendations).

These findings confirm that the Australian insolvency regime has matured and is largely systematic and efficient. Nevertheless, as business globalisation increases, the need for greater international harmonisation of insolvency laws is possibly the biggest impediment to the efficient liquidation or debt restructuring of truly global businesses.

This chapter draws in part on the Australia chapter of the 2003/2004 edition of the Asia-Pacific Restructuring & Insolvency Guide, *contributed by Martin Brown and John McDonough of PricewaterhouseCoopers and Ian Walker and Brendan Watkins of Minter Ellison.*